Towards an agroholding typology: differentiating large farm companies in Russia and Ukraine

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Abstract
A significant post-Soviet agricultural trend is the rise of super-large scale agroholdings. The emergence of these farming companies has occasioned a debate on whether such farms are economically and socially optimal: are they are more efficient than smaller scale farms, and are they squeezing out smaller producers from the market? In this debate, 'agroholding' is used as a blanket term covering a diversity of different types of farms. This was adequate when this trend was first emerging, but now it is increasingly inadequate to describe the many different types of farms with different orientations that are developing.

With the purpose of better defining different kinds of large-scale farms in the former Soviet Union, we propose in this research to develop a critical and empirically grounded typology of different farm companies, differentiating farms according to degree and kind of integration (horizontal or vertical), main orientation (primary crop production or food processing), and origin of capital (foreign, local, stock market, private equity). These distinctions will help to distinguish more successful business models from less successful, provide greater understanding of recent trends in the agricultural sector in the region, and help understand the future role such farm organizations might have in food production.

Keywords: Agroholdings, Russia, Ukraine, Corporate Governance, Large-scale Farming, Financialization

JEL Code: Q100 Agriculture: General

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Introduction

Research Problem: Throughout the 2000s, there has been a trend towards concentration of agricultural land in Russia and Ukraine within mega "agroholdings". Developments in these countries were in fact on the leading edge of a world-wide trend towards concentration of agricultural land within super-large corporate farms that came into focus around (and has been heavily debated since) the dramatic 2007-2008 food price spikes. This development has occasioned debates about the efficiency and productiveness of this new farm organization, and about whether or not such concentration of land – "land grabbing" – endangers local food security. The capital requirements for such mega farms are immense, which has resulted in growing links with international financial institutions and stock exchanges, both globally and in Russia and Ukraine, and debates about the "financialization" of agriculture and attendant consequences intersects with debates on superior farm organization and land-grabbing. In this paper we will focus mostly on the first and third debate.

While there are certainly examples of profitable large corporate agricultural companies in Russia and Ukraine, the "the jury is still out" in terms of determining if this is a superior farm organization. Some studies point to competitive advantages (Balmann et al., 2013; Epshtein et al., 2013), while others find no evidence either way (Deininger et al., 2013; Matyukha et al., 2015), while still others show the tensions and downsides of large farm companies (Kuns et al., 2016; Visser et al., 2014). Much of the research looking into these companies, though with different methodologies and theoretical framings, tends to focus on large samples of companies in a particular region or even whole countries. The regional studies provide important perspectives helping to characterize the development of agroholdings in that region, but it is not evident how results from one region translate to the rather large area where much of this investment takes place encompassing the black earth zone across central and southern Ukraine, western and southern Russia, and Russia's eastern Volga region. The broad country level studies help to identify overarching trajectories and drivers in the sector, but some of the more micro, corporate level reasons for success or failure are missing. While there are corporate case studies of large-scale farming companies from other parts of the world (Chaddad, 2014; Magnan, 2015, 2011; Plunkett, 2015) there are not many case studies of such companies in Russia and Ukraine, though see Kuns et al. (2016).

Thus, what has not been in focus yet in this discussion are differences between companies in terms of the strategies they pursue, and differences between the contexts in which different companies work, and how these contextual and strategical differences might affect corporate performance and help to determine relative success or failure. This is a an important gap to fill as Balmann et al (2015) point to there being considerable "heterogeneity" in performance among agroholdings. Also, some of earlier research discussed above presents snapshot pictures of the sector at different points in time, while the sector is in fact very dynamic, with many entities appearing, merging, transforming, trying out new market segments, exiting other market segments, listing, de-listing or disappearing altogether. It is thus important to look back over the last eight to ten years to begin to draw conclusions.

One challenge in terms of studying this sector is that it is difficult to find out information about company performance since, with a major exception, that kind of information is not in the public domain. Researchers have thus mostly relied on regional or national statistics (Balmann et al., 2013; Epshtein et

al., 2013; Matyukha et al., 2015), and/or media reporting (Visser et al., 2014) for information on agroholdings. The exception of course are the currently 12 public companies in Russia and Ukraine (See table 1), which by virtue of their stock market listing, must regularly report on corporate operations and finances. It is these companies, plus two companies that no longer exist, but have in the past published financial reports, and a third company that publishes annual reports despite not yet being listed, that the present paper will focus on. While, this is a minority of all large farming companies in Russia and Ukraine, they play an outsized influence. Many of these companies figure among the top 10 agricultural producers in their respective countries. The revenues of the companies listed in Table 1 in 2014 amounted to over 11 billion USD (a good year for some companies, a bad year for others), which exceeds the nominal 2014 GDP of countries like Moldova or Armenia. In terms of land, the Ukrainian companies under study cultivate 1.6 million ha (figures as of 2015), which constitutes 25% of all Ukrainian agroholding land[1], and 8% of all Ukrainian farmland used by farm enterprises (own calculations based on State Statistics Service of Ukraine, 2015, 70).

Aim and Questions: In this research we will situate the development of mega corporate farming in Russia and Ukraine in its historical, agro-ecological and institutional contexts to facilitate the development of a typology of agroholding farming in the region, which in turn, we will argue, will aid in understanding the future prospects of this new farm organization. Such a typology would also facilitate a global comparison with large farm companies in other parts of the world, though we will undertake no such analysis in the present paper. Among other specific questions to be addressed are: what conclusions can we draw by looking at up to 10 years of performance of different public companies? What are the more successful business models? What are the achievements of the public agroholdings, and what are their disadvantages?

Agroholdings in Ukraine and Russia

Table 1 below shows the 15 companies that are under study in this paper. Since farming and farmland are in focus for this paper, we focus on public companies that have a crop production segment in their business. This naturally excludes listed companies that are pure food processors, and do not engage in their own farm production. As mentioned above, there are currently 12 public companies with a significant farming component in the region. Table 1 also includes Agrokultura, which was active from 2007 to 2015, but was delisted in 2015, and ultimately divided up between different companies in Ukraine and Russia. Additionally, table 1 includes Razgulai, a Russian food and farming company that was one of the first to be publicly traded, but was recently bought out by Rosagro. Finally, table 1 includes Grain Alliance AB, a Swedish owned company active in Ukraine that is ultimately seeking to be public traded, and towards that end publishes regular, audited financial and operational reports. Table 1 for the moment does not include the public limited company UkrLandFarming, the largest company by land holding in Ukraine, which in 2013 placed Eurobonds on the Irish Stock Exchange, but does not publish annual reports, or Miratorg, a vertically integrated agricultural company in Russia, which has also on various occasions issued obligations and has published annual reports, but remains wholly owned by the owners.

[1] Balmann et al (2013, 15) in their impressive study of Ukrainian agroholdings state that agroholdings farm six million ha in Ukraine as of 2013. Given the dynamism of the sector it is perhaps risky to compare the amount of land under public agroholdings in Ukraine in 2015, with data from 2013 on all (public and non-public) agroholdings. Since 2013, some agroholdings have increased their land holdings, others have shrunk, but going forward such comparisons will be further investigated and substantiated.

Differentiating companies by production orientation

One of the clearest differences that emerges from study of corporate reports is the difference between a strategy focusing mostly on direct agricultural production, in this paper referred to as "pure-play" production following Luyt et al (2013), and one focusing on food processing of some kind, i.e. value added production, where farming is conducted to provide raw materials for food processing and/or for supplemental profits. This determination was made by taking into account the amount of revenue that comes from the crop farming segment. Even farms identified as primarily focused on arable crop farming do engage in some dairy, grain storage or trading for third parties or some other up or down stream activity, but for farms identified as primarily focused on arable crop farming, the crop farming segment clearly dominates. KSG is the pure-play farming company with the least amount of revenue from direct farming: while over 50% of its revenue in 2014 came from crop farming, they are increasingly seeking to move up the value chain with for example meat production.

Already in Table 1, it is possible to see that, all else equal, publicly traded vertically integrated food processing companies are older than companies focusing on direct agricultural production. Figures 1 and 3 further help to illustrate differences between these types of companies. Figure 1 shows the annual net result of pure-play companies between 2008 and 2014/2015.[2] From Figure 1, it is possible to see volatile inter annual net results. This demonstrates the sensitivity of such companies to high commodity prices. Sixteen out of 23 times companies in this time period (2008-2015) received net profits were in the period 2010 to 2012, when commodity prices experienced a brief spike, and in fact reached their highest levels ever in nominal terms, and highest levels in real terms since the 1970s ("FAO Food Price Index | FAO | Food and Agriculture Organization of the United Nations," n.d.). Another reason for volatility in net earnings are rising finance or interests costs, as many pure-play companies took loans or issued bonds to raise additional funds beyond what was raised in stock emissions. While this helped many of these companies to expand very fast, it also proved problematic when, for example, the sudden drop in commodity prices in 2013, left companies with lower revenues, but still high finance payments.

In this regard, of the nine "pure-play" direct farming companies in Table 1 (including now delisted Agrokultura), five of the companies had by 2014-2015 either been forced to restructure their debt or defaulted on loan payments. Among companies not restructuring debt, IMC is now actively working to reduce debt levels (IMC, 2016). BEF has had at times high finance costs compared to the other companies, but they are also one of the financially strongest entities under study, and appear to manage their debt well (though that has not necessarily translated into strong performance). Finally, Grain Alliance and Agrokultura have over the years generally had the lowest finance cost of all the companies, which paid off in 2014, when local currency devaluations caused foreign borrowing costs to sky-rocket. In this environment, only Grain Alliance and Agrokultura among pure-play companies made a profit in 2014 (See Figure 2). While the economic crisis starting in 2014, particularly the devaluation of the Rouble and the Hryvnia, surely aggravated the problem of indebtedness of these companies, the topic of reducing indebtedness was already under discussion at many of these companies going into 2014.

IMC[3] stands out as one of the more successful companies with stable earnings, except for 2014, when the devaluation and depreciation of the Ukrainian UAH caused significant negative foreign currency translation effects. Part of the reason for IMC's success is that it has always been able to store its entire

[2] The first 2015 annual results for the companies under study started to trickle in when this paper was being written. If the 2015 results were available, they were used in Figures 1, 2 and 3. Future versions of these figures will naturally include all the 2015 results.

[3] IMC stands for "Industrial Milk Company." Despite the name however, over 90% of its revenues come from crop farming.

harvest. While it still sells a lot of its produce at or near harvest, it retains enough in most years to smooth out revenues, particularly since prices tend to be lowest around harvest time, and highest in the early to mid-spring before the harvest season commences. Another reason for its success is that IMC appears to have identified and focused on the most profitable crop mix before many of its competitors, including in particular maize and sunflower, and also potatoes. Maize and sunflower have constituted upwards of 60 to 70% of IMC's crop mix since 2011, several years before other companies discovered this winning formula. Companies, such as Black Earth Farming (BEF) that have in later years pursued a similar crop mix will also achieve net profitability in 2015.

Pure-play companies are also subject to more intra-annual earnings volatility (this is not shown in any of the figures), which reflects both the underlying uncertainties of the farming business in general and in particular the difficulty in predicting revenues from future production due to late-year price and yield swings. According to the International Financial Reporting Standards (IFRS) accounting procedures (IAS 41 Agriculture), which virtually all companies under study now use, crops in the field are first valued as the capitalized cost of the works and inputs put into them, but later, at the 6 month reporting date, they are valued at "fair value" based on reasonable yield and price projections. The resulting gain in value is recorded as income, which is adjusted at each subsequent reporting date in accordance with updated information on yield and prices. The point here is that even if the companies are reasonably good at determining by mid-year what the future yield will be, even for crops that are at a relatively early stage of development, there is still enough unavoidable uncertainty in this determination, particularly with respect to prices, to make it somewhat unreliable. The point in saying this is not to criticize IFRS accounting principles, but to underscore a known mismatch between the regular quarterly reporting structure inherent to corporate finance, and the seasonality and volatility of agriculture.

Figure 3 shows the annual net results between 2008 and 2014/15 for vertically integrated companies. Compared to the companies in Figure 1, farming companies with a high degree of vertical integration regularly achieve a quite considerably higher level of profitability. Figure 3 also shows the divergent effect on Russian and Ukrainian companies of the regional conflict and economic crisis, stemming from the sharp drop in the value of the Russian Ruble and the Ukrainian hryvnia (UAH), U.S. and E.U. sanctions against Russia, and Russian counter sanctions against the E.U., particularly in the agricultural sector. Rosagro and Cherkizovo in Russia performed best in 2014 of all companies under study, while Ukrainian companies, particularly MHP which had been a leader in the sector, generally had a bad year. The "import substitution" boost for Cherkizovo and Rosagro in 2014, arising from, among other things, Russian counter sanctions against European food imports, is somewhat reminiscent of the boost Russian food companies received by the 1998 devaluation of the ruble and sharp decline in western food imports that year (Ioffe and Nefedova, 2001).

Models of Corporate Governance and Development Trajectories

Another difference between these companies concerns corporate governance, and the degree to which companies are either "investor-led" or "oligarch-led". Most of the vertically integrated companies are oligarch led to some degree, while the arable farm companies are either investor-led, oligarch led, or something in between. The term "oligarch led" is not automatically meant pejoratively, as the tight interlinkages between business and politics in Russia and Ukraine, and the powerful figures that have arisen in such a milieu are widely recognized (Barnes, 2006; Simonova et al., 2009). There are in any case advantages and disadvantages to both forms of corporate governance.

The primary differences separating investor-led companies from oligarch led companies concern how many shares of the company are in free-float trading and the role of the founder of the company.

"Oligarch-led" companies have only a minority of shares traded on a stock exchange, while the bulk of the ownership remains in the hands of the founder of the company or an entity controlled by the founder. For "investor-led" companies, most shares are in free-float trading.

Another important feature of oligarch led companies are political connections. Either the main owner or highly placed officials in these companies have had political positions in their respective countries. For example some of the owners have served in their national parliaments. While there are also majority-, locally owned companies with no direct connection to national or regional politics, one can raise the question of how important active political support is for large-scale food production in these countries. Even foreign investors like Black Earth Farming, which with its expat management and ownership does not (and cannot) play any direct political role in Russia, had at one point hired an insider lobbyist to help with regional administrations ("Black Earth Rises on Taking Adviser," 2008; Hammar, 2008; Voronina, 2008).[4] In this regard, it has been argued that an important reason for becoming so large is to give these companies more heft and authority in dealing with national and local governments (Koester, 2005). The point of this is not to criticize these companies for seeking political cover and protection for their business activities, but rather to point out that to the degree that the large-size of the companies is actually connected to achieving efficient political cover for their business activities, calls into question the degree to which this kind of production is optimal in terms of the actual production process.

The difference between investor led companies and oligarch led companies also reflects different development trajectories of the companies. Oligarch led companies, which tend to be older, sought stock market financing by allowing a minority packet of shares to be traded in order both to "cash-in" and to boost an already ongoing expansion process. Investor-led companies, on the other hand, represent, by and large, foreign investors. While the founding investor or venture capitalist began acquiring assets in Russia or Ukraine (land) prior to the stock listing, the original intention from the beginning was to be fully publically traded as soon as possible both to finance a very fast growth of the company, and also as a way to make shares in the company liquid (in the sense that it is an asset that is easy to sell), which in itself attracts additional investors, particularly institutional investors with deep pockets, but also serves as an off-ramp for the initial founding investor or venture capitalist. Thus the main investors in the "investor-led" companies per definition has a shorter investment horizon, originally seeking to develop what was believed to be an undervalued asset – agricultural land – and selling it after five to seven years after (hopefully) seeing a capital gain.

In contrast, most of the vertically integrated companies in this study are oligarch-led and pursue longer-term production oriented strategies. This again, partially, is a result of the development trajectory, as these companies began with the acquisition of legacy Soviet food processing infrastructure and factories when it was possible to acquire these facilities at a steep discount. Also, this accumulation process began before it was possible to buy and sell agricultural land in Russia, which became possible in 2002, and before it become possible to more easily lease agricultural land in Ukraine, which became possible in 2002. A relatively greater focus on infrastructure and less focus on land is something that marks even the less actively political, majority-owned local publically traded companies. For example, IMC, whose owner appears to have no direct political engagement, had its origins in food processing. Notably, when IMC was reorganized to focus on crop production in 2007, the company invested immediately in a grain elevator. Investor-led companies (mostly foreign investors), started by acquiring land, and only secondarily, acquired other infrastructure like grain elevators. Many (foreign) investors, including the

[4] Vasily Shestakov, co-author of a judo book with Putin, was hired as adviser by the company in order to, as he stated, keep bureaucrats from 'putting sticks in the wheels'. BEF's announcement of taking him on led to a 2.6 percent increase in the stock value.

primary founding investors in these investor-led projects, were interested in speculating on land values, expecting Russian land values to increase rapidly (Kuns et al., 2016; Visser, 2016).

The advantage of the "oligarch" corporate governance model is their knowledge of local circumstances and control over the company. This advantage was cited to the authors by a representative of one of the investor led companies, who, in speaking about locally, majority-owned MHP, said: "they knew where all the good land was." (Notes from shareholder meeting 2014).

Control is important in post-Soviet circumstances as "corporate raids" and other such takeovers on loose legal grounds are an unfortunate aspect of the business environment (Barnes, 2006). Scheifler and Vishny write (1997) that, from the perspective of corporate profitability, there are generally more costs associated with overwhelming majority ownership than benefits as the owner can privilege their own interests over that of the firm. However, they write that the "principle advantage of large investors (expect in takeovers) is that they rely on relatively simple legal interventions [for legal protection], which are suitable for even poorly informed and motivated courts" (Scheifler and Vishny, 1997, p. 758). This business context helps to understand the purpose of "management agreements" that minority foreign owners of some foreign-owned public agroholdings have concluded with the agroholding in question, whereby the minority owners provide management services to the company (See Kuns et al., 2016). While such management agreements ensure that also minority owners can keep control over the company in question, their downside is that the expat management has to learn a lot about the local agroecology and business environment (Kuns et al., 2016).

Despite the management agreements, however, minority ownership makes hostile corporate take-overs easier, as happened with Agrokultura in 2014. After years of seeing no profits, and falling share prices, tired investors were amenable to what was seen as an acceptable deal from a Russian investment group connected to the giant, but unlisted, agroholding Prodimex. Even though some minority owners initially sought to fight the takeover bid, eventually they had to throw in the towel, and accept the inevitable.

The disadvantage related to having control is that there can be less transparency, as minority investors in Mriya agroholding discovered when it canceled payments on bonds in 2014, amid accusations that they had misled investors ("Mriya's nightmare grows as lenders call in loans," n.d.). Even competitors to Mriya have tried to strongly hint that the related party transactions in Mriya might be problematic (Agroton, 2011, p. 17). However, it should be said, some of the oligarch led companies, such as MHP and Astarta with only 22% of its shares in free float, have been rated as having the best corporate governance in Ukraine (Concorde Capital, 2013). The larger point is that oligarch led companies present a broader range of corporate governance issues from Mriya-type (alleged) fraud to the exemplary corporate governance of MHP and Astarta.

Trends

The general trend with respect to public agroholding crop mix / rotations is, in the last years, towards a pronounced emphasis on valuable cash-crops, in particular maize, soya, and sunflower. This trend is most visible in Ukraine. If in Ukraine in general some 43% of the sown area was under these crops in 2014, agroholdings, whose own plantings would have naturally contributed to the national average, cropped anywhere from 84% (Kernel), 80% (IMC), and 70% (MHP) down to 50% (Astarta) of these crops.[5] Agrogeneration at 43% was right at the national average, though they had 31% of their cultivated land under sunflower compared to 19% under sunflower for the entire country (own calculated based on

[5] Astarta, as a sugar producer, cultivates a lot of sugar beets. MHP uses much of its maize as chicken feed for its poultry division.

corporate annual reports and information from State Statistics Service of Ukraine, 2015). Black Earth Farming, in Russia, has similarly focused on these three crops, devoting 59% of their cropped territory to maize, sunflower and soya in 2014, shifting more to just maize and sunflower (64% of cropped territory) in 2015.

As discussed above, this crop mix explains the profitability of some companies, as maize, sunflower and soya fetch higher prices both domestically and internationally. Companies seek to export maize and soya for export premiums, as international prices tend to be higher than domestic prices. There are, however concerns from government agencies about crop rotations, and in particular about sunflower, because its large root network allows it to take up a lot of water and nutrients, potentially depleting the soil if those nutrients are not replaced (Allina-Pisano, 2007, p. 142; Godzalo et al., n.d.). Indeed, it may be the case that Agroton, which truly maximizes cropping of sunflower, has experienced yield setbacks as a result of mono-cropping sunflower (Koval'chuk, 2013).

Concluding Remarks

This is an ongoing research project, so conclusions are preliminary and subject to change. Among other conclusions:

- Access to finance in the form of stock market capital has spurred considerable investment in important infrastructure, from grain elevators to crushing plants, but finance and interests costs also are a drag on profitability, particularly with respect to direct farming companies who face a lot of volatility in commodity prices, weather, and macro-economic conditions.
- After some bumpy years and painful lessons-learned, pure-play producers may be on the way towards more regular profits, though volatility remains and margins are not so high. Be that as it may, some companies may not survive the debt restructuring process.
- Vertically integrated companies are indeed quite successful. However, these companies were formed, and assets accumulated under unique conditions, that are unlikely to repeat themselves. The more successful "pure-play" actually are vertically integrated in some small but significant way.

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Appendix: Table and Figures

Table 1: Publicly Traded Agroholdings in Russia and Ukraine with a crop production segment

Company	Orientation	Exchange	Founded	Listed	Land-bank	Country
1) Rusagro	Sugar, meat, vegetable oil	London	1995	2011	494700	Russia
2) Kernel	Vegetable Oil, Grain Trading	Warsaw	1995	2007	422000	Ukraine
Razgulay[6]	Sugar	Moscow	1992	2006	350000	Russia
3) MHP	Meat Production	London	1998	2008	320000	Ukraine
4) Black Earth Farming	Arable Crop Production	Stockholm	2005	2007	256000	Russia
5) Astarta	Sugar	Warsaw	1993	2006	245000	Ukraine
Agrokultura[7]	Arable Crop Production	Stockholm	2006	2009	216800	Russia, Ukraine
6) Mriya	Arable Crop Production	Frankfurt	1992	2008	180000	Ukraine
7) Cherkizovo	Meat, Dairy, Grain	Moscow	1974	2006	140000	Russia
8) IMC	Arable Crop Production	Warsaw	2007	2011	136700	Ukraine
9) Agroton	Arable Crop Production	Frankfurt and Warsaw	1992	2009 & 2010	120000	Ukraine
10) Agrogeneration	Arable Crop Production	Paris	2007	2010	118000	Ukraine
11) KSG Agro	Arable Crop Production	Warsaw	2001	2011	94000	Ukraine
12) Trigon Agri	Arable Crop Production	Stockholm	2006	2007	52000	Ukraine, Estonia
Grain Alliance[8]	Arable Crop Production	*not listed yet*	2008		52000	Ukraine

[6] Razgulai was recently bought out by Rosagro, and in any case, no corporate documents appear to be available after 2011.
[7] Delisted in 2015 in connection with a corporate buy-out.
[8] Not listed yet, but seeks to be publicly traded, and issues regular audited earnings reports and operational information.

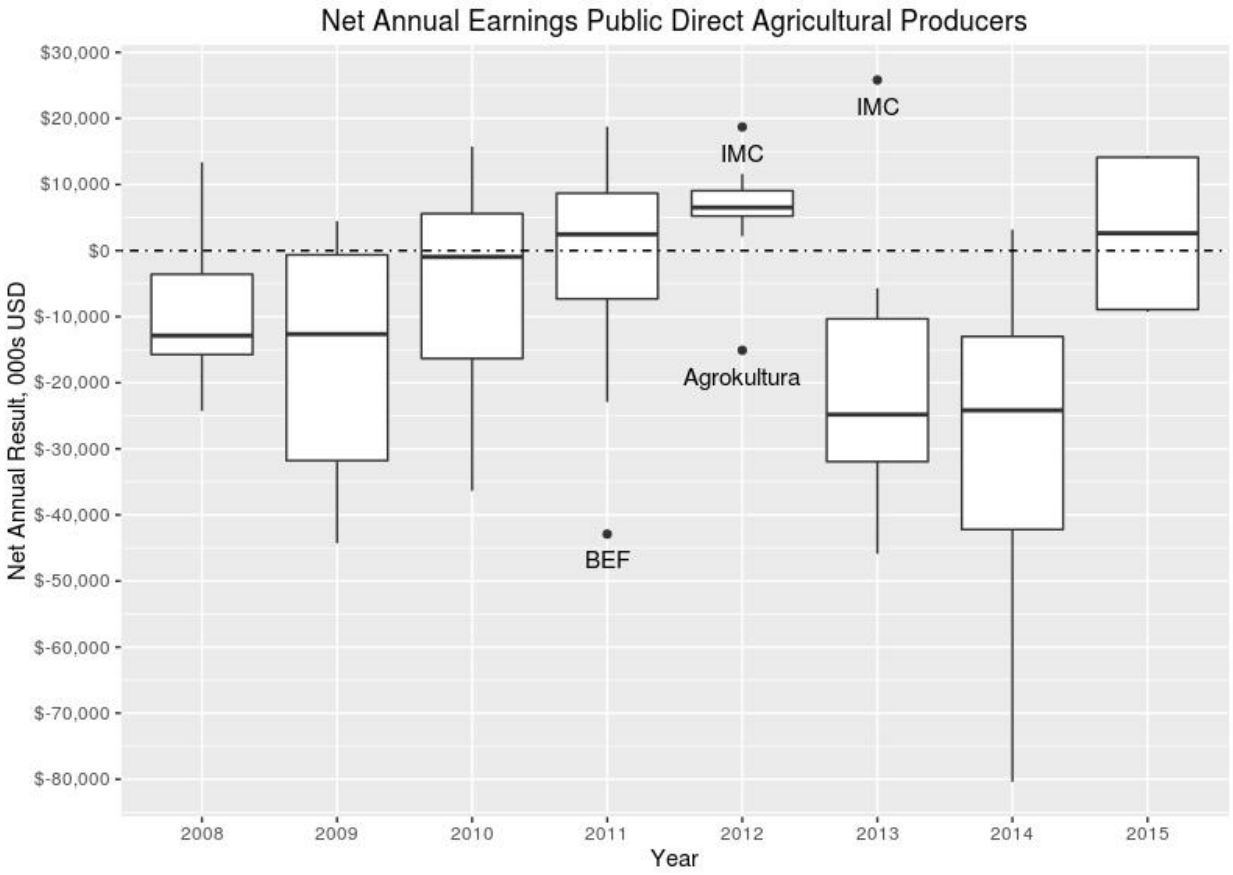

Figure 1: Net Annual Profits from eight "Pure-Play" producers between 2008 and 2014/15 listed in table 1. This figure (and figure 2) shows all pure-play from Table 1, except for Mriya, which, as explained above, has been accused of inflating earnings data. The company is currently under new management, and, notably, the new company web-site only contains current information and reports from 2015. Historical reports are no longer available on the official corporate web-site. Results from 2015 come from the four companies, Black Earth Farming (BEF), IMC, Trigon Agri, and Agrogeneration that had reported results at the time of writing. This figure will be updated as other companies report their 2015 annual earnings.

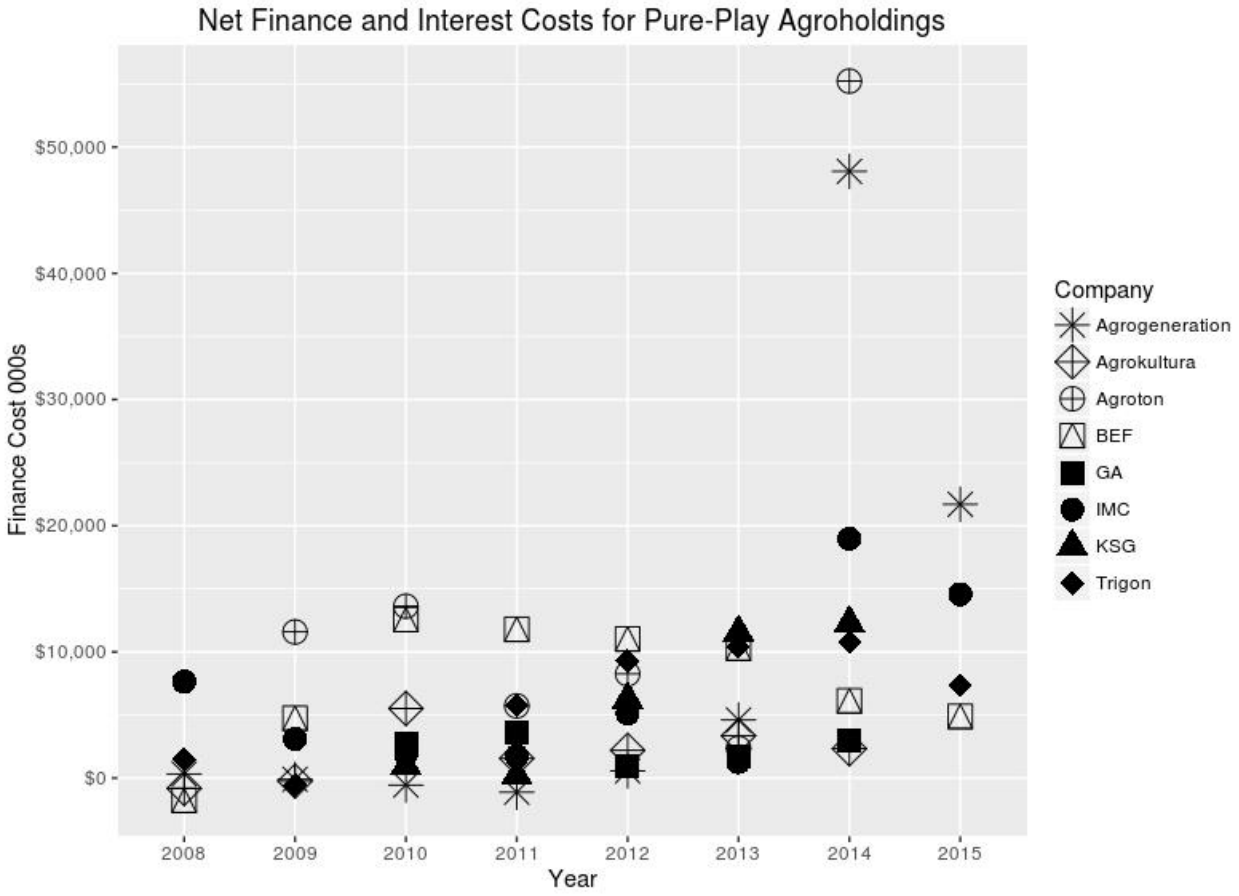

Figure 2: Net finance or Interest costs for the eight pure-play companies also shown in Figure 1 (i.e. not Mriya). Note, some companies actually had interest or finance earnings in the early years (hence the negative net finance costs).

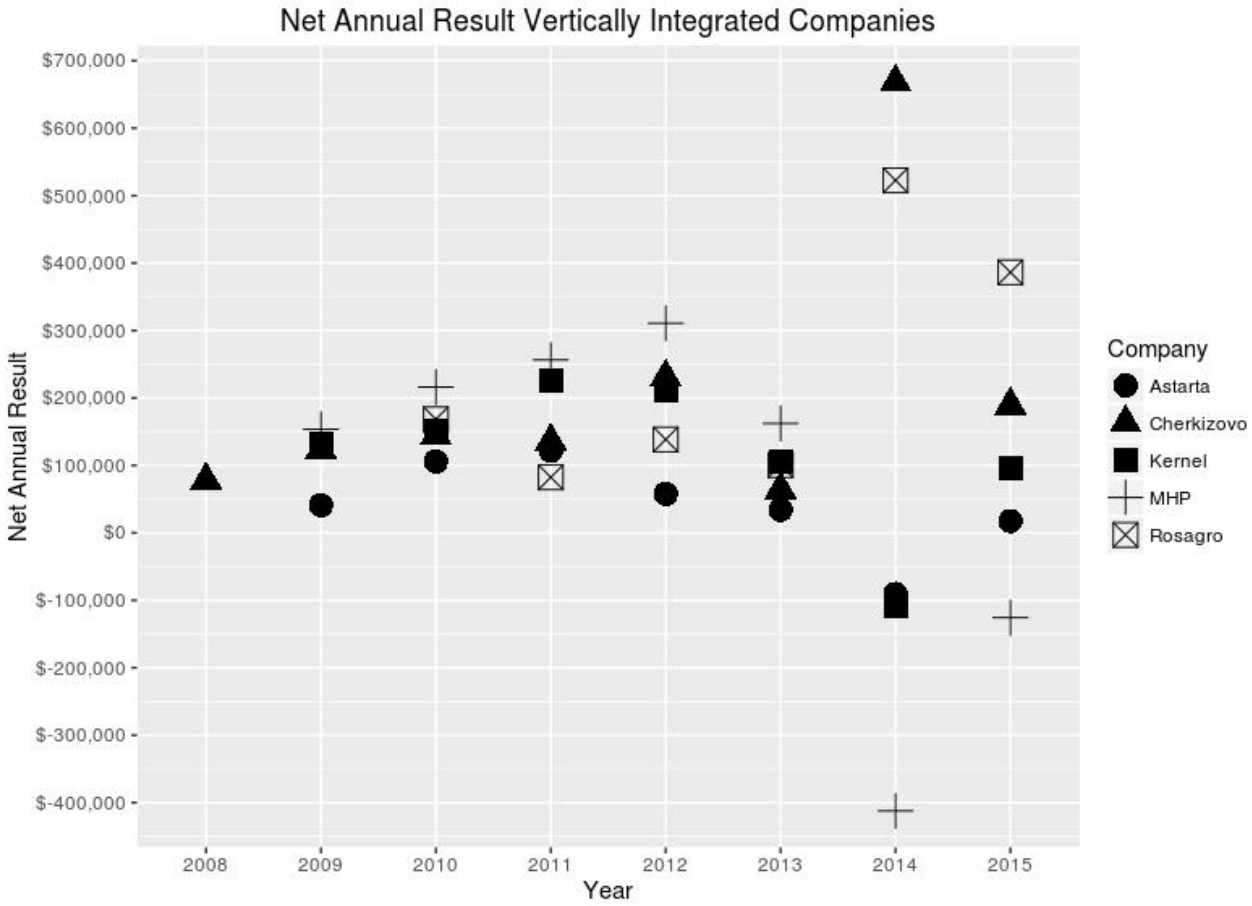

Figure 3: Net Annual Profit for vertically integrated agroholdings 2008-2014/15. Again, 2015 results are presented here if they were available. Future versions of this figure will naturally include all 2015 results.