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Consultancy Report
Quarterly Report July 1 - September 30, 1993

Hungary: Agricultural Input Marketing Support Project
Contract Number: EUR-0024-G-00-1066-00

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AGRICULTURAL INPUT MARKETING SUPPORT PROJECT
GRANT NO. EUR-0024-G-00-1066-00
PROGRAM PERFORMANCE REPORT
JULY - SEPTEMBER 1993

ADMINISTRATIVE DATA

Country: HUNGARY
Implementing Agency/
Point of Contact: AGENCY FOR INTERNATIONAL DEVELOPMENT, EUR/DR/FS
Contractor: AGRICULTURAL COOPERATIVE DEVELOPMENT
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Period of This Report: JULY - SEPTEMBER 1993
Period of Last Report: APRIL - JUNE 1993
AID Project Officer: DR. JAMES G. SNELL
Original Authorization: Amendment 02 to subject grant
dated DECEMBER 31, 1991
Estimated Completion: DECEMBER 31, 1993
Life of Project: \$686,680
Chief of Party in Country: Rifat Barokas

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I. Project Purpose

The purpose of the Agricultural Input Marketing Support (AIMS) Project is to transfer needed business and marketing skills to Hungarian input supply firms in the process of privatizing. Through the transfer process, the project will foster an agricultural input supply sub-sector which is market driven, competitive, financially and operationally stable, and capable of meeting market demand.

II. Summary

During the reporting period, results of activities of the Agricultural Input Marketing Support (AIMS) Project began to appear. The technical assistance focused on four firms selected as most likely to succeed at initiating change. Even as the process was going on, the firms were introducing new procedures, staffing patterns, and structures based on the analyses being developed.

This included:

Agrowest, Ltd.

- created a separate marketing department and appointed a marketing director who reports directly to the General Manager.
- appointed several sales agents in rural areas to increase market share and revenue.
- started procedures to date accounts receivable and to improve cash flow.

Mezomag, Ltd.

- completed a three way debt-for-debt swap which improved their balance sheet.

Semen, Ltd.

- restructuring the entire organization.
- locating potential customers to lease under-utilized warehouse space.

Jasz-Kun, Ltd.

- developing new rules with respect to transfer pricing.
- determining their plant level break even points.

The work is not over yet, but these firms are improving operations and activities and are on the way to being able to effectively compete in the new open market.

III. Implementation Methodology

ACDI formally initiated AIMS on July 9, 1992. The project focuses specifically on facilitating the restructuring of agribusiness input supply firms by assessing their organization, managerial, marketing and technical requirements to become more profitable.

The project's implementation methodology consists of three interrelated components:

1. Preliminary Technical Assistance. ACDI project staff provided technical assistance (TA) in alliance with specialists from Pioneer Hi-bred International in the Autumn of 1992. Profiles of the participating Hungarian companies were prepared and used during the subsequent training phase to assure practical application of the training. This first TA component helped develop the participating companies' organizational, financial, and market data to serve as a basis for planning change. It also focused on building consensus on company objectives and obstacles to their achievement.

2. Exposure to U.S. Agribusiness. After three days of preparatory training in Hungary, three individuals from each participating Hungarian firm attended a two week professional development program managed by Pioneer in the United States. They observed and studied how an American firm conducts business. The Hungarians identified many ideas and approaches that could be applied to the operations of their own firms. Upon their return to Hungary, they attended a follow-up workshop, which covered current Hungarian agriculture policies, business planning, corporate finance and marketing under inflation.

3. Follow-up Technical Assistance. The project has provided for TA as a follow-up to the U.S. training. ACDI is currently providing TA to the companies which have exhibited the highest probability of survival in the transition to a market-economy based on a technical needs assessment. The participants continue to apply what they learned in both the U.S. and Hungary to solving the real problems of their firms.

ACDI expects the impact of the project on the participating firms to be the following: (1) an enhanced ability to serve and expand their markets through better identification of customers' needs and improved customer service; (2) a better position to improve their operational performance; and (3) an increase in their capability to finance their own operations. Indeed, early results from the most recent Technical Assistance intervention indicate that all of these activities are underway.

IV. Situation

Hungary's agricultural economy continues adjusting to the transition from a predominantly production driven command system to one with a market orientation. The former system primarily promoted quantitative growth, not market-driven improvements in product quality, technology adoption, and operational efficiency. This left the sector unprepared for the current economic transition and restructuring.

The transition has been difficult for all sectors of the economy, but has impacted the agriculture and food sector more strongly and negatively than others. Although most of the legislative framework has been completed, indecision concerning the creation of a land or real estate market and the slow pace of implementing relevant laws have constrained transition efforts. Compensation for land proceeds slowly, and without clear tenure rights, investors are difficult to find. Nonetheless, the government recently approved more money to accelerate land registration and a new land law is expected to come before Parliament this Fall.

These transition difficulties seriously constrain the efforts of the project's participating input supply companies. Specifically, privatization efforts of the surviving participating companies have been hampered by a complex web of financial arrangements, bureaucratic constraints and lack of decisive action by the Government of Hungary and the banks. Due to this lack of government action, some of the project's participating firms are in serious financial trouble. The more successful companies continue attempting to privatize. Several are looking into a Management-Buy-Out/Employee Stock Ownership approach. Successful privatization will depend on the government's responsiveness in addressing remedies for current legislative/regulatory constraints.

The continued weak financial situation of farms, the high interest rates on loans, the uncertainty among farm managers about privatization, and management changes at state farms and cooperatives have kept the domestic input market skeptical and pessimistic.

V. Background

Thirteen companies participate in the AIMS project. Eight are small to medium-sized companies, registered as limited liability companies (KFTs). Four participating companies are large diversified corporations. One company is a large seed trading operation owned by the eight KFTs.

The current situation with the participating companies is very complex. At the start of the project, eight of the participating input supply companies began the process of privatization after being under the control of Vetőmag Vállalat for the past four decades. Vetőmag Vállalat (VV), the former state-owned seed production and distribution monopoly, has been in the process of liquidation for almost a year. In 1990, the government spun-off the regional branches of VV as independent companies, but kept approximately a 50% share of each branch.

Following VV's divestment, eleven separate entities existed as KFTs; due to bankruptcies and liquidations, only eight remain.

Presently, five of the eight KFTs are in serious financial trouble or entering bankruptcy. The remaining three seem to be gaining strength by increasing exports, adopting cost-cutting measures and management changes, and implementing new marketing strategies learned in the United States through project activities. For instance, one firm appointed agents in rural areas to sell seeds, a strategy learned by its managers during their training at Pioneer Headquarters in Iowa. The company started appointing the agents immediately after returning from the United States. These agents were able to measurably increase the company's sales in the 1993 season.

The four diversified corporations are called Production Systems. They have seed supply activities as one of their many production, distribution and trading activities. Seed production, processing, sales and marketing activities are minor in comparison to their other operations. However, they are still major players in the Hungarian seed market. Compared to the nine other participating companies, these four diversified corporations have fared much better and are poised for success within the seed industry. Indeed, these four diversified companies have increased slightly their market share of seed sales in 1993. These companies are IKR, KSZE, KITE, and GTR.

The one participating company established with the equity participation of the eight KFTs, Vetomag Kereskedohaz (VK), continues to increase its market share as well. VK, owned by the eight KFTs and the government, originally traded seed only on the account of the eight KFTs. Following its founding, VK chose to expand its operations to become a large diversified "System" type corporation, competing not only with the other four Systems in the group but also with its eight KFT owners. VK has also taken on the role of successor and liquidator of the former state-owned monopoly, Vetomag Vallalat, which owns from 48% to 68% of the equity of the eight KFTs. Thus, in effect the eight KFTs own VK, and VK owns the eight KFTs.

Vetomag Vallalat, a bankrupt corporation, owns most of the eight KFTs' physical assets. VV leases the assets to the KFTs. The KFTs then mortgage these assets to several state-owned banks. The banks are reluctant to call in any of the loans. Thus, the managements of the KFTs who wish to privatize by a combination of MBO/ESOP and participation of outside investors have their hands tied and are unable to sort through this exceedingly complex situation.

VI. Progress Toward Purpose

Based on a technical assistance needs assessment, four of the participating companies were chosen to receive follow-up technical assistance. The companies were Agrowest, Mezomag, Semen and Jasz-Kun.

During the reporting period, three expatriate specialists began conducting individual,

comprehensive analyses of the four enterprises. The objective of this technical assistance intervention was to develop a corporate development plan for the privatization of the four companies. The plan concentrated on privatization issues related to management philosophy, domestic and export markets, and organizational and financial structure.

The technical assistance included the preparation of weekly company analysis reports which outlined preliminary observations, recommendations for productivity and financial accounting improvements. The company analysis reports also included production analysis, cost accounting and financial analysis. When the individual company analysis reports were completed the technical assistance team incorporated the results, observations and recommendations into one report which succinctly analyzes the present situation and provides alternative plans for action.

The participants continue to apply what they learned in both the U.S. and Hungary to solving the real problems of their firms.

VI. Next Quarter's Activities

ACDI plans to use remaining project resources to act on the recommendation of the technical assistance team and implement a second intervention focused on marketing. A specialist has been selected to undertake this activity which includes:

- Developing selection criteria for effective salespersons;
- Contributing to the preparation of the strategic operational plan for each company;
- Establishing a sales and marketing department in at least two of the four companies; and
- Establishing a sales training seminar or workshop which can be used locally after project completion. This includes sales and management aptitude tests and evaluation methods.

Attachments:

1. Expenditures Through September 30, 1993
2. Consultancy Reports
 - Hungarian Sectoral Seed Review
 - Agrowest Comprehensive Business Study
 - Mezomag Comprehensive Business Study
 - Semen Comprehensive Business Study
 - Jasz-Kun Comprehensive Business Study

ATTACHMENT 1

Agricultural Input Marketing Support Project

EXPENDITURES THROUGH SEPTEMBER 30TH, 1993

<i>Description</i>	Budget	Actual	Unliquidated
Salaries	82,018.00	90,304.88	-8,286.88
Other Payroll			
Added Costs	15,182.00	18,346.09	3,164.09
Allowances	51,204.00	27,436.38	23,767.62
Other Travel	122,160.00	104,835.45	17,324.55
Consultant Fees	80,859.00	88,039.04	-7,180.04
Participant Training	39,444.00	37,050.00	2,394.00
Equipment/Commodities	40,452.00	6,850.84	33,601.16
Other Direct Costs	70,507.00	62,701.74	7,805.26
Indirect Costs	184,855.00	160,603.21	24,251.79
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