



# The Russian Diamond Industry Celebrates Its Jubilee Anniversary

Written and photographed by: Yaakov Almor

With 2500 employees, over 600,000 carats manufactured a year, a sales turnover of more than 534 million dollars (2012), 53 points of sale in Russia and 5 marketing branches abroad, Kristall is celebrating 50 years of sensible operations that took it through decades under Communist regime, followed by the tumult of perestroika and now, its participation in the volatile, competitive capitalist world

A lot of water has flowed in the Dneiper since the Soviet government decided to establish a diamond factory in Smolensk, 1350 kilometers west of Moscow. It was 1961, two years before the new factory - Kristall Production Corporation (KPC) - would present its first Russian Make diamond. Another 50 years would pass until Kristall's celebration, with great festivity and grandeur and attended by notables from all corners of the world, the jubilee anniversary of the founding of the Russian diamond industry. It could take pride in a total - so far - of 80 million polished diamonds, weighing a total of 9,3 million carats (approximately 2000 kg).

Not only is KPC the only one of the seven diamond factories established by the USSR in the 1960s that has survived to this day; it is the largest diamond factory in all of Europe, and the mainstay of the economy of the Smolensk area, accounting for 2% of the workforce, 8% of the GDP and 51% of export from the area.

Attending KPC's jubilee celebrations gave me an opportunity to tour the company's facilities, get a first-hand impression of its strength and learn about the upheavals it has survived.



## The Factory Tour

During the long tour we took of the factory, we learned that KPC, which is fully owned by the Russian government, stars on the short list of the country's most important strategic enterprises. This status affords the firm access to major sources of rough, and as a result - to regular, guaranteed monthly production to renew its stock of polished.

A new page in the history of KPC was recorded in 1992, shortly after the dissolution of the Soviet Union, when it became the first manufacturer in Russia to receive a license to export polished

diamonds. It wasn't long before it established the first representative office of Smolensk diamonds outside the borders of the country.

In 1998 Kristall joined the list of De Beers sightholders, becoming the first Russian diamond manufacturer to receive a license to purchase rough from the world's largest supplier.

KPC employs about 2,500 employees, who earn salaries about 40% higher than the average paid in the Smolensk region. Most of the employees are women. In fact, the company's grading department employs women only, because in this job - according



to Kristall - men have neither the patience nor the qualifications that women do.

Since it began, KPC has invested heavily in developing its human resources as well as its own advanced technology. Kristall develops its own work tools, including laser composites and computerized equipment for marking and planning.

The company manufactures Triple X from 30 points up. Kristall's polished diamonds are known the world over as Russian Make. In addition, the company manufactures diamond jewelry, sells rough that is unsuitable for its own manufacturing needs and runs a cutting school, department for technological development, tool shop and equipment-repair department.

KPC's global activities include the manufacture of polished diamonds and jewelry in Smolensk; distribution of polished through five marketing branches in Antwerp, Israel, Hong Kong, New York and Dubai; representation of the firm's interests in state institutions and the domestic market through its office in Moscow; rough purchasing in Yakutia through a special "detached" division located on site, and finally, retail sales through a network of 53 points of sale in 30 major cities throughout Russia.

It's difficult to get a precise answer to the question of whether KPC is a subsidized company. The fullest answer one can extract is "Yes, but ...". What's certain is that the outside world has very little effect on Kristall, barring a few exceptions. At any rate, with a total turnover of 534 million dollars in 2012, KPC is Russia's leading polished diamond exporter.

## Pages from a Book

Active journalists in the world diamond and jewelry industry usually have a hard time putting together comprehensive, in-depth articles on the Russian diamond industry, especially the mining sector, unless they are stationed in Russia for a long time and have access to sensitive inside information.

This time, I found such information in the book, *Setting Light to Diamonds*, which was presented to the guests at KPC's jubilee celebrations. With 450 large A3-size pages in hard cover, and texts in Russian and English side by side, it's the kind of book that many of us receive at conferences and tend to leave in the hotel room or give to our local colleagues, who don't have to deal with the volume and weight the handsome gift adds to their luggage. But this time, I took the book with me and I found myself reading it eagerly. I found treasures of information in the book on the present and past leaders of the Russian diamond industry - mining and manufacturing - and quotations of key figures speaking freely and



**Maxim Shkadov studies the outcome of a rough planning program on the computer**

often bluntly about the past, present and future of the industry. Have you ever heard a leader of the Russian diamond industry wonder why for heaven's sake the diamond manufacturers in Russia were forced to take a sight from the DTC when the government could easily have allocated them more - and much cheaper - Russian-mined rough?

Not only does the book recount the past with surprising candor; it also makes suggestions for future vertical development and growth of the Russian diamond and jewelry industries.

## Beginnings

Viacheslav Shtyrov, now deputy chair of the Federation Council of the Federal Assembly of Russia and previously president of Yakutia and of Alrosa, recalls that the founding Russian diamond industry was a difficult, complex task. It began in the 1960s, in the former Soviet Union. The government built seven large polished diamond plants. The first was Kristall Smolensk, followed by the construction of factories in Moscow, Barnaul (a mining town on the western Siberian plains), Gomel (in White Russia), Vinnitsa (in the Ukraine), Yerevan (Armenia) and Chardzhoum (Turkmenistan). "These factories were unmatched in the world in terms of production scale and they became a model for diamond manufacturing," Shtyrov says.

Most of these diamond factories no longer exist. "Some found themselves beyond the borders of Russia and others, for their own subjective reasons, disappeared into oblivion. While we are among the world's leading rough diamond producers, we occupy a regrettably modest place in the field of diamond cutting and polishing," Shtyrov continues.

## A Crown Fit for a Czar

In honor of its 50th anniversary, KPC decided to demonstrate its professional mastership and skill, as well as the continuity of the Russian jewelry-making traditions in an unprecedented effort of creating a replica of the Great Imperial Crown, that of the czars.

The crown is fashioned from 14-karat white gold, set with more than 11,000 round and fancy cut diamonds, weighting a total of almost 2,000 carats. The center of the crown is set with a 10.11-carat oval-cut diamond. In addition, it is adorned with 74 large white South Sea cultured pearls, and the crown's top carries a 384-carat natural rubellite (a reddish variety of tourmaline). The replica's total weight is 2.312 kilograms.



IsDMA deputy president - David De Toledo, IDMA vice-president under Kristall CEO, Maxim Shkadov, next to the replica of the Great Imperial Crown

## In spite of the government

Yuri Rebrik, who worked at Kristall from 1976-2005 and served as the company's director general from 1998 to 2005, says in the book that it's incredible that KPC has become a model for polished diamond manufacturing operations: "From a company that basically produced what it was told to produce by government officials who had no clue about what the market needed, it has become a firm that operates and competes in the free market," he says.

When he was appointed director-general at KPC, Rebrik's main mission was to protect the interests of the company from encroachments by the rule of the officials: "In those days of the Soviet Union, all the diamonds that KPC manufactured were handed over to the Gokhran, the state repository. The Gokhran marketed the stones through a state foreign trade agency, Almazjuvelirexport, which handled the centralized sale of all Russian precious stones and metals abroad. We began to understand the issues of competition, pricing practices and demand-consistent production practice depending on market situations, rather than orders from above. We started taking the cyclical nature of the market into account," Rebrik recalls.

Looking back, Rebrik criticizes the decision made by these officials to require KPC to purchase rough abroad - in particular from De Beers - instead of allocating the company more rough from the Gokhran, through Alrosa: "To me, the distribution of the Russian rough mined in Yakutia was always very puzzling. We had to buy the same kind of Russian-mined rough from De Beers, at prices higher than at home. I failed to understand why KPC had

to purchase certain volumes of rough diamonds abroad, instead of spending the money within Russia. The company could have been substantially expanded and increased its production, but because of the shortage of rough, the task was nearly impossible. As far as I know, to some extent the same situation prevails to this day."

"Considering that Alrosa, the government-owned rough diamond company, accounts for nearly one-fifth of the world's diamond production," Rebrik continues, "it could easily meet the entire local demand for rough, especially for another government company such as KPC. But that is not the case today: rough diamonds are still imported to Russia to meet the demand of the manufacturers - and still," notes Rebrik, "at higher prices than we would pay for local production." Rebrik indicates that the governments of several African countries ensure that rough mined in their countries is also manufactured in local factories. This is much more profitable for them than exporting the rough, he says, noting that Russia has not yet fully examined and considered these advantages. Instead, KPC is pressed to import an increasing quantity of rough diamonds each year.

In a conversation held in his Smolensk office, Kristall's CEO, Maxim Shkadov, who is also president of the Association of Russian Diamond Manufacturers and of the International Diamond Manufacturers Association (IDMA), remarked: "Some 65 percent of our rough purchases are from Alrosa. We're also a sightholder of De Beers' Diamond Trading Company and in addition, we buy at auctions in the market - in Antwerp, Africa, and other countries. Also, in addition to our representative offices



in New York, Dubai, Hong Kong, and Antwerp, we are active in Botswana, South Africa, Lesotho and other African countries.”

Shkadov remained vague on issues such as government support for the local diamond industry, including Kristall, and possible preferential treatment for rough supplies from the government. A man with military training, Kristall's CEO said that he formed his rough purchasing teams based on the model of military intelligence units, which can move swiftly and act immediately, with precision. "I have a few 'mobile elite troopers' at my disposal for this purpose," Shkadov smiled.

## Mainly Polished Export

In general, one could say that Russians tend to refrain from making straightforward statements and prefer to package their opinions carefully, often in elaborate sentences. Although statistics were not available, it seems that polished stones are largely exported from Russia, and not used to boost the local jewelry industry, even though Russian retail is growing, and importing jewelry made from its own diamonds.

The book presents a critique of this dismal situation by Abel Aganbeghian, chairman of the Russian Academy of the National Economy and Public Administration. "Russia has the world's best polished diamonds, but we don't use them fully to add value during the manufacturing process and increase consumption of the finished product domestically. So far, we have been exporting most of the polished diamonds.”

Aganbeghian's arguments are supported by the statistics, which show that in 2008 Russia's share in the global rough diamond production was approximately 17 percent, while the share of polished diamond manufacturing stood at a mere 4.8 percent.

"The country's polished manufacturing share could be substantially higher - up to ten per cent. The legislation of some other countries stipulates that rough diamonds should first be offered to domestic manufacturers and only those unsuitable for them may be diverted to other marketing channels. Strangely enough, in this country you often have to persuade people that it is necessary to develop our diamond manufacturing industry," Aganbeghian writes.

Fyodor Andreev, president of Alrosa, acknowledges the assistance (read that: special prices on rough) that Alrosa extended to KPC during the crisis years of 2008 and 2009. Arguing that there are lessons to be learned from that period, he urges the rough producers and the other downstream players to "arrive at a new optimal balance that takes into account both the needs of its

mining section, involving above all huge capital expenditure, and the substantial marketing expenses the jewelry segment bears today."

Andreev also recognizes the changes that have taken place in the diamond pipeline and the need for producers to play their part to keep the industry healthy: "The demise of single-channel marketing in the diamond market resulted in more acute competition in every section of the diamond pipeline, which became one, if not the principal cause of the recession in 2008 and 2009. At the same time, the recession demonstrated the readiness of the world's leading diamond producers for industry solidarity in times of crisis.”

The current leadership of the Russian diamond industry says things need to change. In his article, Valery Bogomolov, chairman of the Association of Russian Diamond Manufacturers (ARDM) writes: "Some short-sighted economists and politicians are giving Russia a purely rough-export role, wrongly assuming that our country can indefinitely restrict itself to exporting raw materials and purchasing whatever it needs from other countries. The development of domestic production and consumption should become our strategic priority for the years ahead. Today, the bulk of the Russian Make diamonds are used in jewelry produced by brand-name jewelry houses abroad. This must change," he argues.

"The problem is that although we have the best polished diamonds in the world, we don't use them to add value during manufacturing, or increase the domestic consumption of the finished product. So far, we have been exporting most of the polished diamonds.”

The Russian diamond industry leaders have pinned their hopes on the statements made by President Vladimir Putin, who, disapproving of the trade dynamics described above, recently



IDMA delegation members visiting the diamond grading department of KPC





commented critically on the exports of mineral resources. Development of local industry is the key, he asserted.

In Aganbeghian's article, he offers a comprehensive "roadmap" for the Russian rough and polished production, as well as jewelry manufacturing and marketing: "There are good prerequisites for the development of a local jewelry industry, ensuring excellent products, including names, traditions, schools and the experience of the great jewelers of the past, such as Faberge and other famous Russian artists and designers," Aganbeghian writes.

"There is a need to create added value for the Russian diamond industry and this can be achieved through vertical integration of jewelry manufacturing. These operations would then compete successfully with foreign jewelry firms that currently use Russian polished diamonds, adding enormous value to their products that are purchased overseas, often by none other than Russian consumers."

According to Alex Popov - president of the Moscow Diamond Bourse, this plan requires major efforts and considerable investment: "There is no mass production of jewelry in Russia. It is not an organized industry as in India, China and other countries. Global jewelry brands like Cartier have established local distribution centers that import diamond jewelry for sale within the country at global retail prices, making substantial profits," he adds. On the other hand, the Russian retail industry is growing, with an annual turnover estimated at about US \$15 billion.

## Discouraging Imports

The government has also taken measures to discourage the import of diamond jewelry by increasing the rate of import duty.

"Custom duties for diamonds and diamond jewelry are a flat 20



A diamond setter at work at Kristall Jewellery Company of Smolensk

percent on invoice value. In addition, importers pay a 1.2 percent inspection levy and 18 percent VAT. This has raised the value of the imported jewelry to the retailer by almost 42 percent," Popov explained.

Accordingly, KPC has begun manufacturing jewelry: "The company has master jewelers at work, who also teach, and we are establishing more jewelry schools throughout Russia and in Smolensk. The idea is to develop more local skills," said Shkadov. Although its high-end jewelry is often destined for export, the company is also producing a line for the local market. "Our domestic market is still developing, but it is coming back quite quickly," said Shkadov. He explained that the industry needs to present itself as high-tech, innovative, and possessing its own niche in the international market. The issues of rough supply, simplification of regulations, and VAT exemption for rough diamond transactions, as in cutting centers throughout the world, also need to be addressed.

"In order to increase the competitive edge of Russian enterprises, the government needs to create a good environment for business, especially with regard to national producers and manufacturers, that would ensure continuous rough supply, decision-making flexibility and promotion of appropriate legislation and regulation by the ministries and agencies concerned," Aganbeghian argued. "I am certain that it is feasible, within the next three years, to double polished diamond manufacturing in Russia and to increase it fourfold within the next five to six years," he concluded. ●

