

Restructuring Elinar:

A Case Study of Russian Management Reform, Decentralization, and Diversification

Or, How to Avoid Bankruptcy while Putting a Chicken in Every Pot

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Abstract

Elinar is one of the Soviet-era enterprises that should not have made it. A manufacturer of mica-based insulating materials for turbine and hydroelectric generators, transformers, and low and high voltage engines, Elinar was a supplier to the Russian capital goods industry. Between 1990 and 1994, the Russian capital goods industry suffered a collapse exceeding that of the Great Depression in the United States. Between 1989 and 1995, Elinar's production of insulating materials fell by more than 70% in volume.

Elinar, which is a two-hour drive from the Kremlin, survived the collapse of the capital goods industry through a strategy of management reform, decentralization, diversification, and a successful social contract with employee shareholders. Moreover, in 1994, it carried out a merger with a bankrupt neighboring collective farm, which it has revived.

There is much that we can learn from this case study in all of these areas.

Driven by a radical management reform which has pushed decision making down from the General Director's office into the departments and

shops, this firm where 100% of the stock is owned by its employees has redeployed more than half its workforce from its original core production area to light industry and services. Management's new strategy called for providing a wider range of insulating products to core customers nationally; developing light industrial, service and food processing businesses for a regional market; and avoiding speculative businesses that might attract mafia attention. Its judicious mixture of market orientation and social goals fits neither the stereotypic Western advice (downsize, cut the workforce, spin off divisions as independent firms, export) nor neo-Soviet panaceas (state guarantees, credit infusion). Instead it reflects an appropriately Russian response to Russian conditions that creates a partnership between management and labor at the center of a strategy of radical and successful economic change at the enterprise level.

Instead of being on the verge of bankruptcy, Elinar is a profitable enterprise which pays its taxes, continues to build housing and provide social benefits, has never failed to pay wages on time, and has doubled employment through a 1994 merger with a nearby bankrupt collective farm which it is restoring to profitability. In 1995, it turned a pretax profit of 26.6% of sales while reinvesting in housing and a new telephone system for Ateptsevo's 4,000 residents, building a bakery, and plowing funds back into recapitalizing the collective farm. In 1996, it added a dairy and new production lines and higher value-added processing in its chicken-packing operations. The quality of its chicken is now competitive with the best imports in the Moscow market.

If the rest of the Russian firms matched Elinar's performance, Russian economic reform would be a success. How Elinar accomplished this provides an object lesson in the problems, pitfalls, and potential of restructuring Russian enterprises.

1. Why examine Elinar's experience?

Russian economic reform has been fraught with difficulties. At the time of the collapse of the Soviet Union in 1991, practical experience in how to convert a state-owned planned economy into a privately owned market

economy was virtually non-existent. There were plenty of theories, but they were untried. The fact that they were unproven did not mean that they could not be espoused enthusiastically, however.

By some measures, Russian privatization has been carried out successfully. The state has largely divested itself of most of the ownership of the means of production. The central planning apparatus has been dismantled. Both were done in an astonishingly short time and with the vigor Russians had previously demonstrated in "storming the plan." Indeed, they did storm the voucher privatization plan, largely in the last six months of its existence.

But despite these steps, a vibrant privately owned, market economy has not sprung from the ruins of the moribund command and control system. Instead, there has been a kind of economic free fall. Repeated government declarations that the economy had bottomed out and was moving upward did not reverse the economic decline. Recent governmental statements that the economy really has turned the corner may prove to be correct, but given their experience with government economic promises in the last fifteen years, ordinary Russian wage earners are inclined to skepticism.

The decline of the Russian economy and of industrial production is charted in Table 1.

Yet amid the bleak Russian landscape of wage arrears, collapsed voucher investment funds, and general industrial ruin, there are firms which have successfully made the transition to a market economy. They pay their wages on time, build housing and provide social services for their employees, pay dividends to their shareholders, and generally have achieved the intent of economic reform.

These firms demand our attention because they demonstrate what actually works in Russian circumstances.

Elinar, the only employer in the village of Ateptsevo near Naro-Fominsk in the Moscow region, is one such case. A successful capital goods producer in the Soviet era, Elinar was one of a dozen plants in the Soviet Union producing electrical insulating materials. It specialized in mica insulating paper and board for generating stations and other heavy electrical installations and for smaller electrical motors. Between 1991 and

1995, the volume of production among Elinar's customers fell 50% and, with it, the market for electrical insulating materials.

Given this scenario, Elinar should have collapsed and, with it, the industrial village of Ateptsevo. But it didn't, and thereby hangs a tale.

Elinar has systematically violated most of the premises of Western microeconomic advice and flies in the face of "new Russian" business practices. Throughout its transition maintaining full employment for the work collective has been a core value. Rather than slashing its workforce, it has systematically developed alternative employment for members of its work collective in production for the local market. Despite its location within two hours of Moscow and its impressive management sophistication, it has no joint ventures (although one has remained on the drawing board through several postponements), and it exports a minuscule 1% of its production. Management's strategy has been to avoid high profit natural resource businesses which "only attract the Mafia," in the words of General Director Igor Evgenievich Kuimov, and to invest long-term in supplying local and regional markets. An early firm to privatize first as a cooperative and then as a leasehold enterprise, Elinar remains employee-owned and closely held, and continues to raise its capital for reinvestment internally. It has kept its sculpture of heroic workers at the entrance to the main plant, and one can find an occasional picture of Lenin still adorning an office or breakroom wall.

Yet Elinar is also profitable. Its aftertax profit on sales ran 32% in 1992, 15% in 1993, 5% in 1994, 16% in 1995, 6% in 1996, and 6% in 1997. It pays its taxes. It pays higher wages than the Moscow Oblast average and hasn't ever been in arrears on pay day. It has maintained full employment while neighboring enterprises have shutdown or operated with a tiny fraction of their normal workforces. And it has carried out a friendly merger with a neighboring collective farm which had gone bankrupt and have gotten it to the breakeven point.

For key statistics on the company, see table 2.

2. The Gorbachev years: Consumer goods, co-ops and leasing

The thrust for change at Elinar came shortly after the beginning of Gorbachev's tenure in March 1985. To meet the new consumer goods targets, the Communist Party pressured state production enterprises to produce consumer goods on the side. In Naro-Fominsk, enterprise general directors were called in by the town party secretary and told to start producing consumer goods of their choice within a month.

The then-current law permitted state enterprises to satisfy consumer good requirements by setting up a cooperative within the enterprise, thereby leaving the General Director to focus on the enterprise's core production. This is exactly what Elinar's General Director Yuri Mikhailovich Krivosheev did. After lengthy discussion inside the work collective in which employees rejected everything except new sorts of insulating materials and in which all employee proposals were rejected because they were not alternative consumer production and so would not satisfy the Party, agreement was finally reached in late 1986 to start a co-op to produce plastic pipe which was useful both for Elinar itself (and its village) and which could be sold as a consumer product outside the firm.

The director of the new plastic pipe cooperative, Polyanski, was "a very active, talented man," according to Kuimov, and moved it quickly forward. Within a year using Elinar's assistance on a large scale, it had diversified into plastic buttons, hooks, and automotive parts and employed some 500. Elinar had obviously met the requirement of consumer production.

The co-op's success was not unproblematic, however. There was no ownership relationship between Elinar and the co-op, though Elinar had contributed the co-op's start-up capital. Moreover, the favorable tax treatment of cooperatives (3% tax on co-op profits versus an 87% tax on the enterprise's profits) and absence of wage restrictions for co-ops versus strict wage restrictions for Elinar quickly created massive inequity and envy and discontent among Elinar's workers. As the co-op's wages rose to 3-5 times those of Elinar employees, conflict became open and spontaneous sabotage of the co-op, located within the Elinar complex, began.

The lesson Elinar's management drew from its experience with the pipe co-op was that Elinar itself ought to become a co-op to permit paying high

wages. "We had a highly efficient plant," commented Krivosheev, "but 80% of the profit was taken out by the state." The Elinar work collective endorsed conversion into a co-op by a 75% favorable vote in early 1987. The problem for Elinar was that while the new cooperative law permitted the establishment of new cooperative enterprises, existing enterprises could only be converted into co-ops when they were unprofitable. Elinar was profitable, and consequently its application was rejected.

At the time, however, experiments with work collectives leasing enterprise assets had begun in the Baltic states, and were attracting much interest among innovative Russian managers. The early leases were done on an experimental and exceptional basis.

"We applied to Gorbachev himself to lease Elinar in October 1987," related Krivosheev. "I guaranteed that we would meet our plan quotas. 'Anything else you want?' asked Mikhail Sergeivich. 'Just the right to set our own wages,' I replied." The Central Committee resolution permitting Elinar's work collective to lease the assets of the enterprise was published in the *Journal of the Central Committee*, 1988/3. On October 1, 1988, the Elinar work collective leased under a local agreement which, according to management, helped to set precedents for later lease agreements. Elinar was among the first major state enterprises to be leased.

How this was done legally was straightforward. Elinar's work collective simply declared itself a cooperative. Since it owned no property, much less profitable property, this action met the terms of the Law on Cooperatives. The Elinar work collective co-op then leased the state property of the Elinar enterprise -- the plant, buildings, and equipment -- and, in January 1990, amended the lease to add the right to buy that property at a fixed price when that was permitted in the future.

As a consequence of the lease, the Elinar co-op owned Elinar's production and any profits that stemmed from it but only leased the assets. That profit could be reinvested in production, in housing and other benefits for employees, or to buy the assets when that became permissible. "We expected to buy the assets over a ten year period," said Krivosheev.

The passage of the USSR Law on Leasing in December 1989 gave legal status to leased property, and leased enterprises rapidly became as

independent of the state as co-ops. Elinar's insulation production took off at a 30% annual clip, as Elinar filled the shortage in the market and replaced foreign imports. Production peaked in 1989 at 4900 tons per year and began to decline in 1990. With growing national economic difficulties, the decline accelerated in 1991.

There were no other jobs in Ateptsevo and few in Naro-Fominsk. Under the then-current circumstances, increasing efficiency simply increased the labor surplus. Consequently, Elinar faced layoffs and had to revisit the issue of alternative production.

Driven by employment considerations in 1990, Elinar set up a new, subleased enterprise. Elinar's commercial director, Igor Evgenievich Kuimov, became the new enterprise's general director. The new enterprise, which was established formally on January 1, 1991, hired 250 employees who were fired from the core production as redundant; some 850 remained employed in insulation production. The intent was two-fold: provide employment and retain their skills for further growth in the insulation material production when the market permitted. Unlike the plastic pipe coop, the new subleased enterprise was linked to Elinar through a joint board and a wage equalization policy between it and Elinar was designed to maintain relative wage equality.

The subleased enterprise that Kuimov directed moved in two directions. The first was to commercialize the auxiliary service enterprises that were part of Elinar by seeking orders outside the company. Like most Soviet enterprises, Elinar included the infrastructure to provide construction, repair, and other services within the enterprise. Its fully equipped machine shop, truck and auto repair facility, and construction and installation division certainly had the capacity to handle outside orders, if such orders could be procured.

The second direction was to begin to consider new consumer products: doors, windows, and furniture; a brick plant; a garment plant; and a line of artificial New Year's trees and wreaths followed. Each of these new consumer products had low start-up costs, was labor intensive (especially relative to Elinar's core production), and either helped supply local needs (building materials for Elinar's own housing program; work clothes for the plant) or was spun off of insulation production (the polymer film for

insulating laminates did double service in New Year's trees). The cost was low, the local market guaranteed some sales, Elinar could use some of the production itself in housing construction (which also held down Elinar's costs as inflation began to rise), employment was protected, and Elinar's overhead was spread beyond the declining core production.

Elinar's core production came under increased pressure throughout 1991 with the growing economic and political problems of the Soviet Union, which ultimately collapsed in December. Krivosheev sought to diversify insulation material production by launching a number of new products. Even with the new products, however, total insulating material production fell by a quarter in 1991, and a labor surplus again developed in the insulating business. But again it was successfully absorbed in a new consumer products division of Elinar where employment doubled to 500 within the year.

"I was attacked as a capitalist then," Krivosheev complained in 1994. "There may have been some truth to it. My ideal today is a capitalism that fulfills human needs."

3. Shock therapy at Elinar:

"You should have seen them rush back from vacation"

The year 1992 was the year of "shock therapy" for Russia. Yeltsin's new economic reform team, led by Yegor Gaidar, launched its ambitious program of total reform which combined price "liberalization" and dismantling the state plan in favor of a "market system" with privatization of ownership. The pre-existing monopolistic structure of industry was, however, maintained, and the decontrol of most prices for goods on January 1, 1992, sent inflation soaring; accumulated family savings were eliminated within a matter of weeks, and the government's efforts to stop inflation by stopping the printing presses in the summer produced a shortfall of currency in the banking system and an inability of many enterprises to meet payroll (done in cash in Russia) despite an economy awash in cash. Production plummeted, initially in significant measure because the breakup of the Soviet Union put many suppliers and customers on the opposite sides of the new borders.

Elinar undertook its own "shock therapy": a radical program of management reform and decentralization of decision making that accelerated the cultural transformation of Soviet-era thinking.

Elinar acquired complete independence of the state when the purchase of the plant was completed in April 1992 -- after four years rather than the projected ten. The company laboriously worked out a charter through mass employee involvement; it continues to have the character of an internal constitution. Kuimov was elected General Director by the Elinar employee assembly (which included employees of both his subsidiary and the parent company) when Yuri Mikhailovich Krivosheev retired. The cooperative was reorganized as a closely held joint stock company in April 1992. The two leased enterprises -- Elinar and its consumer products division -- were merged into one (also called Elinar) employing 1300 in June 1992. A new management system and a new wage system were introduced.

Reconstructing management

In the Soviet era, becoming General Director had been the pinnacle of a manager's career, as Kuimov understood well. Under the new dispensation, however, it implied frightening responsibilities to pilot unwieldy Soviet-style enterprises with a Soviet internal culture in the rapidly changing economy. At Elinar this basic problem was exacerbated by the imbalance between lack of work and surplus of employees in the insulating business as production of insulating materials continued to fall.

On June 1, Kuimov undertook his own version of "shock therapy." He dropped a bombshell on the existing employee culture of permanent job security and management structure and culture of inertia. He announced that all employees would be fired effective September 1, thereby meeting the legal notification requirements. However, all workers were asked to continue in their existing jobs for the three month period, while all managers were asked to propose new structures for their departments in July. Kuimov's efforts produced the same reaction that much "reform from above" had met in the Soviet era. Most of his managers simply did nothing and took their usual vacations in July instead.

Kuimov's response was to rally the employees and to turn restructuring

the enterprise over to those who demonstrated interest. At the end of July, Kuimov invited the trade union committee and the managers not on vacation to a meeting. The trade union committee was seated at the table with Kuimov; the managers sat behind as observers. Kuimov appealed to the union for help in really firing those not interested in saving the enterprise.

"Now 1992 was a terrible year," reflected Kuimov in 1996. "There was no money to pay wages. Enterprise after enterprise was shutting down. The trade union gave its strong support. The next day I replaced every manager who had not brought in a restructuring plan. You should have seen them rush back from vacation."

In August Kuimov reviewed the plans from each department, replacing additional managers who had submitted what Kuimov considered to be unrealistic or unacceptable proposals. The surviving managers and Kuimov's new appointees were told to choose their own people who they hired on contract. "I wanted to put full responsibility on the individual manager," Kuimov said.

The personnel department within Elinar was revamped to serve as a labor referral office, organizing an internal labor market. Fortunately, there were a lot of vacancies in the new production areas to absorb the labor surplus from insulation production, which was estimated at about 50% of total employment there. "But, there still was lots of inertia, and we had to recognize the rights of veterans, of seniority. About half the excess labor from the insulation plant did not find work."

In late August, Kuimov met with those who had not taken work. He told them that they either had to take work or they really would be fired on September 1. The first of September was rapidly approaching. The discontent among many of these employees at having their working lives turned upside down was so palpable that you could cut it with a knife. "They were mad," Kuimov summarized laconically. But given the alternatives outside Elinar, the outcome was a mass movement towards the new jobs and the retraining that went with them. "Some of the poorest workers in the insulating plant are today among the most effective in the garment plant."

Ultimately, only two people ended up leaving the enterprise. Work was found even for the managers who failed to perform. Many were dissatisfied after their demotions, but most, according to Kuimov, "have accommodated themselves to the new structure."

As for the new managers, Kuimov stressed in his presentation at the July 1993 conference, "one of the most important criteria for evaluating managers is their successful communication with their subordinates and their attention to our training programs."

This September 1992 reorganization accorded each unit within Elinar substantial independence. Department managers, now renamed "directors" to underscore their independence and authority, received a variety of new rights and responsibilities including obtaining raw materials, making some reinvestment without going to top management, getting some sales contracts themselves, and retaining part of the surplus within the department when the unit beat its plan. Each unit took on the character of a profit center. Employee bonuses were permitted to vary by unit, but unit directors were rewarded on the basis of the performance of the company.

As one workshop director, Alexander Ivanovich Gerasimov, commented during a discussion with about half the new "directors" in February 1993, "Previously, we were shop supervisors. Now both our rights and responsibilities have increased greatly. I'm now personally responsible for getting raw materials, for producing quality products, for educating workers to take care of the equipment properly and improve production. I can go out and get contracts for my shop." And he added, a bit ruefully, "The financial security of the employees in my shop depends on me."

We will meet Alexander Ivanovich later in this story.

What Kuimov did with his management reform in 1992-93 was to create a cadre of rather entrepreneurial shop and plant managers. Over the next several years, he would hire additional managers from outside, including three of the managers we interviewed. He had given them the flexibility to run their shops efficiently while the central office provided strategic direction, most sales, and support services. They did so within the context of a social contract that insured employment and rising social benefits for

the work collective. Elinar would continue to build housing for employees and to improve other amenities in Ateptsevo where much of the work force lived.

Individual incentives

Like other Russian managers, Kuimov and his management team used their independence from the state almost immediately to create a more flexible wage system. On the one hand, there was a concern with community sentiment and with the very substantial egalitarianism in close knit communities like Ateptsevo. Economic differences demanded justification which employees fundamentally could accept as fair.

On the other hand, the old system of virtual wage equality discouraged initiative in almost every way.

Consequently Kuimov sought to restructure the compensation system to reward on an individual basis performance that contributed to the success of the company. Each employee is on an individual contract, and that gives manage great discretion to reward initiative -- or to engage in blatant favoritism.

Further, the individual's salary depends on his or her training, job in the company, individual performance, and the company's annual financial results.

Elinar uses what it calls the "coefficient wage system." It builds on a minimum monthly wage which is fixed individually by the department manager (or, for managers, by the General Director) on the basis of national legislation and company documents.

To that is added an individual performance component, which is evaluated on a daily basis and averaged for the month. At Elinar this performance component rewards primarily productivity (beating your production quota), working nights or weekends, and employee initiative. This last component includes taking on additional tasks not in your individual contract, filling in for absent employees, filling in for an absent supervisor, doing higher skilled work, taking on additional responsibility,

and solving problems. This performance component is evaluated daily on a five point scale and averaged monthly. This average is the individual's "work quality coefficient." Each tenth of a point above the average for the plant adds a 3% individual bonus to the individual's base pay.

This base pay plus individual bonus is then multiplied through by a company financial performance indicator which includes current sales, backlog, production volume, costs, the regional labor market, and inflation. This "business effectiveness coefficient" is set monthly by the General Director.

Management has sought to design a system that rewarded individual performance but with enough of a collective and egalitarian component that the problems with the initial plastic pipe co-op could be avoided.

This is a fairly elaborate and not particularly transparent system, and a class in Elinar's training program was devoted to it. Our employee focus groups did not register complaints about it, however. Their concern was that wages were low relative to costs, particularly to the costs of food. Average wages and incomes at Elinar have, however, basically kept pace with inflation, which is no small achievement given the company's full employment policy.

Adding a service and light industrial sector

During this push to reform management, Kuimov also pushed a marketing research effort as well to select new products and services to keep Elinar's skilled labor force employed until the core business could ride out the economic chaos. This built on the foundations created by the subleased enterprise he had directed within Elinar in 1991.

Elinar has pursued five different kinds of diversification.

The first was to seek outside customers for the auxiliary services Elinar had developed to maintain its core production. Here Elinar started seeking outside work for its machine shop and fabricating operation; commercial and individual customers for its auto and truck repair; and commercial projects for its construction crew. In essence, Elinar offered to

repair almost anything (there were auto, TV, furniture, and even shoe repair shops); do any kind of machine and fab shop work that could be gotten; do industrial equipment repair, including metal cutting, pressing, forging machinery, process equipment and pumps; and build whatever you ordered.

The second was to begin making building products. This production was anchored in supplying Elinar's needs for supplies for housing construction but which also could be sold locally and regionally. These included opening a brick and block plant; a woodshop which produced doors, windows, cabinets, and furniture; and a joint venture between the woodshop and the construction crew to build dachas. A 54% owned subsidiary, Edvis, was set up within the Elinar complex to manufacture electric household heaters. Some of these were more successful than others. Elinar had to leave the furniture business because it wasn't competitive.

The third avenue was to start production that could supply Elinar and local consumers but also sell competitively at least regionally. The major start-up enterprise here was a garment plant, started in 1992, which quickly grew to employ some 120. It strove for niche production -- work clothes (Elinar provided a base market); windbreakers and outer wear for out-of-doors work in the winter and far north; children's winter coats and snowsuits; and a line of luxury leather jackets. Chinese competition did in the children's wear, but Elinar found customers enough, especially for its work clothing, to keep its sewing machines humming.

The fourth avenue for diversification initially was whatever could be spun off from Elinar's core competency in mica insulating materials. The mica paper and board itself offered few possibilities, but the polymer films used as backing offered possibilities and the more general polymer and plastic expertise did the same. The company went back into producing plastic pipe in a variety of diameters and started producing artificial New Year's trees and wreaths. A plastic and rubber injection molding operation is on the drawing boards.

Further, responding to a proposal from Gennady M. Dschamalytinov, a researcher at a Moscow construction industry research center, Elinar set up a wholly owned subsidiary, Esma, to process the waste from its

insulation production into a fire resistant resinous material which it sells. Dschamalytinov now runs Esma, which employs 18. It's always pleasant to convert an environmental problem into a profitable new product and new jobs.

Finally, as the supply system has broken down and prices soared with monopoly, Elinar has turned increasingly to "import substitution" for necessities. In 1995, Elinar opened a bakery to supply Ateptsevo with fresh bread at a lower price. The company did it for "social reasons," i.e. lower the price and insure supply of bread, but it improved quality (bread deliveries had run very slow) and it quickly turned a profit. Employment grew from the initial four to eighteen in 1998. In 1996, Elinar opened a dairy. It had a gas station operating and was building another for Druzhba.

After the Druzhba merger discussed below, the possibilities of adding value to Druzhba's basic agricultural production seemed virtually endless. Between 1994 and 1996, Elinar added a dairy, prepackaging of cut-up chickens (rather than just selling the plucked birds), and experimented successfully with smoking chickens; there is discussion of putting in a chicken sausage line and chicken soup production. Again, Ateptsevo and Druzhba provide a solid consumer base, and some products, like the initial small scale smoked chicken production, is virtually entirely consumed within the Elinar complex.

By and large, these new consumer products had low start-up costs, were labor intensive (especially relative to Elinar's core production), and helped supply local needs. The risk was low, the local market guaranteed some sales, Elinar could use some of the production itself, employment was protected, and Elinar's overhead was spread beyond the declining core production. While they comprise a quarter to a fifth of sales, their labor content is much higher than in Elinar's core production, many are services, and the cost of raw materials tends to be much lower than in the insulating material area.

Diversifying core production

Kuimov's research and planning effort missed on insulation where it overestimated the labor requirement. Manning there was based on the

assumption of a 15% increase in productivity following the shake-up; instead, the increase was close to 40%. Elinar dealt with this by diversifying its core production, launching about 20 new insulating products. A number of these replaced production lost in Armenia and Azerbaijan because of the war there; in these cases, Elinar supplied existing customers with a broader product range. In other cases, Elinar sought new customers with new insulating products.

Continued national economic decline in 1993 and the collapse of the capital goods industry in 1994 exacerbated the pressure on the company. By 1995 Elinar's core production of insulating materials had declined to 45% of the 1991 production and 31% of the 1989 peak production in terms of volume. This decline occurred in spite of the fact that 30% of Elinar's 1995 sales were made up of new insulating products which Elinar had not produced in 1991. Production fell further in 1996 to about two-thirds of the 1995 level, or little more than 20% of 1989 production. Worse yet, fully 74% of 1996 insulation sales were on a barter basis. A modest recovery in 1997 to about 70% of the 1995 level reflected increasing sophistication in Elinar's barter operation.

With the continued industrial decline, Elinar found itself buying a plant in Vladimir which makes fabric backing for insulation materials. This plant, which was a supplier to Elinar's insulation production, had gone bankrupt, and Elinar bought it from the local authorities who put it up for sale. Unlike the rest of Elinar's diversification, this was a straight business move which does not otherwise strengthen the community. It does protect Elinar's ability to continue core production by insuring supply.

4. Merger with Druzhba ('Friendship')

In May 1994, Elinar merged with Druzhba, a neighboring collective farm which had gone bankrupt.

Druzhba suffered from most of the ills of Soviet enterprises: it was inefficient, overdimensioned, and its components, which were designed for a commitment of resources which never appeared, didn't fit together very well in practice. The feed mill was too large relative to the actual numbers of chickens and cows. The dairy for the five dairy herds (totalling 1500

head) never was built and the milk was shipped elsewhere. The farm started raising chickens in 1987, and got production up to 1 million birds a year and finally made 2 million while construction was underway on facilities to house 10 million chickens. All this fed a slaughter house which was frighteningly dated, barely able to accommodate the existing production, and widely believed by employees to be a health hazard both for those who ate the product and for the workers who killed and cleaned the birds. As those who have worked in Soviet enterprises will find familiar, the new slaughter house equipment had arrived several years before and was still crated outside.

Designed as one of the "socialist projects of the century," Druzhba's chicken growing operations physically look like so many other late-Soviet projects: unfinished construction stands in weeds awaiting the resources to be committed in the next five year plan.... or whatever salvage operation Elinar managers can dream up.

In addition to these planning ills, Druzhba was poorly managed in the sense that its management waited patiently for the government to provide the resources to finish this huge project rather than making the most of what they had. While this behavior may have been appropriate as late as 1990, by 1992 it was problematic and by 1993-94 it led to disaster. As usual in situations like this, there were rumors of management corruption; during our visits, we were in no position to judge their accuracy. In any case, Druzhba was forced into bankruptcy when feed suppliers refused to advance more credit.

Despite worker ownership, employee morale and discipline matched that of management. Druzhba had been converted in 1993 into a joint stock company owned by the employees under option 2 (i.e., majority employee ownership) of the privatization law with a remaining minority state share, and there were no outside shareholders. So in theory it was employee-owned and -controlled. But no one saw it that way in practice. Management ran the enterprise just as it had before: poorly. The cliché "they pretend to pay us and we pretend to work" could have been coined for Druzhba.

Why should Elinar acquire a bankrupt collective farm? From an economic perspective, it was hard to justify. Elinar's management had no

expertise in that field, Druzhba was hemorrhaging cash, and Druzhba's problems were so great that they could easily threaten to sink Elinar itself -- which was struggling with the continuing decline in its core market.

"People laughed at us," commented Lubov Nikolaevna Senichkina, Elinar's chief financial officer who joined the company in 1993 after Kuimov revamped the management. "Even specialists in collective farms couldn't run this farm successfully. Now these crazy specialists in insulation materials were going to try to do it."

The primary reason for the merger was the threat that Druzhba's bankruptcy posed to Elinar employees. Some 500 Elinar employees lived in the Druzhba villages, and there was a considerable fear that someone would buy the farm and throw them out. "They are our neighbors," was Kuimov's ultimate explanation. The economy was in disarray, and Kuimov had no desire to have chaos border his plant and village. "We had to do it."

"We spent a lot of time discussing this acquisition, including the risk," Kuimov reflected in 1996. "Druzhba was not just near bankruptcy, it was bankrupt. While Elinar was stable, the combined firm would be critically near bankruptcy." After rounds of small and large group meetings and an intense debate in winter 1994, ultimately 96% of Elinar's employee shareholders voted "yes." In no small part, they voted for cheap food.

"We sure didn't want to supply the country with chickens," said Lubov Nikolaevna. "And we didn't do it just to prove we could turn it around."

Druzhba is both a geographical entity with a population of 12,000 and a economic enterprise employing about 900 in dairy farming and broiler chicken production and packing, in addition to some general agriculture, particularly grain and feed.

Having merged with Druzhba and put its survival on the line, Elinar had to stop the bleeding and develop synergies and economies of scale where none were obvious. Elinar's management undertook two different types of action simultaneously.

First, Kuimov remodeled the management system at Druzhba on the Elinar model. He abolished the position of general director, and made a

clean sweep of management personnel. Kuimov's analysis was that part of Druzhba's inefficiency stemmed from centralization, and that it was far better off as three separate enterprises: the dairy farm, the chicken growing operation, and the chicken packing plant. He brought in new managers, made them directors, delegated responsibility, and asked them to introduce incentives for efficiency.

Second, Elinar made some major investments in Druzhba. By 1996, it had built a dairy to go with the dairy herds. In the chicken operation, the new equipment that was sitting around was uncrated and set up for a new, notably more hygienic, kill line. It added a new incubator to the chicken farm in an effort to raise production to 3 million birds a year. And it rebuilt the sanitation system in Druzhba village.

Let's look at how this worked in the chicken side of Druzhba's operations.

The chicken farmers

Gennady Petrovich Bokov, the director of the chicken raising operation, is new at Elinar. He started work in the fall of 1995, after 24 years in agriculture in Kazakhstan, including 17 in raising chickens. As we bounced in 1996 over the farm road between unfinished construction from the 10 million chicken dream, he gave us his take on his job: it wasn't primarily to raise larger numbers of chickens, though he certainly was pushing to raise output to 3 million birds in 1996; it was rather to increase efficiency (more chicken weight relative to feed, and fewer days from incubator to full weight for slaughter) and improve quality.

As a chicken expert, Bokov knew about breeding stock, chicken ailments, and the other nuts and bolts of raising chickens. While Elinar had received a number of Western European proposals for breeding stock, Bokov's view was that they needed a hardier bird. Consequently they bought additional Russian breeding stock, and Bokov focused on upgrading Druzhba's breeding stock over time. Hardy English breeding stock was added in 1997.

But Gennady Petrovich's secret weapon in his effort to increase efficiency and improve quality wasn't expertise or capital. It was Druzhba's most

under utilized resource: its employees.

Druzhba was beginning a major experiment with turning each house over to employees essentially as a self-managed enterprises, where they would get much of the surplus from the improvements they made.

We talked to Tatiana Leonidovna Syrman, the "first farmer" at Druzhba as she called herself, in July 1996. Tatiana Leonidovna had worked for seven years at Druzhba. A year ago when the self-management experiment was proposed, she had put in her proposal, and had won the bid to take over the first growing houses under this self-management system, primarily because she had demonstrated more desire for independence.

Tatiana really runs her own chicken farm. She chooses her own team. She sets a contractual plan with Gennady. If her team meets the plan, extra production raised their income. She has credit for a full cycle of growing chickens from getting them from the incubator until they are ready for slaughter. She pays for outside services, such as repairs, and for feed. She and her team have fixed salaries but make a bonus by exceeding their planned deliveries and holding down costs. If they don't, the deficit is recorded against the team. So far it has worked. In the first cycle of chickens, pay went up 25%; in the second cycle, they hit 35%. "And no Americans came to help us, either," she laughed.

Tatiana took on a second house and she and her team of five were considering bidding on a third house in the next competition. Her goal was to cut the time it takes her chickens to grow to slaughter weight from the then-current 58 days to 42-49 days.

"There have been a lot of changes in the work collective [at Druzhba] after Elinar took over," Tatiana told us. "Only those who wanted to work and make progress stayed. The Ministry of Agriculture previously ranked us at the bottom. Now we've reached the level of the best chicken operations."

Thanks to Tatiana's demonstration of success, Gennady and Alexander guessed that there might be 10 bids at the next competition, and that two or three more of the growing houses would be turned over the self-management.

Tatiana Leonidovna's farm combines self-management with planning. The chicken growing operation has an annual plan broken out by quarter and month, and results are compared to plan on a monthly basis. Beating the plan produces the bonuses. Eventually every growing operation would be self-managing, we were told in 1996, and that team leaders will draw annual contractual plans broken out by quarter and by month. In fact, by summer 1998, the entire chicken growing operation had shifted to team production. Tatiana and her team were running five houses.

Running the packing plant

Alexander Ivanovich Gerasimov received us in a spartan office next to the slaughter house and packing facility. An equally spartan office for a secretary was untenanted. Trained as a mechanical engineer, he had put in 18 years at Elinar, most recently as director of the insulation plant, which is where he was when we met him in 1993. Kuimov had asked him if he were willing to take directing on the chicken slaughtering operation, offered him a free hand and his support, and after some consideration he agreed.

Alexander Ivanovich painted a grim picture of the situation he inherited. "Our processes were rudimentary," he explained in 1996. A lot of changes had to be made just to meet health standards in operations. The line often didn't run, because they didn't have a preventive maintenance program. He solved that problem by bringing in maintenance workers from Elinar who "gave a positive impulse" -- i.e., didn't believe that bankruptcy was a law of nature.

The management issue puzzled Alexander Ivanovich. He came into a situation where there were three levels of management: the manager (a doctor of veterinary medicine), his deputy (a mechanical engineer), front line supervisors, and then the floor workers. If the plant ran badly, it wasn't for lack of numbers in management. After working with this system for a while to understand it, he cleaned house, getting rid of most of the old management, elevating two manual workers into management, and restructuring the operation along functional, rather than hierarchical lines. He sliced out one level of management, and put together a team of a

maintenance specialist, an electrical specialist and four supervisors, one for each department.

His new team settled on two simple goals: processing birds faster and meeting health standards. If these could be achieved, Elinar could sell in the Moscow market, at least in terms of quality.

Getting the new line in was crucial to both. To hear Alexander Ivanovich tell it, it was easier than the management issues. In the first months, about 16 billion rubles went into the new line in construction and equipment. Between half and two thirds of this was equipment which had been bought in 1985 by Druzhba but never put into use. Elinar still had to invest between 5 and 8 billion rubles in labor and capital equipment in getting the line running.

Both goals were met by the end of 1995.

With better management and a clear purpose, employee discipline and morale improved too. When the new plant came on line, Alexander Ivanovich threw a party in the plant for management and workers alike, and champagne and toasts flowed freely. This was symptomatic of the new spirit, he thought. "In the past, management would have celebrated by itself." The point, of course, was that the old management had had most of the equipment sitting in the crates it had arrived in for nine years and hadn't gotten it installed.

With the new line up and running, Alexander Ivanovich's next goal was to increase value added in production. Where the plant had previously simply slaughtered birds and shipped them to market, Elinar began to do further processing. Cutting up and boning was added. The experiment with smoking was so successful in terms of quality that all the production was sold locally. Space for expanding the smoke house had already been freed up, and the equipment was on order. A chicken sausage line is on the drawing board.

Why did he succeed? "There were really three reasons," Alexander Ivanovich said: "(1) We finally had clarity in our goals, (2) we had new management, and (3) we had some new investment. It was both people and money."

A chicken in every pot?

"We are the best of the worst," was Kuimov's succinct reply when we discussed our visit with him in 1996. "We've actually raised Druzhba to be the most efficient chicken operation in the Moscow Oblast. In the last two years, we achieved a 50% improvement in the relation between feed consumption and growth in weight. On the average, we now slaughter the birds at 56 days old versus 70-76 days old previously. But we still aren't making money. Your President Clinton has kept Moscow flooded with cheap, frozen American chickens."

"Will Druzhba pay off?" we asked in 1996.

Kuimov was thoughtful. "If we look at Druzhba as an investment, it doesn't look bad. It has a nominal value of 200 billion rubles [about \$40 million in 1996]. The real cost to us was 2 billion 1994 rubles to pay its debt, 5 billion 1995 rubles for construction and reconstruction -- about 40% of Druzhba's plant is finished today versus 30% in 1994 -- and 5 billion 1994 and 1995 rubles to cover its losses. We have to bring it to the breakeven point."

From the employee-shareholder point of view, Druzhba has already paid off already. Chicken has become a staple. Though Elinar hasn't done a chicken consumption survey, the gross statistics suggest that the average Elinar employee buys close to 100 chickens a year. Add in the number of two employee households, and you have one of the world's higher family chicken consumption rates.

By the 1997 shareholder meeting, Kuimov could report that Druzhba's chicken operations had broken even on production of 2.5 million birds. More houses had been subcontracted to employee teams, like Tatiana Leonidovna's, and the results had been sharp improvements in productivity. By the first quarter of 1998 (see Table 3), growth rates were up two-thirds over 1994, feed to weight ratios down by a third, average slaughter weights were up by a quarter but time to slaughter was down to 48 days -- Tatiana's aspiration -- from 71 days in 1994.

At the same time, quality was up to the level of the best quality German

imports, and Druzhba was continuing to add additional value in processing. "We have won the chicken war," Kuimov told employee shareholders, "on quality but not on price."

Would full private ownership work even better?

In 1996 Kuimov remained doubtful. "Private farming is no panacea in Russia. What we aim at is somewhere between collective farming and full private farming. We have 700 years of culture to change."

5. Reorganizing the company again for the market

In 1996-98, Elinar undertook an administrative reorganization to prepare itself for increased competition. This reorganization had two primary components.

First, Elinar increased the independence of some of its component units. The intent was to permit greater flexibility to respond to market conditions. Four subsidiaries were established as independent companies though Elinar continued to hold a majority stake in their ownership. These were the Vladimir plant VZPM, 75% owned by Elinar; Edvis, which produces electrical heaters, 54% owned by Elinar; Eluk, in the Ukraine, 51% owned by Elinar; and Esma, which reprocesses insulation waste materials into fire resistant product for sale, 100% owned by Elinar. Together these subsidiaries had sales of about 11% of Elinar's in 1997.

Elinar's two stores and its bakery were also given increased independence to increase their flexibility, though they remain 100% owned by Elinar. With the success of the initial experiments, core units -- the insulation plants, garment plant, etc. -- will follow.

Second, Elinar reorganized its central management into six departments to respond to the demands for strategic planning and product development, for quality, and for marketing. The new departments are (1) product development and planning, which handles research and development; (2) quality, which focuses on ISO 9000 certification so Elinar can eventually export to Western Europe; (3) personnel, which has added quality training to its tasks, (4) commercial services, which handles

both sales and purchasing by region within Russian and the Commonwealth of Independent States (these functions fit together because of the degree to which barter has become key to insulation sales, so the commercial services department often seeks to pay for supplies with goods obtained in barter); (5) finance, which is the traditional bookkeeping department, and (6) production services, which provides logistical support with transportation, warehousing, customs, and the like. In effect, Elinar has moved increasing away from a production-driven management structure to something which increasingly resembles a market-driven structure.

The ISO certification effort is supported by a loan from the National Training Foundation, which is sponsored by the World Bank, and Elinar won a competition for German funding for management training.

As a consequence of this inflow of training resources, Elinar's Education Center has begun to take in outside business itself on a fee for service basis.

Elinar's restructuring permits it to move toward a holding company model in which the central management provides coordination, planning, and some common services for quasi-autonomous, market-driven enterprises within the Elinar family. Employee shareholders voted to authorize that transition at the 1998 annual meeting.

6. Developing a sense of ownership

Economics cannot be abstracted from its cultural context, and Kuimov was as deeply embedded in his culture and the responsibilities of leadership that went with it as he was committed to reform. Developing some real sense of ownership -- of real shared ownership -- was key to Elinar's success.

Ownership

In May 1992, the Elinar cooperative was reorganized as a closely held joint stock company ("aktionernoe obschestvo zakritogo tipa"). At the time of the conversion of the cooperative into a corporation, more than

85% of the co-op members converted their accounts into shares; 15% took money instead. At the time of the March 1994 shareholders meeting, before the Druzhba merger, 924 of the 1200 Elinar employees were shareholders, including 20 new hires. Of these, 570 attended the 1994 annual meeting.

Elinar has simply failed to respond to governmental efforts to force larger closely held companies to permit their shares to trade freely. Instead, the company provides an internal market for trading shares on a monthly basis. The company makes a market by buying shares, some of which it reserves for new employee owners, and by auctioning the rest in a bidding process.

Unlike the stock in most Russian companies, Elinar's stock is seen to have value by its owners. The reason is simple: it pays dividends. In 1994, for instance, Elinar stock paid a 220% on nominal value of 1000 rubles per share, and this averaged approximately 120,000 rubles for the average shareholder. At that time, the average monthly wage was 150,000 rubles, so the average employee owner derived close to the equivalent of a month's pay from his/her ownership stake in the company.

A similar dividend was also declared in 1995, and employees were given a choice between taking it in cash or in stock. The majority seem to have chosen the latter. Additional shares were emitted in 1995 at 5000 rubles per share. About 600 shareholders were then trying to buy shares. In 1996 and 1997, the company continued to pay dividends to its shareholders, including both active employees and retirees.

Elinar's merger with Druzhba was carried out on a one-share-for-one share basis through a new issue of Elinar shares that diluted existing Elinar shareholders and obviously benefitted Druzhba's shareholders. Elinar's management estimate was that Elinar shares were worth 40 times those of Druzhba, because Druzhba, which was bankrupt, had negligible value as an operating business in 1994. It had, however, large fixed assets, and Elinar and Druzhba shares had the same nominal value. The 1 to 1 exchange was simply "considered fair" says Kuimov.

In July 1996, Elinar had some 2000 shareholders. Of these, 1400 were active employees out of a total 2220 employees. Most of the others are

Elinar and Druzhba retirees. The "control package" -- i.e., the majority stake -- is owned by 300 "and we try to keep this group broad," Kuimov says. About 90% of the original Elinar employees who went through the co-op and leasehold period and continue as active employees remain shareholders, and random interviews in Elinar's shops in 1993, 1994, 1995, and 1996 indicate growing understanding of ownership and the business.

According to the company's CFO, in 1996 36% of the stock was held by a broadly defined management group of about 40 people.

Elinar continues to encourage ownership among new employees. It developed early an elaborate system for awarding shares to new employees on the basis of education, seniority, and position which was probably helpful in giving newly hired managers a sense of ownership. New employees in the shop get 1-3 shares at a low price 6 months after hiring, if recommended by the board, and this has become something of a right of passage for employees ending the equivalent of their probationary period.

But there is a sense in which the work collective continues to own Elinar regardless of share ownership. Elinar rests upon a social contract between management and workers. Management's goal is to maintain employment -- even when the entire insulator production was shut temporarily in February 1996, practically all workers were transferred to other jobs -- and do what it can to improve living standards; the workers' quid pro quo is an astonishing flexibility in moving among the Elinar enterprises.

In 1995, we sat in a breakroom talking to two of the most senior workers in the plant who were playing dominoes, using a set they had made in the shop. We talked about what ownership might mean. Alexander Petrovich who had put in 44 years at Elinar, and currently worked maintenance, didn't have much doubt about *his* ownership. "I've seen general directors come and go," he noted pointedly to Kuimov who, exceptionally, sat in on the session. "A lot of us were opposed to buying Druzhba because we had to spend our money on it," he continued, "but it has actually made some progress. I think that the bakery was a really good investment for us."

As we walked back through the plant, Kuimov commented that Alexander

Petrovich "had been an active Communist. Now he is an active shareholder." Kuimov's point was that Alexander Petrovich had been acting like an owner for years. "Active people will be active."

Ownership education

Our experience with employee ownership in the United States, where private ownership is deeply entrenched, is that employee stock ownership requires considerable explanation to employees. In Russia, where there is no tradition of private ownership of productive assets, that task is greater.

As part of the internal change process -- and probably partly stimulated by Kuimov's trip to the United States to visit employee-owned companies in the fall of 1993 and his staff's participation in a variety of seminars that the Ohio Employee Ownership Center and Russia's Economic Reform Foundation began running in 1995 concerning employee ownership and participation training -- Elinar embarked on an ambitious training program in 1995. This program involved regular classes for all employees taught by their supervisors. The supervisors were brought together previously for training by top management on the same subjects. During the 1995-1996 period, this involved some eighteen classes on various aspects of understanding Elinar's business.

The subjects of these classes included understanding financial information (vital because the company distributes financial information quarterly), share ownership, the market economy, quality standards, marketing, safety, the incentive system, and the new directions for the development of the enterprise.

For an American standpoint, the structure of Elinar's training seems to have substantial similarity to that of the Soviet era in being top down. But fitting this established pattern may work well, at least when management enjoys a reputation for probity and competence.

In any case, during a discussion in a focus group in the New Year tree production shop in July 1996, employees certainly seemed to understand their ownership. All continued to be shareholders despite the fact that they clearly had uses for cash. One of the rewards of ownership is that

shareholders with 10 years or more seniority as employees have rights to trade up to larger apartments with credit advanced by Elinar. Rather surprisingly, three of the four had chosen to take their dividends in additional company stock rather than in cash. The fourth, who selected cash, was using it to buy an apartment.

7. Community values, community economics

In May 7, 1996, Boris Nikolaievich Yeltsin visited Ateptsevo and Elinar. The ostensible purpose was to visit World War II veterans and to dedicate the war memorial. In fact, he was hitting the campaign trail for reelection.

Yeltsin visited Ateptsevo's food store and was startled by how well stocked it was, still unusual in village shops. In the store, he asked whether it was always that well stocked; the Potemkin food store is a staple of Presidential visits. Outside he grabbed the microphone to ask the crowd whether the selection was really that good everyday. "Yes," came the answer. "All we need is more income to buy it."

"Enterprises of this sort should have the support of the government," Yeltsin told the crowd, but he didn't promise any subsidy. Leaving Ateptsevo, he praised the village and Elinar for its self sufficiency.

Creating a local economy

One striking consequence of Elinar's development is Ateptsevo's growing autarky or local economic self-sufficiency. With the addition of a bakery to Elinar's own complex, the chicken, beef, and general farm production at Druzhba, and the addition of a dairy at Druzhba, Elinar covers the bulk of its own food needs. Its shops do truck and auto repair; its construction crew continues to build another apartment building every second year. Ateptsevo is significantly less dependent on the outside world than it was in 1992.

As the national economy has spiraled down, Elinar built a local economy. Building the bakery was a response to the fact that sometimes 5-6 days passed between bread deliveries. "Why should we pay for someone else's profit on stale bread?" our driver complained on the way to Ateptsevo in

1996. Although the bakery was set up "for social reasons," says CFO Lubov Nikolaevna Senichkina, "it is now turning a profit. The dairy also has reduced our food costs, but it was designed to make a profit from the start." Elinar has also built a gas station to service local needs and will build a second. "We won't build a third elsewhere," Kuimov says, "because gas is criminalized."

Ateptsevo has a village government, but the government has no money. As a consequence, Elinar continues to include the costs of the village and its infrastructure in its costs of production. In essence the enterprise covers the costs of the town. Apartment rent covers only 20% of the upkeep; Elinar covers the rest. It provides water, heat, and power to the village too. In addition to providing 48,000 sq. meters of housing, it supports one hospital, two schools -- Elinar's school is claimed to be the best in the Naro-Fominsk region -- two kindergartens, and a number of clubs.

Is there a conscious strategy of self-sufficiency? Kuimov says "no." He argues that in opening the bakery, improving the Ateptsevo and Druzhba stores, and building gas stations and dairies, he is simply responding to local needs. "It's Elinar shareholders who benefit," he says. It is also in the old Soviet tradition of enterprises providing the infrastructure for the community.

Yet Elinar is not an island unto itself. It houses many who work (or, more accurately, who would work, if there were work) elsewhere in the Naro-Fominsk area, and many of its employees live in the Druzhba villages. Others from the area buy in the well-supplied Elinar store. In effect what is happening is that a local economy is being created in Ateptsevo in which a significantly larger portion of goods consumed in the village are produced there or within a five mile radius than was true in Soviet times or as late as 1993. It marks the emergence of a *local economy* absent in Soviet times.

As a result, Elinar offers a local economic development model that stresses local sustainability and sufficiency -- indeed the bakery is a clear "import substitution" measure -- but which is compatible with broader market relations. If we look at Druzhba's chicken production, for example, 10% of Druzhba's production is sold locally in Ateptsevo and Druzhba, and many of the votes for the Druzhba merger were cast for cheap meat. The

biggest complaint about the Druzhba merger we heard in employee focus groups was the fact that the chicken prices hadn't turned out to be as cheap as they were supposed to be.

Elinar's local sales provide about 10% of the company's total sales. But they are far more important to the company than that: local sales are cash sales, and they generate enough cash to meet 100% of payroll. This has been crucial to Elinar's ability to meet payroll every pay period, even when the government stopped the printing presses and created a cash shortage in the banking system. Local sales permitted the company to tap the sea of cash in the economy.

Community values

Maslenitsa -- "Forgiveness Sunday" -- fell the day after the 1994 Elinar shareholder meeting. It was the kind of late winter day when you stamp your feet in the snow and blow on your fingers trying to get bills out of your wallet at the Sunday village market, but, when the sun finally breaks through, warms you up enough that you can sense that spring really is around the corner. In short, it was a good day for celebrating the end of winter and for burning *chuchelo*, the symbol of departing winter.

It was also a good day for understanding what drives an industrial village like Ateptsevo. The center of the celebration and of the village is the school, which is heavily funded by Elinar. It had provided a modern computer lab which would have been the envy of many American schools in towns of 4,000 in 1994. Alona, Kuimov's daughter, was one of the pupils there; she had already helped show off her classroom to the American visitors during a previous visit.

On this Sunday, the focus is on the school porch and school yard. The chorus and dances of the school children were followed up by songs and dances by their mothers and grandmothers, including Marina Anatolevna, Kuimov's wife, who led much of the women's activities, as befits the wife of the village's general director, and who took part in the program in traditional dress. Kuimov circulated through the hundreds who had turned out, greeting and chatting, and drawn, like his American guests, into dancing with the aggressive pensioner women who did not stand on ceremony. Despite the modern apartment buildings that ringed the school

yard and house at least 95% of Ateptsevo's inhabitants, that there was something as traditional about the festivities as the cluster of traditional village houses that survive from the days before the Elinar plant began to rise in Ateptsevo.

Elinar is not purely an enterprise in the market sense, nor is it an intentional community of like-minded idealists, like the Israeli kibbutzim in the first generation. It is something in between: it is a community that is based on a shared economic enterprise, nurtured by that enterprise, and at some level coterminous with its work collective. In some ways it bears resemblance to the ideal Japanese company type.

But there is more in community terms. Kuimov lives in the village, his children go to school there, his son was married in the plant cafeteria with several hundred guests, largely drawn from the village and the plant in the summer 1996 the weekend before we arrived to visit the plant, etc. It is, to use the revealing language of the Israeli writer Amos Oz,

an acquaintance community in which people relate to one another in circles of respect and shame. What you have done well will bring you respect and even admiration. What you have done wrong or badly will bring shame on you.... [R]ather than spending most of your time among strangers and superficial acquaintances, in and out of work, you are among people whose respect you seek. Rather than profit, or professional recognition, or envy of your material achievements, you look to them for personal admiration. (Oz 1997: 44)

There are many Ateptsevos in Russia.

Their culture combines the village communitarian roots of the 19th century with an ideological residue of seventy years of Communism. Whether the party elite of the 1980s (many of whom have enriched themselves in the privatization process in the 1990s) ever believed in the ideology they preached in the 1980s may be dubious. But the old men wearing their war medals on Sunday on their suit jackets in the parks came by them honestly, and the war monuments in every village, including the new monument in Ateptsevo, attest to the sacrifice of those who did not come back. Three generations struggled in the name of Communism

to build a modern industrial society and to rebuild it after it was destroyed. There was, at least on occasion, a belief in solidarity there, a pride in achievement, a sense of collective accomplishment. That too does not pass without a trace.

Russian economics is embedded in that culture, and it is a very different culture from that in the West. During the debate about foreign models in the early 1990s, Arkady Volsky, then the head of the Civic Union, an association of large enterprise directors, commented tellingly in dismissing the Swedish model: the trouble with the Swedish model, Volsky said, "is that we don't have enough Swedes."

Russia does have enough Russians, and many of them live in communities like Ateptsevo.

Russian reformers and their Western advisors who ignore this miss a key element in making economic reform succeed.

8. Why Elinar has succeeded?

Elinar is a Russian economic reform success story. Elinar is profitable, pays its taxes, and has never missed a payday for its employees. Furthermore, wages in its lower wage garment plant match the average industrial wage in the Moscow region and its higher wage insulation plants pay double the average industrial wage, it provides full employment, it has built so much housing that the workers' dormitory, the old Soviet-era fall back, is virtually empty, it has put in a modern phone system, it has held housing costs for an apartment to a seventh of garment worker's wages, and it is continuing to reinvest from its profits after all social costs are covered.

There is no single answer to why Elinar has succeeded. Rather, there are a number of contributing factors, several of which run counter to accepted Western wisdom on what makes for Russian economic success. Here are the ten which seem to be most important.

1) Elinar made a virtue of what has usually been regarded as a Soviet vice: the overgrown enterprise. It converted its various service affiliates -- construction, auto and truck repair, hauling, and machine shop -- into subsidiary enterprises which supply the local market.

2) Elinar's commitment to maintain its core production and to full employment led it to start light industrial production to employ underemployed workers from its core production until the core production recovered. While that recovery has yet to take place, light industrial production has proven its economic value, and Elinar's workers' living standards are better than they were at the end of the Soviet period.

Much of the reason for higher living standards, however, is that the enterprise has continued to provide for collective consumption through continued housing construction, a new telephone system, protecting the school and medical system against collapse, and rebuilding the sanitation system for Druzhba.

3) Most of Elinar's light industrial enterprises have been partially rooted in supplying either Elinar as an enterprise or Ateptsevo as a community. The two are essentially different sides of the same coin. While this is hardly a "market driven" strategy in terms of the global or national market, it certainly is a successful community-driven strategy.

4) Elinar has dodged all the panaceas: foreign investors, bank ownership, exports, mafia entanglements, and dependence on governmental support.

5) Leadership cannot be underestimated. Kuimov is not only thoughtful, independent, and innovative, he has substantial leadership skill. His predecessor, Yuri Mikhailovich Krivosheev, is also said to have been a good manager who stayed ahead of the curve. Elinar's early experience as a cooperative and then as a leased enterprises gave them time to experiment before the bottom fell out of the economy.

A major reason why Elinar's tough decisions and reallocation of labor have been accepted has been the fact that the General Director is part of the community. His values and the community's values are aligned. That facilitates trust and communication.

6) In effect, Elinar has undertaken the kind of alignment of values -- honesty, communication, teamwork, trust, and cooperation -- which many hold to be central to high performance enterprises. The alignment includes the general director, the managers, and the employees, and it helped to shape a corporate culture in which decentralization and learning were stressed.

7) Decentralization of decision-making has made a substantial difference. Elinar has successfully shifted responsibility downward. It flattened its hierarchy and made promotion on the basis of merit and motivation the standard. At the same time, it hasn't really abandoned the planning idea; it has internalized it. Its internal planning sets realistic targets against which performance can be measured. Again there is fit with Soviet-era enterprise culture within the new market dispensation.

8) Learning is really a central part of the success of Elinar. It's an underlying feature. Everyone is encouraged to learn: to learn new jobs, how to do things better, and to make continuous improvement in existing processes.

9) While employee participation is far from universal, there is far more employee participation in decisions which affect daily work. Management celebrates employee success with employees: witness the champagne for everyone when the chicken slaughter line was successfully installed.

10) At a metaphorical level, Elinar is a giant business incubator. There are businesses of all sizes within it, from shops which employ several hundred (in insulation production) through units which employ only a handful, like Tatiana Leonidovna's chicken "farm." There is a lot of learning going on, a lot of mentoring, and a lot of experimentation. The same characteristics of decentralization and pushing decisions down in the hierarchy which work for managers seem also to work for employees.

In short, Elinar represents a relatively successful synthesis of communitarian values, innovative management, decentralized decision making, individual incentives, collective consumption, and market empiricism. If there is any single common denominator for these features, it is a willingness take an experimental and empirical approach to economic reform.

Tatiana Sergeevna Luchkina, an 18 year veteran who had been transferred after twelve years in the insulation lab and who was now learning to mix plastic in the New Year's tree shop, summed up succinctly what she saw as the company's business philosophy: "Every time we faced a challenge, we tried something new."

We put the same question to Kuimov: Why was Elinar successful in making the transition to the market economy when most Russian capital goods producers were collapsing? He offered a somewhat more Russian answer.

In interviews in both 1995 and 1996, he emphasized the advantage of being "in a sphere where there is little corruption" and his determination to avoid involvement in business ventures, such as oil or metal exports, which would attract the mafia.

In 1995, he speculated on the fact that monopoly in Russia was not only the preferred method of organizing production, but it was also the preferred method of organizing management ideas. Most Russian managers fought against the market, he thought. He himself saw it as forcing a meritocracy, forcing a sharing of information, and driving an improvement in quality. At least this was the way Elinar had sought to deal with the transition.

Confronting the same question in 1996 of why Elinar continued to succeed while the rest of the economy continued to decline, Kuimov's immediate answer was "good luck." Elinar was driven to diversify into light industry in 1991, he explained, by the need to hold skilled labor for the core insulation business. Now, ironically, less than a quarter of work hours were left in the core production. "Nobody wanted to move from insulation to our new businesses. Now many people prefer their new jobs to their old ones." Maintaining employment for the Elinar work collective was crucial, but there had to be a balance, for, as Kuimov puts it, "we are not a charitable organization. We are a commercial organization. But we invest in the long term, not short-term speculation like too much of the Russian economy."

Of course, if much of the rest of the Russian economy had done as well as Elinar, Russian economic reform would be a success.

jl.russia.summer96.elinar.wpd

Sources

Interviews & visits

This case study rests primarily on five visits to Elinar and perhaps thirty individual interviews with managers and group discussions with employees (generally without managers present) in 1993, 1994, 1995, 1996, 1997, and 1998. Principal interviews cited are the following:

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Ludmila Yurievna Ivanova, July 13, 1995, and July 8-9, 1996

Lubov Nikolaevna Senichkina, chief financial officer of Elinar, July 8, 1996.

Irina Sergevna Shitkina, July 6 and 7, 1998.

Aleksei Pavlovich Stepanovich, director of one of the two insulation facilities, July 8, 1996, and Lelja Mustafaevna Gorbacheva, director of the other insulation facility, July 8, 1996, and July 6, 1998; Svetlana Petrovna Tertyshnaya, director of the garment plant, July 8, 1996; Galina Sergevna Martinova, director of the bakery, July 6, 1998; Gennady Myslomovich Dschamalytinov, director of ESMA, July 6, 1998; Aleiksei P. Sedov, one of Elinar's barter experts, July 7, 1998.

Alexander Ivanovich Gerasimov, director of the chicken processing plant at Druzhba, Gennady Petrovich Bokov, director of the chicken growing farm at Druzhba, and Tatiana Leonidovna Syrman and her team in the experimental self-directed chicken growing team, all on July 9, 1996, and

all on July 7, 1998.

General group discussions: with a dozen managers February 19, 1993; with two senior blue collar workers July 13, 1995; with workforce of New Year's tree shop, July 9, 1996.

Internal reports

Annual financial reports for 1993-1998 and General Director Kuimov's oral annual report to the 1994, 1997, and 1998 shareholders' meetings.

Published materials

"Does Employee Ownership Have a Role in Russia's Future?" *Owners at Work*, v. 5, no. 1 (Spring 1993), pp. 5-6.

***Elinar*, monthly newsletter, which began publication in 1997.**

Igor Evgenievich Kuimov, "Joint Stock Company Elinar," proceedings of a joint Russian American conference sponsored by Russia's Economic Reform Foundation, *Opit razvitiya form aktsionernoi sobstvennosti rabotnikov* (Moscow: offset, 1993), pp. 31-39.

John Logue, Sergey Plekhanov, and John Simmons, *Transforming Russian Enterprises* (Westport, CT: Greenwood Press, 1995).

Amos Oz, "On Social Democracy and the Kibbutz," *Dissent*, Summer 1997, pp. 39-46.

jl.russia.summer96.elinar.wpd

Table 2. Key statistics on Elinar's performance

1975 1985 1989 1990 1991 1992 1993 1994 1995 1996 1997

Insulation production 946 3436 4878 4528 3261 1810 1823 1567 1489 882
1023

in tons

Insulation as percent 100% 100% 100% 100% 100% 96% 90% 77% 81% 69%

of sales

Total sales in millions 65 71 135 841 10,506 34,733 107,733 128,406
170,630

of rubles*

Profit in millions 400 2,708 2,764 28,684 16,409 19,959

of rubles*

Profit after tax in 268 1,628 1,801 17,084 7,792 9,921

millions of rubles*

After tax profits as 32% 15% 5% 16% 6% 6%

a percentage of sales

* excluding subsidiaries