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Threats and Opportunities for Small and Medium Sized Food Enterprises of the Region under WTO Conditions

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1. Introduction

The food industry is an essential branch of the Russian economy. It is a strategic sector that forms the agro-food market and ensures the food and economic security of the country.

The geographic distribution of food production enterprises in Russia has historically developed together with the demographic development of its regions and availability of raw materials. Most large food industry enterprises are located in the European part of the country, where 80% of the population resides.

It should be noted that a large portion of the Far East Territory, and of Khabarovsk Krai in particular, lies within the high risk farming zone, which prevents the cultivation of a significant number of crops. The severe climate and the lack of accessible transportation from regions producing grain crops limits the management of animal and poultry production. All these factors affect the food industry of the region and decrease its competitiveness. Thus the quantity of products produced by the food industry enterprises cannot meet the demands of the region's population, which results in Khabarovsk Krai seeking outside for food sources (Levintal, A. (2004)).

Under WTO conditions, when international competitiveness is increased and foreign products can be delivered to regional markets at a low cost, these dangers greatly increase.

This article will discuss the current status of the food industry in Khabarovsk Krai and possible consequences of Russia joining the WTO will have on its development will be analyzed. Alternative food industry development plans will also be discussed under WTO conditions.

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Table 1 – Main economic characteristics of Khabarovsk Krai organizations in food production (including beverages and tobacco) from 2006 to 2010

Indicators	2006	2007	2008	2009	2010
Index of industrial production, %	110,1	103,7	103,8	97,1	91,7
Volume of shipped products (including work and services) in RUB (millions)	10.293,5	11.704,2	13.728,8	15.291,2	15.230,1
Average annual number of people employed (thousands)	16,9	15,5	13,1	14,6	14,0
Average monthly employee salary in RUB	10.816,0	11.730,0	154.040,0	17.080,0	18.279,0
Balanced financial result (profit, minus loss) of organizations in RUB (millions)	57,9	133,3	308,4	94,9	-95,7
Profitability of goods sold (including work and services) by organizations, %	5,1	6,1	9,4	8,2	4,7

Source: Food production in Khabarovsk Krai (2011).

2. The status of the food industry in Khabarovsk Krai

The food industry is one of the most important economic sectors of the region, as it provides high quality, healthy food products to the population. These include meat and meat products, dairy products, bread and pastry products, beverages, fish, seafood, and canned goods (GICS classification (2008)).

Table 1 shows the main economic characteristics of food production, including beverages and tobacco for Khabarovsk Krai.

As the table shows, in 2010 there were domestic shipping, works and services in the amount of 15.230,1, which amount to 17,6% of the total quantity of manufacturer shipments. It should be mentioned that the current indicator had a stable increase from 2006 to 2010.
In regard to the structure of shipped products (including work, services), brewing has the greatest share (33,6% of overall volume of enterprises shipment, making food products), followed by the production of meat and meat products (20,2%), dairy products (18,6%), bread and pastry products (8,2%), fish, seafood, and canned goods (7,7%) (Food production in Khabarovsk Krai (2011)).

The investment volume in a basic capital (except for small business), focused on the development of food production, had the amount of 433 million rubles in 2010. Compared to last year this indicator is higher by 39,4% (in comparable prices). The main flow of investments in the food industry is oriented on: brewing (37% of total a investment volume), fish, seafood and canned goods (14,7%), and the production of dairy products (12,6%) (Food production in Khabarovsk Krai (2011)).

The brewing development in Khabarovsk Krai is explained by the presence of Baltika-Khabarovsk, the biggest brewing plant in the region and in the Far East. The plant possesses modern equipment and produces over 100 million liters of beer per year. Baltika invested 54 million dollars in the economy of Khabarovsk Krai (Baltika Khabarovsk official site).

In the investment structure of the basic capital sources of financing, the share of Khabarovsk Krai organizations' private funds, used for the investment purpose, has reached 58,9%. Additional raised funds has correspondingly reached 41,1% (Food production in Khabarovsk Krai (2011)).

The average monthly nominal salary (without social payments) at the food industry enterprises has increased by 7% in 2010 compared to its level in 2009 and has reached 18.279 rubles. However the real salary has decreased by 0,4%. It should be noticed that there is the salary differentiation in industry. Thus, the salary amount of brewing workers is 33.544 rubles, which is in a 2,4 times more than that of bread and pastry workers (14.009 rubles.)

Table 2 shows the main data for the types of output produced in Khabarovsk Krai.

Small and medium sized businesses contribute to the development of the food industry in Khabarovsk Krai. These include the production of meat and meat products, dairy products, bread and pastry products, drinks, fish, seafood and canning.

In 2010 the share of the production volumes of small and medium sized enterprise subjects (hereafter referred to as SME) in overall volume of the food industry in Khabarovsk Krai reached 7,03%. From 35.794 individual entrepreneurs 299 (0,8%) were engaged in food, drinks and tobacco production (Food production in Khabarovsk Krai (2011)).

The leading food industry enterprises in Khabarovsk Krai are: dairy production and off-load - Dukgomz, JSCo; Viazemsky Molochny Kombinat, LLC; Kombinat detskovo pitaniya Molochny krai, JSCo; Pereiaslovsky molochny zavod, CJSC; bread and pastry production – Kolos-prom, LLC; Konditerskaia Fabrika Khabarovskaia, LLC; 60,4% of brewing production – branch of Pivovarennaia Kompaniya Baltika – Baltika-Khabarovsk, LLC; meat production – Merilen, LLC; Cooperator-2, LLC; Grig Chernobelskovo, LLC.

Table 2 – The production of general types of food, including beverages from 2010 to 2011

Product types	2010	2011
Fish and seafood processing and canned goods, t	175.695,55	182.062,70
Frozen fish (except herring), fish liver, caviar, milt, t	127.841,81	127.020,35
Herring (under all types of processing), t	30.913,16	38.331,37
Seafood, t	4.825,68	4.485,83
Meat and poultry meat variety, t	7.602,13	7.968,15
Sausage products, t	7.361,44	6.463,30
Whole milk products (in conversion to milk), t	66.301	63.018
Mayonnaise and sauces. Seed-based sauces. Seed-based crèmes, t	2.488,97	2.413,87
Fish preserves, tubes	1.321,26	1.250,56
Horticultural preserves, tubes	5.607,37	6.899,25
Bread and breadstuffs, t	71.610,06	72.073,03
Pastry products, t	5.970,87	6.979,31
Plain macaroni products, t	3.813,4	3.489,15
Beer, except brewing waste, thousands. dL	22.863,06	24.200,76
Mineral and sparkling natural waters, cc	113.166	86.756
Sparkling waters, containing sugar and other dulcifying and flavor additive, thousands. dL	273	213
Compound animal feedstuff, t	79.617	80.973

Source: Food production in Khabarovsk Krai (2011).

3. Threats and opportunities for small and medium sized food enterprises in Khabarovsk Krai under WTO conditions

At present there are certain threats that could complicate the activity of small and medium sized food enterprises in Khabarovsk Krai under WTO conditions. These include:

1) Importation of meat and dairy products access to the domestic market.

In the midterm, this issue denotes the result of reduction for the specific constituent of import duty on finished meat products from existing 0,40€ to 0,25€ per kg. Under WTO conditions there will be a reduction of duty by 4,4% on average in the agricultural goods and food supplies sector.

Table 3 shows the data for the change in import customs duties after Russia joins the WTO.

Table 3 – The change of import customs duties after Russia joins the WTO

Product Group	Current Import Duty, %	New Import Duty, %	Import Products Price Change, %	Transitional Period, Years
Agricultural products in total	13,2	10,8	-2,1	1-7
Industrial products in total (as a comparison)	9,5	7,3	-2,0	1-7
Agro-industrial complex (selective numbers of products)				
Grain crops	15,1	10,0	-4,4	3
Oil crops and seed oils	9,0	7,1	-1,7	3
Potato	15,0	15,0	0,0	n/a
Meat products	25,0	15,0	-6,0	3
Dairy products	19,8	14,9	-4,1	4
Wine	20,0	12,5	-6,3	4
Milk, cream powder and condensed cream	25,0	20,0	-8,0	5

Source: Food production in Khabarovsk Krai (2011).

According to the table, under Russia's incurred liabilities, there will be a reduction of import customs duties on milk, cream powder, condensed cream and butter from 25% to 20% (15% till 2017). This will no doubt affect import products values.

2) Meat products displacement from Khabarovsk Krai market (smoked meat products, uncooked and cooked sausages, high-quality cooked sausages).

This will happen as if consequence of the reduction of ad valorem duty starting in 2015. This in turn will affect the sales of more expensive pork and poultry products (Mamikonian, M. (2012)).

3) New orders placement on the import of meat products by wholesale and retail organizations and processing enterprises.

This is explained by the fact that the price of raw material, such as pork, in EU is lower than in Russia by 40-50%. And in the result there will be an increase in import meat products, as it was the case in 1990's. An overexposure from the food import is one of the greatest threats for the food industry.

The food industry in Khabarovsk Krai particularly is unable to provide enough meat and dairy products, sugar and seed oil. It should be noted that in order to provide such goods, some output of food enterprises is often imported (Mamikonian, M. (2012)).

4) Delivery of import products on the market at low prices.

This may lead to the reduction in competitiveness, and as a consequence, in the drop in quality of Russian manufacturers.

5) The abolishment of quotas for import products and the reduction of state subsidies.

This decreases the competitiveness of domestically produced goods.

In connection with the above matter possible effects for the food industry in Khabarovsk Krai under WTO conditions might be the following:

- import share increase of foreign raw material for meat and milk production;
- deterioration in the quality of meat and dairy products;
- share decrease of Khabarovsk Krai manufacturers for dairy and meat products as the result of the lower cost of imported dairy and meat products;
- import food product assortment (delivery increase of dairy products with extended holding period, cheese, butter and other);
- sizeable reduction of goods from other regions in Russia (it is necessary to mention that Khabarovsk Krai own production is equal to 53,3 thousand tons, while goods from other regions amount to 225,9 thousand tons, and imported goods total is 25,3 thousand tons).

Nevertheless it is very important to take into account the fact that the influence on SME can be multidirectional. These include:

1. An increase in imported goods coupled with the reduction of customs duties will pose a threat to the food security and sovereignty of the region.

It should be noted that food sovereignty is secured when the import share of the domestic consumption ranges from 20-25%. The import over limit (especially of the food and consumer goods) of this index may lead to the destruction of the domestic industry, home market take-over and fixed prices (Fradina T., Pavlova T.). In Khabarovsk Krai, the share of import raw material (including powder milk) for dairy products is about 60% and for meat products about 75%; and these two indexes greatly exceed the limits mentioned above.

However, the increase in imported raw material combined with the reduction of customs duties can result in an increase in purchases, reduction in the production cost and an increase in the volume of production. This will positively impact the development of industry and SME in Khabarovsk Krai.

2. Food enterprises are the raw material demanders of local agricultural enterprises. The share of domestic raw material used for production by Khabarovsk Krai enterprises is about 30% for milk and dairy products, and 24% for meat products.

In the case of customs duties reduction and import production increase in Khabarovsk Krai there will be no need for domestic raw material, as domestic prices would be significantly higher than import prices. Thus, the price of import meat, purchased in Khabarovsk Krai under quota on 20-25 RUB per kg will be lower than the price of meat produced by the domestic enterprises.

3. Under WTO conditions it will be necessary for regional manufacturers to protect their trademarks in response to increased competitiveness from foreign companies. Therefore it is important to check inventory and estimate the enterprise's intellectual capital. It should be noted that the costs for estimating intellectual capital, trademark registration, projects patenting and etc, may lead to an increase in food enterprises' expenses in Khabarovsk Krai.

4. The main problem for alcohol enterprises may lie in increased importation of alcoholic products due to the abolishment of licensed trade. At present, within the WTO framework, Russia confirms applied system of import licensed trade and types of activity, except for switching to automatic licensed trade of the import alcohol.

5. It terms of production on the international market there will be a possibility for enterprises to purchase equipment at decreased prices, as WTO conditions allow for the reduction of import customs duties on technological equipment. This will contribute to the equipment modernization of material and technological advancement of the enterprise and production technologies.

We presume that the opportunities and threats of small and medium sized food enterprises in Khabarovsk Krai under WTO conditions do exist.

Opportunities:

- Delivering of import equipment for food enterprises with the reduction of import customs duty;
- Reduction in manufacturing costs due to the reduction of customs duty on raw materials (milk and dairy products, butter, meat and meat products);
- Khabarovsk enterprises' (including SME subjects) access to the foreign markets with their own (domestic) production;
- Innovations in production and implementation of products certification according to international standards for competitiveness increase.

Threats:

- Increase in imported raw material share for meat and dairy production, deterioration in the quality of meat and dairy products;
- Share decrease for Khabarovsk Krai manufacturers on the market of dairy and meat products as a result of an increase in imported dairy and meat products;
- Expansion in imported food products (delivery increase of dairy products with extended holding period, cheese, butter and other);

- In the case of duties reduction and an increase in the share of import products, there will be the reduction in purchases of domestic raw materials share;

- A sizeable reduction of goods from other regions in Russia (it is necessary to note that Khabarovsk Krai own production is equal to 53,3 thousand tons, goods entry from other regions – 225,9 thousand tons, import – 25,3 thousand tons).

4. Prospective measures for the development of small and medium sized food enterprises in Khabarovsk Krai under WTO conditions

If Russia is to join WTO, then immediate measures must be taken to ensure the survival of local food enterprises. These include:

1. The formulation of a development strategy in the food industry in Khabarovsk Krai that will set objectives, clarify priorities for development, and estimates industry status.

2. Formulation and implementation of investment projects in development and production modernization of food enterprises oriented to increase organizations competitiveness (Development strategy of food industry in Russian Federation on till 2020 (2012)).

3. Assistance to organizations and enterprises in the implementation of programs, projects and measures aimed towards increasing the competitiveness and quality preparation of outgoing products.

4. Development of the primary production in the food industry: bread baking, meat and dairy production and et al.

5. Stimulation for creation of production chain (cluster) such as: agriculture → food industry → consumer market.

The following actions should be taken:

- increase in operational activity;
- creation of own trademarks;
- introduction of resource and energy conservation programs;
- implementation of inventory checking system and complex estimation of a given enterprise’s intellectual capital;
- increase in competence in foreign trade management, in adherence the regulations under WTO conditions.

5. Conclusion

Generally, positive trends of food industry development in Khabarovsk Krai may be noted. This is confirmed by economic indicators such as increasing volume of shipped products, investments in nominal capital, average monthly salary and et al. However, it is necessary to note that during the crisis period there was an index reduction in manufacturing (index of balanced financial result of the enterprises activity).

We highlighted the conditions of Russia's joining WTO, which directly concern the activity of small and medium sized food enterprises in Khabarovsk Krai. Our concerns associated with the reduction in customs duties on raw material and semi-finished goods that poses a threat to the domestic food industry of this region. On the other hand, food enterprises may also benefit by having greater access to raw material for food production with reduced prices. This in turn will reduce manufacturing costs and increase various companies' competitiveness.

In our opinion, these proposed measures, focused on the adaptation of the region's small and medium sized food enterprises under WTO conditions, will not only temper possible negative effects but will also contribute to its successful functioning under international market conditions.

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