

# **GENDER AND AGRIBUSINESS PROJECT (GAP)**

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## **CASE STUDY: INTERNATIONAL CHEESE COMPANY-PASLEK POLAND**

A JOINT VENTURE OF OSM PASLEK  
AND  
LAND O' LAKES

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This case is intended to serve as a basis for group discussion rather than to illustrate effective or ineffective handling of administrative or management problems.

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## **CASE STUDY, INTERNATIONAL CHEESE COMPANY - PASLEK, POLAND**

### **The Problem**

In November 2000, Dave Peters, General Manager of International Cheese Company-Paslek, once again finds himself sitting behind the desk in his office overlooking the ICC-Paslek plant in Northern Poland contemplating the next steps that need to be taken to ensure the economic survival of this joint venture milk processing operation between Land O Lakes and the Polish dairy cooperative OSM.

Dave has been here before. He was the head of the Land O Lakes establishment team that initially set up the joint venture in the early 1990s and remained on until the mid-90 s to assist in the operations management. In 1996 however, Dave returned to the USA, assuming that his tour of duty in Poland was completed. But by late 1999 the joint venture was struggling and the Land O Lakes board requested that Dave return to Poland as the General Manger of ICC-Paslek with a mandate to initiate a restructuring program to return the joint venture to profitability and prepare the firm for possible future sale. During the interim three-year period, a range of external and internal problems had hit the joint venture, adversely affecting its profitability and the ability of the business to survive.

In order to return ICC-Paslek to profitability, Dave has been forced over the past twelve months to implement a range of corrective programs, both internally and externally. Not

all of the joint venture s employees have happily accepted these programs and initiatives, although everyone seems to recognize that they are necessary . The long-term impact of these programs on human resource management, employee relations, job satisfaction, and general shareholder value remains highly uncertain. Nearly half of ICC-Paslek's labor force is female, and many of the changes have particular impact on women workers. Thus, the profitability, and indeed the survival, of ICC have a direct bearing on the lives of many rural women.

### Country Context

#### **Women in Poland**

Fifty-one percent of the Polish population is female. One legacy of the communist system is the high rates of labor force participation for women; in 1992 women comprised 46% of the total labor force. However, despite the high participation rates, Poland s labor force is still sex-segregated, with women dominating health and education and men dominating industry and construction. In the transition to a market economy, women were disproportionately affected by unemployment. Although this gender gap has begun to converge, women still account for more than half of the unemployed in Poland (Exhibit 8). The Polish constitution guarantees men and women equal pay for equal work, but women typically earn less than men because women tend to work in lower paying fields. These problems are even more marked in rural areas.

In recognition of this problem, the government s National Action Program for Women 1995-2000 has

given high priority to addressing

the problem of gender- based segmentation of the labor market, occupational segregation and discrimination against women in employment decisions....the labor market, with particular emphasis on women s unemployment;...various aspects of the feminization of unemployment and poverty in rural areas (editor's emphasis)... together with the economic status of women and their problems (<http://www.un.org/esa/gopher-data/conf/fwcw/natrep/NatActPlans/poland.txt>).

For each area of the Program, strategic goals have been defined, and a number of actions proposed to be undertaken by national and local governments, non-governmental organizations, trade unions, the media and research centers.

One trend that is adversely affecting female labor force participation is the reduction in the number of childcare centers. Since 1991 the number of spaces has decreased by approximately 50%. Thus, working mothers are having an increasingly difficult time finding suitable day care for their children -- a problem that affects ICC workers, particularly for the night shifts.

Educational attainment is a key indicator of women's progress in Poland. Almost 60% of the high school graduates are women. This is a legacy of the equal access educational system under communism. Additionally, there is little evidence of segregation by fields of study.

Poland has a low divorce rate relative to other Central and Eastern European countries as well as a young age of marriage (women marry on average at age 23 years and men at age

26). These observations may be partly explained by Poland's strong Catholic ties; over 90% of the population is Catholic. Yet fertility rates have been well below replacement levels for more than a decade (Exhibit 8). When divorce occurs women tend to be provided sole custody of the children in over 70% of the cases. Such responsibilities reinforce women's need for cash income.

### **The Polish Agricultural Sector**

Poland is Europe's ninth largest country at 312,685 kilometers (km). It has a population of 38.7 million, of which 14.7 million (38%) live in rural areas. Currently 18,413,000 hectares (ha), or 59% of Poland's total land area, is used for agricultural production.

The economic viability of rural Poland is closely intertwined with the profitability of the agricultural sector. Agriculture still dominates economically in many regions, but its importance has continuously declined since 1988. The reduction resulted from a combination of declining agricultural output prices and volumes accompanied by rapidly increasing input prices in agriculture and output prices in other sectors of the economy. Employment in the agricultural sector (including hunting and forestry) currently rests at almost 4 million people (25.8% of the total labor force) with agriculture providing the main source of income for 4,390,000 Poles (over 11% of Poland's total population, including 27.4% of the rural population).

The organizational structure of Polish agricultural production varies considerably with respect to ownership types, farm sizes and volume. Despite efforts after World War II to collectivize agriculture, private ownership has prevailed over the past 50 years through most of Poland. The political and economic transformations launched in 1989, along with the introduction of new forms of legal ownership, have further reinforced the importance of private agricultural production. Between 1990 and 1998 the percentage of arable land operated by private operations increased from 80% to 92% (Exhibit 3). The 1996 agricultural census indicates significant differences in farm sizes across both different ownership forms (Exhibit 4) and different regions ranging from an average farm area of about 18 hectares in Northwestern Poland to below 3 hectares in the South. Many private Polish farms are highly fragmented: 20% of private farms have 6 or more plots, and on some 3.9% of farm holdings the distance between individual plots exceeds 10 km.

Most Polish farms are mixed cropping and livestock production units, with the exception of larger farms where specialization is more common. Over 38% of these enterprises specialize in crops, and 17% in animal production.. Cereals are produced on 90% of all farms; potatoes on 83%. Cattle and dairy cows are found on 64% of all farms and pigs on over 50more than 50%. Both men and women work on farms in rural Poland, with women often found tending the vegetables, poultry and goats, as well as dairy cows and helping with field crops.

During the early 1990s a combination of unpredictable weather conditions, disruption and restructuring of traditional supply chains, decreasing terms of trade, and market uncertainty adversely affected gross agricultural output (GAO). However, towards the end of the decade the value of gross agricultural output had rebounded to be only 1.6% lower than in 1990. Cereals, pork, and dairy were the key commodities contributing to this recovery. The Polish Ministry of Agriculture estimates that currently more than half of all family farms produce agricultural products, mainly or exclusively, for personal use. Only 57% of total agricultural output is commercially marketed. Agricultural production contracts are seldom used, the exceptions being sugar beets, rapeseed, flower and vegetable seeds where contracting is more commonly accepted.

Since 1992, Poland's agricultural trade deficit has steadily grown, especially with respect to the European Union (EU). Processed food products make up the largest share of foreign trade, however the traditional non-processed products, such as meat, fruit, and vegetables, continue to be important export items. Tropical fruits and vegetables tend to dominate imports.

The Polish agricultural sector faces numerous problems including excessive employment in the agricultural sector with (hidden) unemployment (workers whose labor is partly or totally redundant) now estimated at 900 thousand farm workers. There are many extremely small-scale and fragmented production units, whose disproportionately high-cost structures and low profitability limit their ability to implement new technologies,

particularly those related to production quality and sanitary improvements. Very low and declining farm incomes, lack of market stability along with inadequate links between agricultural producers and food processors, increasing competitive pressure from foreign products, and lack of alternative income sources for farmers are among the other problems. Only 1.5% of those involved in farming are self-employed in their own businesses other than farms, whereas 15.2% have jobs in non-agricultural sectors.

A growing number of government programs covering both agricultural and rural sectors continue to be implemented in Poland, often under EU and World Bank leadership. The development of non-farming rural business activities is seen as an important step in accelerating the structural transformation of Polish agriculture, thus enabling the outflow of labor force from agriculture and creating possibilities for supplementing farmers' income.

### **Structure of the Polish Dairy Industry**

The Polish dairy sector emerged from the Communist period as a very important driver of the rural economy, but historical legacies have burdened it with a highly fragmented organizational structure, both at the farm and processing levels which are in desperate need of consolidation. Following a sharp decline at the beginning of transition (Exhibit 6), total milk production has stabilized at around 11,500 million liters per year (or 72% of the pre-reform levels). Similarly, there has been an overall reduction of 57% in milk delivered for processing over the decade. The level of reduction differs across regions,

ranging from as high as 53% to as low as 30%. The total number of dairy cows now stands at approximately 3.3 million cows. After an initial decline, the average milk yield per cow has increased to 3,500 kg/cow/year, which is above pre-reform productivity levels, but still below the EU that currently averages 5,500 kg/cow/year.

There are two major dairy producing regions in Poland: the Northeast and Central-west. The Southeast is another important region; however, very little milk produced here is commercially marketed and delivered to dairies for processing. Over 1.3 million of Poland's farms (or more than 60% of all the farms in Poland) have dairy cows and are therefore, in the strictest sense of the word, dairy producers. Approximately 25% of Poland's milk is produced by almost 1 million individual farms holding only 1 to 3 cows, 50% of the milk is produced in the 3 to 9 cow category (see Exhibit 5). Most cows are still milked by hand and half the dairy farmers market less than 7,200 liters of milk per year.

For many of these small farmers, milk collection is still done through a system of local collection facilities, as farmers usually lack suitable storage and cooling systems. They deliver their milk cans to the local collection station after every milking on a trailer or cart pulled by a horse or small tractor. All delivered milk is checked for quality at the collection point and farmers get paid accordingly.

A number of factors have caused some interesting industry dynamics. The sector's increased export orientation, along with Poland's pending European Union accession, has necessitated the accelerated introduction and implementation of stricter food industry quality grades and standards to meet domestic and international market requirements. Consequently, domestic and foreign processors alike are both being forced to make major investments in upgrading their processing facilities to comply with EU and international food standards. As of December 2000, 25 dairy processing firms had been certified and granted EU export licenses that allow them to sell products on the EU market, with approval expected in the near future for 20 pending applications, including the application of ICC-Paslek. Additionally, five processors are introducing the ISO 9000 international certification system.

On the supply side, milk deliveries to processors have recently dropped by 5-10%. This is partly in response to a new national law introduced in January 2001 that raised the minimum quality standards that processors can accept for raw milk and partly due to feed constraints following a drought in Central Poland. At present approximately 30 to 40% of milk delivered to dairy processors meets EU standards.

Many factors affect milk quality. Farmers with smaller herd sizes generally struggle to reap both the quantity and quality premiums that larger farms do, as they cannot afford to make the requisite investments to improve feed rations, hygienic standards, milking technology, or to increase cow numbers. The lack of on-farm cooling equipment and

suitable milk collection systems increases bacteria counts, making regulatory compliance more difficult. Those who can no longer meet the required grades and standards are effectively excluded from the official market and maybe forced out of production completely, as the investments required to remain in the market become prohibitively expensive.

Similarly, both fragmentation and consolidation are evident in the processing sector that has over 300 processing plants. Two hundred of these plants are cooperatively owned. Many are both technically insolvent and outdated, and several private industry experts think they should be liquidated. However, there are three key factors hindering this consolidation process from occurring quickly. Board members are often reluctant to relinquish their power and status, member-workers are fearful of losing their jobs, and farmers fear losing market access. Combined, these conflicts result in a dynamic where consolidation primarily occurs via bankruptcies because none of the three parties' positions can be guaranteed if a merger occurs. Financially sound neighboring cooperatives slowly integrate the bankrupt cooperatives' larger and more efficient producers into their supply base while excluding the less efficient producers. Typically, the excluded producers attempt to establish new supply cooperatives that collect, cool, and store raw milk for the farmers in the existing bankrupt cooperatives' storage facilities, prior to selling it to other processors. This process has led to a highly volatile and competitive bulk raw fluid milk market in Poland. In the end, many of these cooperatives of inefficient producers will not be able to survive, as they are producing poor quality

milk and lack the capital necessary to support the reinvestment in processing and cooling facilities mandated by the market and regulators. In the short-term, however, these cooperatives have destabilized the industry by initiating price wars in both procurement and product markets, in an attempt to secure short-term cash flow as they struggle to survive to the next period.

### **Warmisko-Mazurskie Voivodship (District)**

The Warmisko-Mazurskie Voivodship, the home of ICC-Paslek, is situated in the North-Eastern part of Poland bordering on the Kaliningrad enclave of Russia. Agricultural land comprises about 54% of the land area with nationally protected areas comprising another 45%, including 8 national parks and over 60 natural reserves.

Individual private farmers farm only 72% of the agricultural land, compared to the national average of 82%. The State Treasury's Agency for Agricultural Properties controls a large share of the agricultural lands. Cereals, rapeseed, potatoes, sugar beets and fodder crops are extensively cultivated in the region.

Individual farms within the region are generally large, averaging 16 hectares (ha), compared to the national average of 8 ha, with over half of them in the 10 to 30 ha range. Farms over 50 ha make up less than 3% of individual farms but cover over 25% of the arable land. By purchasing or leasing land from the state, many industrial groups have been able to establish large agricultural concerns. For example, *Romi-Agro*, formally the state-owned Romnicki Kombinat Rolny, operates over 7,000 ha within the region. Many of

these industrial concerns are investing heavily within the region, especially in the poultry industry where Warmisko-Mazurskie is now the leading region.

The region has relatively good road and rail links to the rest of the country. There are 6 border crossings with Russia and domestic and international airflights out of Szmany and nearby Gdansk. Food and beverages, forestry, lumber processing, plywood and compressed board manufacturing, and furniture industries dominate commerce within the voivodship. However, there are still other important manufacturers within the region producing car tires, electrical and steam turbines, food and agricultural processing equipment, forest products, light fixtures and clothing products.

### **Company Operations**

#### **OSM Paslek Cooperative**

##### *History*

In 1947 an association of cooperative dairy processors was set up in Warmisko-Mazurskie voivodship. In the mid-1980s, a separate company Zakad Im. 40-lecia was formed from this association of cooperative dairy processors, which later became the basis for the establishment of the dairy cooperative OSM Paslek.

The region's climatic conditions are very suitable for dairy production. Traditionally, the region has hosted numerous small to medium-sized processors capable of processing

between 500 to 10,000 liters of milk per day with each town or village having their own collection facilities. In previous periods, the state was especially concerned about ensuring a steady supply of milk for consumers. As one farmer noted, A grocery store was allowed to run out of bread but never allowed to run out of milk. Consequently, the state ensured that the local dairy factories processed at least the amount of milk required to support the local population. To assist in this process the state either provided farmers with subsidies to transport milk to the collection points or a state-funded tanker would visit the farm to collect the milk. Thus, a combination of factors, including favorable government policies and climatic conditions, made dairy production a very profitable activity within the region and ensured an abundance of dairy collection and processing facilities servicing producers. The region's favorable climatic conditions often resulted in an excess supply of milk during the summer months. Then the association would sell its excess milk to deficit regions, such as the dryer areas around Warsaw. During the next 30 years milk production continued to increase, escalating the problem. In 1978, the government decided to build one large processing plant with a dryer in Paslek to serve the entire region, thereby solving much of the annual oversupply problems they faced each summer due to insufficient processing capacity. This plant was completed in 1983.

In 1990, following the initial economic reforms, the cooperative association gained full ownership, control, and management rights to the plants from the government. However, these economic reforms also reduced the government subsidies supporting farmers and

processors, thereby reducing the sector's profitability. Local farmers indicated that during the last decade numerous dairy farmers have gone out of business as a result. One farmer estimated that "the number of farms in the region has decreased 4 to 5 times since 1990 with the average farm size increasing from 6-8 ha to 18-19 ha during the same period. As a consequence, milk deliveries to the cooperatives have decreased, often substantially in some areas, forcing them to shut down many of the smaller processing facilities.

### *Cooperative Membership*

Traditionally, all farmers who delivered milk to the plant automatically became members of the processing cooperative. A portion of their milk receipts would be withheld each period and these retained earnings become their ownership share. In the 1970s OSM Paslek had more than 2,000 members. As a local farmer noted, Anyone with between 1 to 3 cows effectively became a member of the cooperative as they would be delivering to the OSM Paslek plant. In previous periods, employees of OSM processing plants were also members of the cooperative. These initial employees have been allowed to remain members throughout the changes, although new employees are not allowed to become members of the cooperative.

Currently, to become a new member farmers are required to provide the cooperative with a portion of the milk check as retained earnings, have their formal application for membership approved by the cooperative's board, and make a one-time contribution of 400 zlotys (zl). The 400 zl purchases one share in the company and is the minimum

ownership requirement, although farmers can purchase more shares if they wish. Voting has remained one vote per one member since the cooperative was established. The cooperative's profits are divided upon the basis of these ownership shares and are paid as cash dividends. The general assembly of the cooperative decides every year what percentage of the profits will be distributed among the shareholders (members) and what percentage will get reinvested. Members are allowed to leave at anytime, conditional upon the acceptance of the general assembly. On exit, members receive their initial contribution less their portion of losses that the cooperative may have incurred in that year. Members are also allowed to pass their cooperative memberships on to a designated successor if they wish.

Separate supervisory and management boards control the OSM cooperative. The supervisory board is composed of 10 farmer and 5 employee representatives, who are elected every four years. This board consists of a chairman and a series of commissions. Currently there are two commissions, audit and business; previously there had been commissions for feed and education. Once the supervisory board has been elected; it then appoints the management board, which is comprised of a president, one farmer representative and one employee representative. This board deals with the day-to-day operations of the cooperative and supervises the paid staff.

### *Current Situation*

Currently there are 800 cooperative members of OSM Paslek -- 300 farmer-members who continue to deliver milk to ICC, 120 employee-members (not farmers but ICC employees), and 380 farmer-members who are no longer delivering milk to ICC, as they have either quit milk production or are delivering to another processor. Many of these farmer-members quit supplying ICC-Paslek with milk in 1998, following the initial Russian economic crisis when milk prices plummeted. ICC was one of the first processors to lower the price they paid for delivered raw milk, triggering many of the farmers to look for alternative processing options.

### **History of the International Cheese Company - Paslek , Ltd (ICC - Paslek)**

The OSM cooperative is currently part of a milk processing joint venture with Land O Lakes. This relationship initially began as a contract lease operation and then developed into a 50-50 joint venture (JV). Consequent reinvestments by Land O Lakes have increased Land O Lakes shares to 71%. OSM holds 29% of the shares (Exhibit 7). OSM holds 2 (of 5) seats on ICC-Paslek s supervisory board, holds 2 (of 5) seats on ICC Paslek s management board, and influences ICC-Paslek s strategic direction through the shareholder meetings. Besides its share in ICC-Paslek, OSM has a number of other businesses including a series of collection facilities they lease to ICC - Paslek. They also operate a general agricultural input supply company.

Land O'Lakes, Inc. is a cooperatively owned US-based food and agricultural company serving more than 11,000 producer-members and nearly 1,100 local dairy cooperatives throughout the USA. It is headquartered in Arden Hills, Minnesota, a suburb of Minneapolis. Land O'Lakes processes 12 billion pounds of milk annually and markets more than 600 different dairy products across the United States and throughout the world. Annual sales exceed \$6 billion with the company holding total assets of \$2.7 billion and total equities of \$769 million. All of Land O'Lakes members -- both local cooperatives and individual producers -- are owners of the cooperative and participate in a democratic process with direct connection to the policy decisions and direction of the organization. All members also share in the profits of the company, based upon the volume of their business. See Exhibit 1 for a review of the company's financial performance over the past ten years.

Land O Lakes has operated internationally as a commercial trader of milk products and inputs for many years. It also operates processing and feed manufacturing operations in Canada, Mexico, Poland, and Taiwan, most of which are joint venture plants. For the past 15 years Land O Lakes has provided small farmers with technical assistance through a range of international development projects funded by external donor agencies such as USAID and the World Bank. They have development projects operating more than 20 countries.

Land O Lakes initial entry into the Polish Dairy sector began in 1991 with establishment of a co-operative agreement with OSM Paslek, leasing manufacturing space at OSM's large dairy processing facility in Paslek to produce Land O Lakes calf milk replacer.

Through this agreement Land O Lakes assisted OSM in developing a dried whey powder with 40% tallow, or animal fat base used as the primary ingredient in its Land O Lakes branded calf milk replacer that was blended and packaged at this leased facility. By 1993, Land O Lakes had obtained #1 market share in calf milk replacer sales to Polish farmers.

In 1993, Land O Lakes Dairy Foods decided to enter the cheese manufacturing business in Poland. It was felt that cheese consumption would increase in Poland in subsequent years and that the timing was right for a producer of premium cheeses made from high quality Polish milk to enter the market. After considering several investment options, Land O Lakes felt that establishing a joint venture with OSM Paslek presented a low risk, low investment market entry into the Polish cheese business. Such a cheese joint venture at Paslek would also benefit the existing calf milk replacer business that depended on an increasing supply of high quality cheese whey for drying into fat base. Further, it was thought that the milk supply in the Elblag-Paslek area would recover more quickly than other parts of Poland due to the high concentration of large commercial dairy farms (former state farms) in the area. The milk quality from these large farms with milking systems and cooling tanks was also of higher quality than from smaller, more typical Polish farms.

For all the above reasons, Land O Lakes established a 50/50 cheese joint venture (JV) with OSM Paslek in December 1993 by contributing \$500,000 US in cash and arranging a working capital line of credit. OSM contributed cheese inventory of equal value. The JV leased the building and equipment from OSM together with utilities and other services. The primary responsibility of OSM was to supply milk to the joint venture. Land O Lakes responsibilities were to provide a general manager and overall western business management, marketing and new product development expertise. It is important to note that by this time, OSM was already coming under increased financial pressure.

#### *Expanded Joint Venture in 1995*

In September 1995, the joint venture was expanded to include the entire processing facility at Paslek. OSM needed additional financial assistance to help farmers increase the milk supply and to improve milk quality. The dryer and butter facilities and infrastructure were in need of extensive renovations and maintenance. Land O Lakes calf milk replacer would benefit from improvements in the dryer and the Company needed additional high quality milk for cheese production.

OSM contributed their buildings and equipment valued at 3.2 million USD and Land O Lakes contributed 3.8 million USD in cash to create an expanded 52% Land O Lakes

and 48% OSM joint venture. Land O Lakes provided loan guarantees for additional working capital needs. The basic responsibility of the two owners remained the same.

The additional investment led to the need for an immediate expansion of the sales and marketing departments. Additional volumes were required to more efficiently utilize the plants unused capacities and to overcome increased depreciation and operating costs. Distribution was expanded nationwide as new products were launched in the cheese category. New equipment, including a computerized cheese slicing and inert gas packaging line, was added to move from commodity to higher margin, value-added cheese products.

#### *Dutch Cheese Line Addition in 1996*

In 1996, the Company entered into a strategic partnership with a large international cheese company to become a co-packer for the company. Based on an exclusive sales agreement for Dutch-type Gouda and Swiss wheels that were to increase cheese sales by 50%, the Company invested \$2.6 million US to purchase a second-hand cheese plant from the Netherlands along with the knowledge to install and operate the machinery which added 13 MT per day additional cheese-making capacity to their plant.

The partnership was dissolved in 1998 as volumes never reached forecast and disagreements over pricing eroded the trust of the partners. The investment resulted in additional depreciation of \$500,000 US per year. With little increase in sales volumes

resulting from the investment, operating profits suffered from 1997-1999. At the end of 1999, large portions of the remaining Dutch cheese line assets were written off.

#### *Land O Lakes Butter Launch in 1999*

In 1999, the Company proposed to launch two Land O Lakes branded products into nationwide distribution. The target volumes were to capture a market share for butter equal to the Company's 1999-cheese market share of 3%. The launch would require a capital investment of \$500,000 US for equipment and several million more for advertising and promotion.

The joint venture could not finance the project, nor was OSM willing to increase the Company's capital to allow Land O Lakes to input the needed cash and increase their share of ownership. Therefore a new company, Land O Lakes Foods Poland, a 100% Land O Lakes owned entity, was created to implement the butter project. The idea was that the JV would manufacture the product for Land O Lakes Foods. Land O Lakes Foods would buy the product and then re-sell and distribute the product at a profit for Land O Lakes. Additionally, Land O Lakes Foods was to supply sales and marketing services to the joint venture for the remaining cheese and butter products for a fee. The Company would benefit from reduced overhead and could concentrate on manufacturing.

The butter was launched in March 1999 with initial volumes near forecast. However, a series of quality and distribution problems caused delays in customer orders. By summer

1999, the repeat orders failed to reach projections and volumes were not sustainable without additional heavy advertising and promotion. Though the product is still in the market, volumes are a fraction of the original plan. The losses due to the failed launch primarily affected 1999 financial statements; however, some additional write-offs were taken in 2000. Again, Company profits were reduced as the result of additional operating costs, such as the lease on the Land O Lakes butter equipment and depreciation.

### **Decision to Exit Poland**

Land O Lakes has decided not to continue to invest in Poland due to heavy demands for capital to support anticipated acquisitions and mergers in the US dairy and feed sectors over the next few years, and to build several new plants in the US. In 2000, Land O Lakes undertook a re-structuring program in Poland that would allow them to position the business at Paslek for sale.

Land O Lakes converted a 3.0 million USD loan from Land O Lakes to ICC - Paslek to equity with the approval of OSM. This resulted in Land O Lakes increasing its ownership in ICC - Paslek to 71% of the shares and having total management control of the business. This was necessary for Land O Lakes to implement the restructuring process and to move quickly to close a sale with a prospective buyer for the business when found. See Exhibit 7 for a diagram of ICC s current organizational structure.

The re-structuring was completed in 2000. The Land O Lakes Foods office in Warsaw was closed and moved to Paslek. Fifty percent of the Land O Lakes Foods employees had already been terminated after the butter failure. Basically, the ICC - Paslek purchased Land O Lakes Food s assets and all remaining employees were be transferred to the ICC - Paslek as of October 31, 2000. This resulted in additional cost savings and consolidated all of the company's manufacturing, sales, marketing and distribution functions under one General Manager making management easier.

### ***ICC-Paslek Situation in 2000***

By the end of 2000, ICC - Paslek had seen significant increases in sales in all areas - butter, cheese and dryer products. The Company expected revenues of \$20.0 million US in 2000, up from \$13.5 million US in 1999. The Company s market share for cheese has grown to 4.2%, making them #8 on the Polish market. The Company introduced three new cheeses and three new butters in 2000. They have added new packaging and flavors for processed cheese targeted for the deli trade. Both industrial and food service accounts have grown to nearly 25% of sales.

The re-structuring has been completed. The Company is forecasted to earn a pretax profit and have a positive cash flow in 2001. The Company also expects to receive certification for export to the European Union in 2001.

The Company received ISO 9002 Certification in May 2000 which has become a positive motivational mechanism and point of pride for the workers. This certification is required to be renewed every 6 months. The basis of the ISO certification process is the development of written procedures for all processes and jobs within the company. The written procedures are designed to ensure quality control by standardizing the processes. Internal and external audits continually check to see if procedures are being correctly followed. The total system is employee developed and driven and has played an integral part in the company's endeavors to increase productivity, quality control, and team work.

### **Women's Situation Within the Company**

#### ***Labor and Employment Issues***

When the initial joint venture was established in 1995 between Land O Lakes and OSM, the processing facility employed 325 people. That number has now decreased, through layoffs and natural attrition, to 243 employees; 101 women and 142 men. In addition there are 26 women employed on short-term flexible contracts. The employees break down between functional areas is: 80 administrative staff, 163 production staff, 5 directors, 3 regional directors and 18 managers of functional areas. Most of the current employees previously worked for a dairy cooperative that was taken over by Zaklad in 1984 and later became ICC - Paslek. Many were graduates of the three-year dairy processing school that the cooperative previously owned and operated in Paslek. Of the new employees who have joined the company following the establishment of the joint

venture with Land O Lakes, most found out about the job opportunities either through approaching the company directly or through word of mouth from family and friends who worked at ICC. Other methods included local advertisements or the local government employment office. Most recent hires started on short-term employment contracts and shifted up to full-time employment as opportunities arose.

One of the initial challenges Dave Peters faced as Land O Lakes entered the joint venture was streamlining the plant's operation to reduce costs, which required removing unnecessary business units and staff. This was achieved both through natural attrition due to the increased work requirements and intensity and the closure of service units traditionally supplied by the company, such as laundry, maintenance, electrical, and medical. These services are now out-sourced to specialist local companies, often established and owned by the previous employees of these units.

As part of this process, a new employment contract was negotiated with the workers and their two unions in 1996: Solidarity Union and Independent ICC-Paslek Union. This employment contract is designed to roll over into perpetuity, unless all of the parties accept a negotiated change. Polish law requires that ICC negotiate salary changes with both of the unions (combined), and they must jointly agree to any renegotiated contract changes before they can take effect.

The ICC-Paslek Union comprises about 50 members, or a quarter of the work force, mainly office and maintenance workers. The Solidarity Union comprises about a third of the work force, primarily processing workers. Employees are not legally required to join a union, hence the rest of the work force do not belong to any union. There are, however, special Polish laws that define the rights of unions and employees within the firm. For example, any person not belonging to a union can elect to have a union defend them if they have a problem with the company. By law, the union must accept. Workers can discuss and negotiate wage, salary, employment, and benefit issues with ICC - Paslek on an individual basis if they so wish; however, this rarely occurs as generally everyone accepts the union's negotiated contract.

The members of each union elect 5 members to a union board that then represents them in all of their employment and dispute negotiations with ICC - Paslek, such as working conditions, grievances and salary negotiations. Polish law provides each of the union board members with complete job protection.

### *Workforce*

The company runs a 42-hour workweek, which is the equivalent of 5 eight-hour shifts per week, plus one Saturday per month. This is the norm for Poland. The plant operates three production shifts per day, 7 days per week, for processing milk and producing cheese and milk powder products. The day shift runs from 7 am to 3 pm, evening shift from 3 pm to 11 pm, and nightshift from 11 pm to 7 am. The packaging line, however,

only operates during the day and is closed during the evening and night shifts. Each shift is provided with two 15-minute paid breaks per shift. The timings and structure of breaks differ across departments, as production runs do not stop for shift breaks, hence the individuals within each group must decide when to allow individuals to take their rolling breaks. Under the previous system workers received a common communal 30 minutes break, as all of the plants operations were closed down for the period of the break. This no longer occurs. In focus groups, many of the workers complained that they preferred the previous system as it provided an opportunity for everyone to socialize at work. They also felt that a 15-minute break was not long enough to eat a decent lunch.

### *Shift Scheduling*

The work schedule is set one month in advance by each unit's production director, with workers rotating through the three different shifts. Organizing a schedule that satisfies everyone is a difficult task, as employees have different preferences. For example, some employees indicated that they preferred the evening or night shifts, as they provided them with more opportunity to run errands during the day, whereas others indicated a dislike for these shifts, as they could not see their families, especially on weekends. Others complained that the evening shift restricted their sleep to less than eight hours when directly followed by a day shift. When scheduling problems or shift conflicts occurred, company procedures provided employees with the possibility of discussing them with the individual's immediate supervisor. This rarely occurred as the production

workers pointed out that there are very few alternative job opportunities and they do not want to rock the boat or do anything that may jeopardize their current positions. The scheduling of shifts was a particular point of concern to many female employees with children, especially those with large families or limited availability of home support, as the local kindergarten is only open from 6:30 am to 4:30 pm and is relatively expensive at 120 zł per child per month.

Scheduling was also a concern to individuals who did not have personal transport to get to and from the processing plant. Previously, ICC - Paslek had been able to use the workers social funds to subsidize the provision of a bus service between the local town and plant. However, recent changes in Polish law have meant that the company can no longer legally use these funds to provide the service. As a result, many women said that they felt more insecure walking to and from the plant, especially on winter evenings.

### *Sick Leave*

The company provides sick leave, up to a maximum of 180 days per year. Employees are paid 80% of their regular wage for the first 90 days, and then 10 % after that. To receive this, employees must get a doctor's certificate indicating the specific sickness. If the sick leave is caused by an accident at work or on the way to or from work, employees receive 100% of their average wage.

By law, employees can take maternity leave for 140 days after the birth of a child at 100% of their regular wage. Also by law, women can take a maternity leave for up to 3 years without losing their job. The government provides women on maternity leave with an allowance of 226 zl per month for those with 1 or 2 children and 440 zl per month for those with 3 or more children for the first two years. Single mothers receive this for the whole three years of the maternity leave. Pregnant women are protected by specific government stipulated regulations and restrictions with respect to overtime and job protection.

In addition, women with children under 4 years of age receive additional protection under the law in that the company can not send them on business trips, allow them to work at night or work overtime, unless they agree to it and sign a form or letter acknowledging that they agree. Women usually sign the forms, although some individuals indicated that they felt compelled to agree given the current economic climate. Mothers can also take two days of leave per year to look after sick children at full pay.

### *New Employees*

Most new employees begin as short-term flexible contract workers employed on an as-needed basis during heavy sales volume periods to fill extra sales orders. The company keeps a list of individuals who are willing to work on flexible contracts and contacts them as needed either by phone or through friends at the plant. They are usually notified two weeks in advance of the required starting date. Currently, there are 26 people - all women

- being employed at the plant on flexible contracts. It is now the norm that most new employees begin with ICC - Paslek as short-term flexible contract workers before being upgraded to full-time workers.

Many of the women employed on short-term contracts complained in the focus groups about the stress created by renewal uncertainty. One woman complained that even though she had been employed continuously from March until November, with the exception of a two-week break in July, ICC-Paslek could not promise her whether or when there would be permanent employment. She had to continuously inquire about future opportunities, and she felt she could not afford to take any holidays for fear of missing a permanent job opportunity. The short-term contract workers receive fewer employment rights and benefits than their full-time counterparts. Family sickness benefits or free flu shots were of particular concern to many of them.

### *Training*

All new employees initially receive 1 month of specialized training in their specific area of operations. This includes at least one day of mandated safety and hygiene training. After this employees receive regular refresher training in safety and hygiene. Employees also receive additional specialist training as required if they change jobs. Supervisors and experienced workers are expected to provide new employees with continuous on-the-job training.

Prior to privatization, OSM had operated a specialized dairy training school for new employees, which took 3 years to complete. However, this school was closed in the 1990s. For the few occupations where specialized skills are required, such as in the production of butter and cheese, ICC pays for employees to attend a dairy school in Wrzesnia. Traditionally these programs ran for two months. However, they have been substantively reduced in length and now average two weeks. A number of female workers indicated that they had attended these courses.

Specialist technical training is also provided for many of the administrative positions. For example, the export manager indicated that she had twice attended selling and client services courses in the USA. She had also been sent to external courses on export insurance and EU trade law. The administrative employees also indicated that anyone working with the company's computer system received specialist training; the system's vendor provides continual training on demand.

The company is currently assisting two of the office employees to attend university on a part-time basis. Because the government does not provide free university education to part-time students, such students incur substantial costs. The company has established a policy to reimburse employees for the tuition and fees they incur in attending university, if they study subjects related to their job, such as Dairy Management, Food Technology, or Marketing, and if they pass their exams.

Dave Peters indicated that the company is continually on the lookout for suitably trained English-speaking employees for administrative positions, but there is a lack of candidates. Most of the office staff can communicate, at least rudimentarily, in English; several are fluent. During the first couple of years of operation the joint venture provided free English classes for all workers, but these have now been discontinued due to lack of interest. Many of the production employees indicated that the company did not provide them with enough incentives, financial or otherwise, for them to learn English inside or outside of working hours.

#### *Employee Pay and Benefits*

Employees are paid monthly. The gross wage averages 1,600 zl per month, ranging from 1,100 zl to 5,000 zl per month. Production workers receive an hourly wage, whereas administrative workers are generally paid on a fixed salary basis. The factory workers receive a 3 to 5% bonus on their hourly wage for working on the evening or night shifts but many felt this was insufficient to compensate them for the increased burden. There seem to be no problems with payment delays or arrears, which are a common problem across Central and Eastern Europe. Long-term workers' wages and salaries are electronically direct deposited to the individual's personal bank account at the end of each pay period while short-term contract workers receive their wage earnings in cash. The employees appreciated the direct deposit service. There are plenty of money machines in town..

Employees indicated a concern about their pay level and said that inflation adjustments were insufficient. In 1990 the inflation adjustment was set at half of the inflation rate. They felt this was insufficient given the price increases they faced. One production supervisor commented to the workers in her focus group, How can you live on such low wages?! Given the weak labor market in the area, workers said that they have been unwilling to push management on the pay issue, as they fear losing their jobs if they did. They also recognize that ICC - Paslek provides them with secure employment and a regular pay check paid on time; an exception within the region. Dave Peters indicated that the company had initially had a policy of paying workers a wage above the regional average; however, this is no longer the case since it is no longer financial viable. Although they do not like it, the employees understand why.

Workers also indicated concern about not being financially rewarded for their level of experience; employees now only receive a long-service employment bonus of an additional one month's salary at the end of every five-year period of employment. They noted that new employees often seem to receive higher wages for the same jobs. The experienced employees thought that this seemed unjust. Dave Peters, during his first management period with ICC-Paslek, introduced an incentive scheme whereby production employees received a 2 to 3% yearly wage increase based upon a performance metric that graded their individual and team performance. The system is no longer operating, which the employees assumed has something to do with the firm's current financial situation.

Financial bonuses are also provided to any employees who suggest innovations or help change processes that lead to increased productivity or sales, or workers who undertake extra work beyond their normal duties, such as the team of workers who assisted with the ISO 9002 certification process. Workers also receive an end of year bonus if the company does well financially. Due to ICC-Paslek's current financial situation, a bonus was not paid in 1999,

Although there are no explicit policies that exclude employees from working in specific jobs, the human resource director indicated that women tend to be more commonly found in areas that require more patience, greater dexterity, and long hours of concentration and standing, such as butter and cheese production, packaging and dividing cheeses, and lab analysis. These jobs often involve computers and specialist machinery. Men can be found in these areas too, but usually doing different jobs. They are more likely to work loading trucks or operating the generating plant.

The female administrative workers indicated that their pay was equal with men's in similar positions. However, many female production workers felt that male production workers and supervisors were getting paid more than their female counterparts. This was difficult to compare as they tended to do different jobs.

In the focus groups, women indicated that men generally do not want to work on the cheese processing line, as the jobs were very difficult, repetitive, and required a lot of

heavy lifting and twisting to shift the blocks of cheese. Each block of cheese weighs between 3-12 kg. Males were however sometimes required to assist the women in these areas during busy times, possibly once or twice a year. They did it under duress, as they were required too, not because they wanted too and as one woman noted, It's like a punishment for the males to work on the cheese line. The female cheese line workers indicated concern that they were doing jobs that would not normally be done by females; however, the current labor market dictated it, as there were no other jobs available. The workers stated that there were no male workers in their department, as every male worker who had ever worked there had soon realized how physically and mentally taxing the jobs were and quickly requested a transfer or looked for a job elsewhere. The production workers presumed that management no longer employed males in this department, as they were disruptive, caused too many problems, and quickly quit. The cheese line workers felt concerned that they were being discriminated against, as they felt like they were doing second-class jobs that males did not want to do.

### *Overtime Opportunities*

In general, there are very few opportunities for overtime and they usually only occur in cases where sickness reduces the available workers. The maximum overtime allowed under Polish law is only 150 hours. If waged factory workers do work overtime they receive 150% for the first 2 hours and then 200% after that. They also receive 200% of their base wage for working on weekends. However, the one standard Saturday per month is paid at normal rates. The workers indicated that the weekend bonuses provided

sufficient incentive to work on weekends, even though they would prefer to spend this time with their families. On special holidays, full-time employees receive an additional 100% special bonus of their regular wage plus one day in lieu. However, short-term workers only get a 50% bonus.

There are no opportunities for salaried administrative staff to earn overtime: salaried employees receive days or hours in lieu, instead of overtime, for any additional work that they may be required to do. They indicated that this was ok, but they would like to have had an opportunity to earn additional money through overtime like the factory workers. Many of the women, especially the single mothers, indicated that they struggled to pay all of the bills on one salary; hence any opportunities to earn additional funds were greatly appreciated.

#### *Holiday Pay and Social Security*

The law stipulates that all employees pay 18.71% of their gross income for social benefits including retirement, healthcare, disability, etc. In addition, the company also pays the government a social security tax equivalent to 20.41% of the gross employee salaries. The government uses this to cover a number of social programs. ICC can deduct any social costs it incurs with respect to sickness or maternity leaves.

#### *Safety and Health Requirements*

Government law requires any company with over 50 employees to have a safety manager and safety department. Employee safety is an important concern at ICC. The company has a financial incentive to keep the accident rate low as the Polish government charges the company a variable insurance premium based upon the number of accidents. There is a large board in the front of the plant indicating how many days it has been since their last accident. As a motivational incentive, the company puts on a picnic for all of the workers if there has not been an accident in 100 days. Everyone perceives that ICC-Paslek is a safe environment. There are no longer any doctors or nurses on site, but first-aid facilities are available and intensive training ensures that accidents are minimized. Many people pointed out the safety sign indicating the number of days since the last accident.

## Conclusion

Given the rapidly evolving nature of the Polish dairy industry and the dependence of farmers and workers on the success of ICC-Paslek, Dave Peters wonders what the future holds for the company. Both Polish and European Union markets hold promise for companies who can adjust to their demands. Yet these demands place pressure for higher productivity and better quality on both workers and farmers. Polish laws protect workers in many ways, but market pressures will demand sophisticated strategic response. By 2001, ICC is organized for efficient production. What are the next steps that should be taken to assure the best results for all concerned?

**SELECTED REFERENCES**

## APPENDICES

**Exhibit 1                      Review of Land O Lakes (USA) Financial Situation for the Past Ten Years**

(\$ in millions)	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
<b>Operations:</b>										
Net sales	\$2,415	\$2,458	\$2,562	\$2,733	\$2,859	\$3,014	\$3,486	\$4,195	\$5,174	\$5,613
Earnings before income taxes	43	59	65	51	82	132	129	107	70	21
Net earnings	37	54	57	47	75	121	119	95	69	21
Allocated patronage refunds	32	50	48	41	66	104	101	84	76	35
Cash returned to members	22	29	37	40	41	46	53	59	40	49
<b>Financial Position:</b>										
Working capital	\$153	\$152	\$158	\$151	\$151	\$185	\$199	\$228	\$305	\$362
Investments	128	126	125	129	152	184	240	242	397	460
Property, plant and equipment	132	144	153	165	180	205	218	283	450	462
Total assets	748	823	841	866	943	1,149	1,235	1,566	2,292	2,684
Long-term debt	138	147	147	160	155	180	212	297	347	483
Capital Securities	0	0	0	0	0	0	0	0	200	200
Equities	279	300	318	326	353	417	480	539	781	769
<b>Financial Measures:</b>										
Return on equity	14%	19%	19%	15%	23%	34%	29%	20%	13%	3%
Return on invested capital	13%	16%	16%	12%	17%	24%	21%	16%	10%	50%
Long-term debt-to-capital	33%	33%	32%	33%	31%	30%	31%	36%	26%	33%
Current ratio	1.50	1.42	1.44	1.42	1.38	1.36	1.40	1.34	1.34	1.31

**Source: Land O Lakes, Inc. Annual Report 1999**

**(<http://www.landolakesinc.com/OurCompany/ANNUALREPORT.CMF>)**

## Exhibit 2                      General Information about Poland

	Poland	Warminsko-marurskie	Podlaskie
Total Area (km <sup>2</sup> )	312685	<b>24203</b>	18293
Population ('000)	38653	<b>1467</b>	2192
- % in Urban Areas	61.8	<b>68.5</b>	60.1
- People per km <sup>2</sup>	123.6	<b>60.6</b>	119.8
Employed Persons ('000)	15751.8	<b>507.6</b>	773.6
- as % of Total Population	40.8	<b>34.6</b>	35.3
Registered Unemployed ('000)	2349.8	<b>142.4</b>	124.7
Registered Unemployment Rate (%)	13	<b>22.8</b>	14.3
Avg. Gross Monthly Salary and Wages (zł)	1789	<b>1568</b>	1532
Agricultural Land ('000 ha)	18434.7	<b>1272.6</b>	923.4
- Arable Land as a % of Total Agricultural Land	76.7	<b>69.5</b>	79.7
- Private Farm Land as a % of Total Ag Land	83.7	<b>76.6</b>	75.4
Cattle (head per 100 ha Ag Land)	35.6	<b>32.2</b>	27
Pigs (head per 100 ha Ag Land)	100.6	<b>69.1</b>	112.6
Animals sold (kgs per ha Ag Land)	106	<b>126</b>	56
Milk Sold (liters per ha of Ag Land)	352	<b>379</b>	199
Lime use (kg per ha of AG Land)	104.2	<b>126.5</b>	64.2
Fertilizer use (kg per ha of Ag Land)	87.4	<b>69.9</b>	126.4
Tractors (units per 100ha Ag Land)	7.3	<b>3.8</b>	7

*Source:* Polish Statistical Agency (GUS)

*Note:* ICC - Paslek is situated in the voivodship of Warminsko-Marurskie. It collects milk and draws employees from both the voivodships of Warminsko-Marurskie and Podlaskie.

**Exhibit 3                      Ownership Structure of Polish Agricultural Land**

	<b>1990</b>	<b>1998</b>
Total Arable Land ('000 ha)	18 720	18 443
including:		
- private sector	14 978	17 020
(% share of the total):	80	92.3
- public sector	3 742	1 423
(% share of the total):	20	7.7

*Source:* GUS; EU Commission DG VI

#### Exhibit 4                      Structure of Polish Farms

	Number of farms	% total arable land	Average farm acreage (ha of arable land)
Private family farms	2 041 380	82.2	7
Farming co-operatives	2 467	2.9	203
Foreign capital property	100	0.4	729
Mixed capital property	36	0.3	1 249
State-owned farms	1 953	7.2	636
<b>including:</b>			
State Treasury (AWRSP) owned	503	4.5	1 550

*Source:* GUS; EU Commission DG VI

#### Exhibit 5                      Dairy Herd Structure

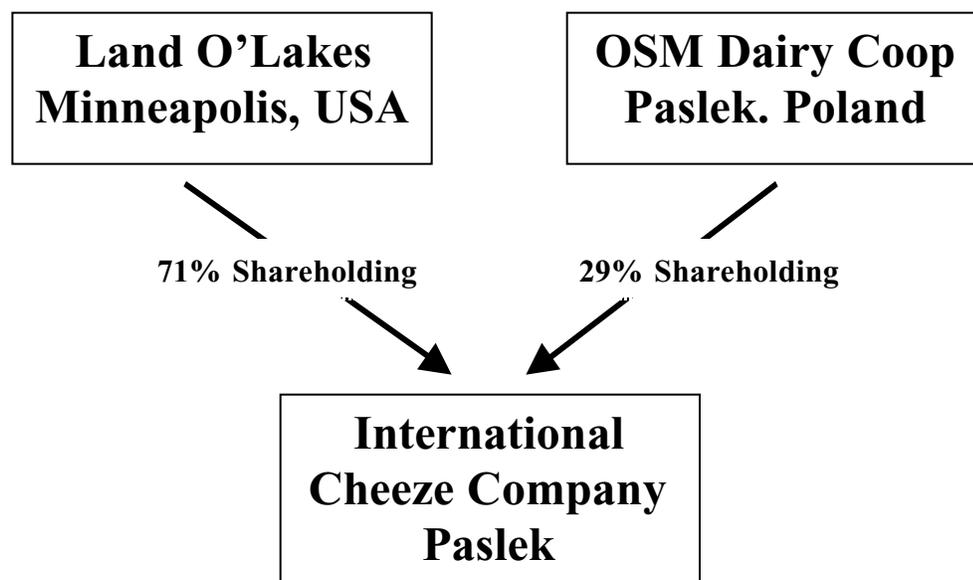
No. of Farms with dairy cows	% of Total Farms	Avg. No. of Cows per Farm	% of the National Dairy Cow Herd in the Herd Size Category						
			1-2	3-4	5-9	10-19	20-49	50-100	>100
1 309	64.0	2.6	37.5	24.8	23.0	6.8	1.2	1.2	5.4

*Source:* European Commission - DG VI

**Exhibit 6****Changes in Polish Dairy Production since 1989**

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
<b>Number of Dairy Cows (000)</b>	4990	4919	4577	4257	3983	3863	3579	3461	3490	3542	3418	3300
- Index 1989 = 100	100	99	92	85	80	77	72	69	70	71	68	66
<b>Total Milk Production (mil l)</b>	15926	15371	14022	12770	12271	11866	11303	11355	11770	12229	11763	11500
- Index 1989 = 100	100	97	88	80	77	75	71	71	74	77	74	72
<b>Total Milk Delivered (mil l)</b>	11385	9829	7844	6854	6682	6269	6139	6396	6832	7070	6608	6500
- as a % of Total Milk Production	71	64	56	54	54	53	54	56	58	58	56	57
<b>Milk Yield (l/cow)</b>	3260	3151	3082	3015	3075	3121	3136	3249	3370	3491	3466	3500
- Index 1989 = 100	100	97	95	92	94	96	96	100	103	107	106	107

Source: Rynek Mleka (2000); EU Commission - DG VI (2000).

**Exhibit 7: Current Ownership Structure of ICC - Paslek**

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**Exhibit 8 Summary Gender Profile : Poland**

	<u>1980</u>	<u>1985</u>	<u>1990</u>	<u>1998</u>
GNP per capita(US\$)	..	..	..	3,910
<b>Population</b>				
Total (millions)	35.6	37.2	38.1	38.7
Female population (% of total)	51.3	51.2	51.3	51.3
<b>Life Expectancy at Birth (years):</b>				
Males	66	67	67	69
Females	74	75	76	77
<b>Adult illiteracy rate (% of people aged 15+)</b>				
Males	1	1	0	0
Females	1	1	1	0
<b>Labor Force Participation</b>				
Total labor force (millions)	19	19	19	20
Female labor force (% of total)	45	45	46	46
<b>Unemployment</b>				
Total (% of total labor force)	..	..	..	11.2
Female (% of female labor force)	..	..	..	13.2
<b>Education Access and Attainment Net primary enrollment rate (% of age group)</b>				
Male	99	100	97	100
Female	99	99	97	99
<b>Total Fertility Rate (births per woman)</b>	2.3	2.3	2.0	1.4
<b>Birth Attended by Skilled Health Staff (% of total )</b>	..	99	..	98

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Source : GENDERSTATS, Worldbank.