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A Proposal to Establish A Joint Venture Among U.S. and Soviet Cooperatives

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A Proposal to Establish A Joint Venture Among U.S. and Soviet Cooperatives

Abstract
-Significant Soviet political and economic restructuring is occurring- Soviet leaders are making public admissions that the command system of central planning instituted by Stalin is not resulting in the standard of living desired by Soviet citizens and perhaps more important, it has not generated economic growth for sustaining a long—term global leadership position.

Disciplines
Behavioral Economics | Economic Theory | Growth and Development | International Business

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This proposal is designed to foster discussion among and possible action by U.S. cooperative entities concerning the opportunities and risks of establishing a joint venture with Soviet cooperatives.

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A Proposal to Establish A Joint Venture  
Among U.S. and Soviet Cooperatives  

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March 1, 1989  

THE OPPORTUNITY  

-Significant Soviet political and economic restructuring is occurring. Soviet leaders are making public admissions that the command system of central planning instituted by Stalin is not resulting in the standard of living desired by Soviet citizens and perhaps more important, it has not generated economic growth for sustaining a long-term global leadership position.  

-Exchange missions to the U.S.S.R. confirm widespread use of dated technologies, lack of quality control, major inefficiencies in production and distribution, and lack of diversity in goods and services for consumers due to bureaucratic management.  

-As a result, the U.S.S.R. is initiating many measures to deregulate their command economy. The initiatives are making business relationships more compatible with western principles and potentially profitable for joint ventures with western firms. These trends include placing limitations on government role and authority, decentralization of planning and resource allocation, development of markets and competition, developing enterprises that are autonomous from government, less government involvement in state-owned enterprise management, and formation of new coops.  

-This environment of deregulation represents a unique opportunity for Soviet business entities with access to superior management abilities, superior distribution concepts, superior marketing abilities, and production technologies to establish national networks that are more efficient and productive than the current USSR institutions that do not have access to these skills.  

-The U.S.S.R. has invited western business interests to establish mutually beneficial joint ventures that would help them improve their economic performance. The Soviets in general, and certain Soviet institutions in particular, would prefer to establish such international joint ventures with cooperatives.  

-These developments provide a unique and significant potential opportunity for U.S. cooperatives to develop a major market presence in the U.S.S.R. and to increase the returns to U.S. farmer members. Only two questions remain: Will U.S. cooperatives initiate efforts to seize the opportunity? And if so, what form should such joint ventures take to assure a mutually beneficial business relationship.  

-This white paper presents one plan for consideration.
SHOULD THE U.S. HELP THE U.S.S.R. IN IMPROVING THEIR FOOD SYSTEM?

The current political and economic restructuring will create opportunities for western business interests to indirectly access national Soviet markets through joint ventures. This approach not only has the potential to significantly improve the performance of the Soviet economic system and allow perestroika to succeed, but it also represents the potential to develop significant economic relationships and returns for western interests, while simultaneously improving the national security environment.

U.S. firms continue to adopt a wait and see attitude. Japan and Western European business interests are currently establishing Soviet market presence. If perestroika succeeds, U.S. firms will enter Soviet markets late with disadvantage.

Second, if the performance of the Soviet food system is not improved, perestroika is more likely to fail. This could stall the warming of U.S.-U.S.S.R. relations and result in continued high deficits and defense spending in the U.S. and Soviet Union.

There are two competing global security strategies. The U.S. and U.S.S.R. can both continue down the road of military build-up. Or, the U.S. and U.S.S.R. can both plan mutually agreeable and verifiable military reductions in armaments along with building political linkages and economic interdependence. This would reduce the need for high defense and deficit spending in both nations.

U.S. assistance in helping Soviet perestroika to succeed has the potential of becoming an integral part of the latter global strategy. It can become a major cornerstone for developing a more secure political and economic world environment for the future.

SHOULD U.S. COOPERATIVES TAKE THE LEAD?

Soviet leaders have placed heavy emphasis on cooperatives and coop-type organizations in their restructuring efforts. Other things being equal, Soviet political and cooperative leaders prefer to develop international joint ventures with other cooperatives. This creates a unique opportunity for U.S. coops.

Given the present lack of product diversity, product quality and competition, Soviet deregulation provides a unique opportunity to introduce new products and services into Soviet markets and to build national distribution networks by selling franchise packages to Soviet cooperatives. Such self-contained franchise networks could solve many of the bureaucratic problems that plague the current Soviet economic system. As a result, the potential returns to U.S. cooperatives and their members from a U.S.-Soviet joint venture are very large and of global magnitude.
Soviet cooperative institutions have been given special emphasis and more legal flexibility under perestroika. Thus, U.S.-Soviet cooperative joint ventures may have more inherent potential for profitability than joint ventures among noncooperatives.

If U.S. cooperatives develop a superior and favored system for introducing U.S. products, management skills, and equipment into the Soviet economy, there would be significant opportunities to add additional U.S. joint venture partners that could make the initial joint venture even more successful.

As a result, there is perhaps a once in a lifetime opportunity for U.S. cooperatives to dramatically enhance their economic and political stature at home and abroad.

WHAT TYPE OF U.S.-SOVIET COOPERATIVE JOINT VENTURE IS NEEDED?

IT MUST:

- Have the capability to generate significant returns for U.S. cooperative members.

- Have the capability to protect U.S. investment and personnel by possessing the appropriate legal, financial and political relationships.

- Have the ability to leverage pilot enterprises and test markets into national markets.

- Have the ability to attract significant Soviet capital and managerial talent.

- Have the ability to organize efficient production, distribution and retail networks and train Soviet management talent to deliver superior products and services.

- Have the initial ability to attract U.S. cooperatives willing to make an initial capital commitment.

WOULD A NEW INTERREGIONAL COOPERATIVE STRUCTURE MAKE SENSE?

The Soviet Union has a unique culture, political system, legal structure and a unique set of business institutions. In addition, the rules of the game are being revised. Therefore, any potential U.S. cooperative considering a joint venture with the U.S.S.R. would need to assemble a highly talented management team with the stature and capabilities to accomplish three goals critical to the success of the project:
First, the management team must have the capabilities to fully understand Soviet history, language, culture, institutions, rules, tastes, preferences and other factors that are influencing the emerging Soviet markets and market structures.

Second, in order to enhance profits and limit potential losses, the team must be able to provide thorough assessments of the business opportunities and risks in the U.S.S.R. and negotiate realistic plans given U.S. and Soviet market constraints.

Third, the management team must be able to develop the political, business management, legal and financial skills and relationships in the U.S. and U.S.S.R. necessary to assure the greatest possible success of the project.

As a result, such a U.S.-Soviet joint venture must either be initiated by an existing regional cooperative with significant international personnel and resources or by pooling the resources of several regional cooperatives to assemble a new interregional.

An interregional cooperative is more likely to develop the economies of scale to achieve the maximum economic returns from U.S.-Soviet joint ventures for U.S. cooperative members. The knowledge gained and training resources assembled from setting up initial test-markets, pilot enterprises or franchise networks can be used in establishing other test-markets, pilot enterprises and franchise networks. An interregional cooperative would be more able to utilize the specialized resources from several coops. In addition, the interregional cooperative would be in a better position to gain the experience required for success by observing various pilot projects at the same time.

An interregional cooperative is more likely to develop the financial clout, political stature, and negotiating talent that would make the U.S.-Soviet joint venture a success. If regional cooperatives individually develop their own joint ventures, they are less likely to multiply franchise networks in Soviet markets and they are less likely to leverage the joint venture by adding other potential U.S. cooperative and noncooperative partners.

An interregional cooperative would reduce the financial and business risks for each regional cooperative partner. Regional cooperatives presently provide a number of opportunities that could potentially be leveraged in the developing USSR markets. However, some of the opportunities may be too risky for a single cooperative. An interregional cooperative would spread the financial risks and could reduce the business risks by providing the necessary expertise, resources, experience and relationships to develop such opportunities in U.S.S.R. markets.

Finally, an interregional cooperative would establish a single central focus for a new business entity that could generate significant public support and goodwill that would in turn generate private and public financial resources.
WOULD A COOPERATIVELY CONTROLLED STOCK COMPANY MAKE SENSE?

Under perestroika, Soviet leaders are placing high emphasis on the cooperative form of business enterprise. As a result, Soviet managers and enterprise leaders are more likely to prefer to work with U.S. cooperatives, if everything else is equal.

In addition, many of the new laws give preferences and flexibility for cooperatives. This implies that cooperative joint ventures may likely be more profitable than noncooperative joint ventures. As a result, several U.S. corporations are likely to seek a relationship with U.S. cooperatives if it is likely to enhance their marketing opportunities in the Soviet Union.

Adding corporations as partners may enhance the success of a U.S.-Soviet joint venture, if the particular corporations possess special enterprise expertise desired by the Soviets or if the corporations have strong ties and can provide access to Soviet leaders required for a successful joint venture. For example, regional cooperatives are not known for dominant expertise in food processing machinery manufacturing, international merchandising or retail franchising. Therefore, if access to this expertise was critical to the success of the U.S.-Soviet joint venture, the interregional cooperative members could benefit by forming a stock company and retaining majority control.

DOES A HOLDING COMPANY (UMBRELLA CONCEPT) MAKE SENSE?

Each member and partner of the interregional is likely to have proportionately more interest in a specific enterprise or set of enterprises. The holding company approach would allow more direct and equitable participation in management and returns by those members and partners with disproportionate interest in certain enterprises. At the same time, a holding company assures that the interests of all members and partners are protected by managers of each individual enterprise in the joint venture.

The ability to vary the ownership and financing package of each subsidiary provides flexibility in designing attractive packages targeted to specific Soviet desires or in attracting new potential U.S. cooperatives and noncooperatives partners into the interregional joint venture. This flexibility would not be present in the traditional corporate pyramid structure.

WHAT WOULD BE THE MISSION OF THE COOP TRADING COMPANY?

To enter a joint venture with Soviet cooperatives for the purposes of fostering mutually beneficial commercial trade, building national franchise networks and developing Soviet markets that would generate large returns for U.S. cooperatives and their farmer members and would foster better U.S.-Soviet relations for enhancing global peace and economic stability.
WHAT WOULD THE US-USSR COOPERATIVE JOINT VENTURE DO?

Interregional Cooperative
Stock Holding Company
United States

Provides
-Farm commodities and other U.S.
goods for export to the U.S.S.R.
-Provides materials and expertise
to build new plants and equipment.
-New products for test-marketing
in the Soviet Union and eventual
licensing for production in
the U.S.S.R.
-Management expertise for training
potential franchise managers and
developing production, marketing
and distribution networks to
service the franchises developed.
-Technologies that are new to the
USSR that would improve the
quantity, quality and diversity

Centrosoyuz
Affiliates
Soviet Union

Provides
-Fertilizer and other goods
for export to the U.S.
-Provides capital investors
to buy plants and equipment.
-Pilots several test markets
and identifies local coops
for prospective licensees to
produce successful products.
-Identifies local coops with
capital and potential talent
for prospective franchisee
investors.
-Undeveloped markets, labor
intensive technologies, and
management unfamiliar with
competition.

HOW MIGHT THE U.S. INTERREGIONAL TRADING COMPANY BE STRUCTURED?

A tentative initial structure has been developed for purposes
of conducting a feasibility analysis. Such a structure might
look something like the one described below.
WHAT ARE THE STEPS IN SETTING UP SUCH A VENTURE?

For discussion purposes, a four phase plan is described below. We might initially expect the plan to involve a four-year cycle. Each phase would last about one year. However, the length of each phase depends upon the progress made. The cycle concept is important because additional cycles can be initiated when additional partners are attracted to the joint venture.

PHASE I. PARTNERSHIP DEVELOPMENT PHASE

1. Inform and revise the joint venture proposal based on discussions with leaders of major U.S. cooperatives and others. Make formal presentations directly to boards and perhaps at the 1989 AIC-NICE Conference. Acquire letters of intent.

2. Facilitate the appropriate US-USSR exchange missions to foster a refining of joint venture concepts as needed. Perhaps a major presentation could be made at the NCFC/AIC-CENTROSOYUS sponsored symposium scheduled for Moscow in October, 1989.

3. Identify the potential enterprises, products, and pilot packages that are of interest to the Soviets. Determine which ones are doable by U.S. cooperatives.

4. Begin to identify the available cooperative, noncooperative, and public resources for establishing such a joint venture. Inform and seek the support of the highest political leaders.

5. Develop plant and equipment designs and formulate a business plan to initiate the joint venture.

6. Investigate the potential joint venture partners identified. If acceptable terms are negotiated, charter the new interregional and sign the US-USSR joint venture.

PHASE II. PILOT CONSTRUCTION PHASE.

To identify markets, build pilot plants and install equipment.

PHASE III. FRANCHISE PACKAGE DEVELOPMENT PHASE.

To test, develop, and begin to market franchise packages.

PHASE IV. FRANCHISE NETWORK DEVELOPMENT PHASE.

To train franchisees and build national franchise networks.
WHAT ARE THE FINANCIAL REQUIREMENTS?

Each U.S. interregional partner might be expected to invest $3 to $5 million toward each pilot enterprise to cover the first four phases of the project. The Soviet cooperatives would be required to match an equivalent amount. In order to achieve initial economies of size, a minimum of four pilot enterprises would be required but more would be desirable. For discussion purposes, the initial 50-50 joint venture partnership would have capital of $24 to $40 million.

Each partner, U.S. and Soviet, would have to provide satisfactory proof of commitment to the other partners before the venture could proceed. Much of the capital would not be required until the construction, test-marketing and franchise marketing occurs in Phase II, III and IV.

Access to $1 to $2 million would likely be required to complete the Phase I studies that determine whether such a joint venture is feasible, to determine which pilot enterprises provide the best opportunities, and to negotiate an acceptable joint venture agreement. Such up-front costs might be shared equally by the potential interregional partners. However, future partners would likely be charged a partnership entry fee reflecting the added value of the company at a future time.

To initiate the effort, four potential regional cooperative partners might contribute $100,000 to begin initial discussions. Additional funds could be pledged if satisfactory progress is made. Thus, the study may discontinued at any time without risking an inordinate amount of seed money.

In addition, it may be possible to partially fund some of the initial work from contributions by other public and private funding groups that have a strong interest in economic development, world peace, and/or management training.

Some of the initial work on the study might logically be coordinated by a disinterested outside consultant. A university consultant may also help to shape a partnership proposal that could become more acceptable to other future potential partners and attract funds that would not otherwise be available to the project. Such work would naturally be conducted under the direction and guidance of a board committee of the funders.
WHAT ARE THE OVERALL BENEFITS OF A U.S.-SOVIET JOINT VENTURE?

1. Increased access to Soviet markets as they are developed.
2. Shared joint venture earnings from U.S. and Soviet exports of goods and services, facility construction and equipment sales, initial franchise fees, annual franchise fees, fees from Soviet product and service manufacturing licenses.
3. Increased political and economic stature at home and abroad, if a highly visible development was to be successful. The global security implications of a successful effort are phenomenal.

WHAT ARE THE RISKS?

1. Risk of changes in the political environment.
2. Risks of joint venture agreement non performance.
5. Risks that western products, markets, management skills, and quality control techniques cannot work or will not be accepted in Soviet society.

It should be noted that insurance and government guarantees can be used to reduce or limit the economic impacts on U.S. firms for many of these risks. The development of superior intelligence capabilities, rigorous payment procedures and tough negotiations on the design of a joint venture agreement can incorporate checks and balances that would alert management to problems as soon as they develop. This could limit the economic impacts on U.S. firms before additional investments are made.

It should also be noted that a number of joint venture agreements have been signed with the USSR. However, only a relative few are underway. Some of the remaining ventures will not progress until the potential gains improve and the new perestroika rules are more clear. However, in each case those with a joint venture agreement are in an advantageous position compared to those who don't as the new rules and incentives under perestroika are refined and clarified further during the next few years.
REFERENCES


