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AGRICULTURAL MARKETING IMPROVEMENT STRATEGIES PROJECT

Sponsored by the

U.S. Agency for International Development

Assisting AID Missions and Developing Country Governments
to Improve Agricultural Marketing Systems

Prime Contractor: Abt Associates Inc.

Subcontractors: Postharvest Institute for Perishables, University of Idaho,
Deloitte Haskins & Sells,

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AGRICULTURAL MARKETING IMPROVEMENT STRATEGIES PROJECT

Under contract to the Agency for International Development, Bureau for Science and Technology, Office of Rural Development
Project Office 4800 Montgomery Lane, Suite 600, Bethesda, MD 20814 • Telephone: (301) 913-0500 • Telex: 312636

IMPLEMENTATION PLAN
FOR THE RESTRUCTURING OF
COMMERCIAL AND INDUSTRIAL
OPERATIONS FOR SOMALAC -
MADAGASCAR

James G. Brown
Elsie Rasolohery

September 1990

Prime Contractor: **Abt Associates Inc.**, 4800 Montgomery Lane, Suite 600, Bethesda, MD 20814 • (301) 913-0500

Subcontractor: **Postharvest Institute for Perishables**, University of Idaho. Moscow, Idaho 83843 • (208) 885-6791

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Implementation Plan for the Restructuring

of Commercial and Industrial

Operations for SOMALAC - Madagascar

Prepared for:

USAID/Madagascar

Prepared by:

The Agricultural Marketing Improvement Strategies Project (AMIS)

James G. Brown (Deloitte & Touche)

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September 1990

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GLOSSARY

AID/W	USAID Washington
AMIS	Agricultural Marketing Improvement Strategies Project
BCIM	Banque nationale pour le commerce et l'industrie
EAE	Etablissement d'aménagement et d'entretien
EIC	Etablissement Industriel et Commercial
EIP	Etablissement d'intensification de production
FMG	1405.92 = $1 US
GOM	Government of Madagascar
USAID	United States Agency for International Development

PREFACE

The Agricultural Marketing Improvement Strategies Project (AMIS), core-funded by the Agency for International Development's Bureau for Science and Technology, is a five-year project designed to assist USAID Missions and developing countries to:

- improve diagnosis of agricultural marketing system constraints, using rapid appraisal techniques;
- conduct in-depth analysis of specific marketing problems identified during rapid appraisal or by other studies;
- identify, design, and monitor appropriate marketing system innovations and improvements; and
- build local capacity in both the public and private sector to do marketing systems analysis.

AMIS is also assisting AID/W and USAID Missions in planning new marketing initiatives and projects.

The rationale for the AMIS Project, which began operations in October 1987, was the realization that benefits from increases in agricultural production, often the result of successful AID or other donor-sponsored projects, frequently do not reach farmers and others in the marketing chain because of constraints or bottlenecks in marketing systems. Likewise, inefficient distribution systems for fertilizer and other inputs may result in late deliveries and high costs to farmers. These constraints may be technical, institutional or infrastructural, but they are often the result of government policies with disincentive effects - policies that discourage private sector participation in marketing. Through analysis and active interventions, AMIS is promoting a better understanding and appreciation of the importance of marketing in the agricultural development process.

The prime contractor for the AMIS Project is Abt Associates, a Cambridge, Massachusetts-based policy research and economic analysis firm, operating through its Washington, D.C. area office. Abt is assisted by two subcontractors: The Postharvest Institute for Perishables at the University of Idaho, a research and information centre dedicated to improving postharvest handling and marketing of perishable crops; and Deloitte & Touche, an accounting, management, and agricultural development consulting firm with special expertise in market liberalization studies.

EXECUTIVE SUMMARY AND GENERAL RECOMMENDATIONS

It is important to recognize at the outset that the Établissement Industriel et Commercial (EIC) does not exist as a separate legal entity. Its status is that of a management and accounting unit of SOMALAC, which does have its own legal identity, that of an "entreprise socialiste". While assets and liabilities have been assigned to EIC in relation to its activities in the purchasing, processing and sale of rice, these assets and liabilities are legally part of the balance sheet of SOMALAC. All financial transactions - sale, purchase or encumbrance - pertaining to the activities of EIC must be entered into by SOMALAC or its agents.

Since EIC does not legally exist, it cannot be sold. On the other hand, the owners of SOMALAC have the right to sell any or all of the assets of their company, including those which it has assigned to EIC. If they were to sell portions of the assets of EIC as going concerns, they would effectively transfer the activities previously performed by EIC to the new owners.

The discussion in this report therefore centres on the sale of the assets assigned to EIC, and problems attendant to that sale. While changes in the ownership and management of the other activities of SOMALAC are beyond the terms of reference of this report, reference will be made to Etablissement Intensification de Production (EIP) and Etablissement Aménagement et Entretien (EAE) where there appears to be some complementarity between the approach recommended for EIC and the concerns of these other activities.

There are three basic areas of preliminary work to be addressed before the sale of EIC assets can be undertaken: separation and identification of assets; clearing up titles to real estate considered to be part of the assets of EIC; and resolving the rights and disposition of personnel. Inasmuch as a company is not being sold, liabilities are not a direct concern. However, if the assets of EIC are to be sold, the Government of Madagascar (GOM) will want to know what liabilities remain to be settled, either out of the proceeds of the sale or in some other manner.

The consultants' specific operating recommendations are presented in relevant sections of the report, but the recommended strategy to achieve the sale of EIC assets is as follows:

<u>The majority of EIC assets should be sold in three lots</u> corresponding to the three rice mill complexes. Independent assets such as surplus equipment, isolated houses and blocks of real estate, not essential to the mill operations, can be sold separately.

<u>The sale of the mills should be phased</u>, with either Amparafaravola, Manakambahiny or both being offered ahead of Ambongalava. This approach is expedient in terms of preparatory work, but it is also concluded that the real estate and personnel issues of these two mills can be resolved more quickly than those of Ambongalava. In general, phasing permits the gradual release of assets, with the transfer of unresolved issues to the EIC and its remaining operations.

EIC should be dissolved by SOMALAC's Board after all saleable assets have been sold and its remaining assets and liabilities incorporated into the accounts of the Directorate General, EIP or EAE.

Management contracts should not be considered for transition periods of two years or less. The effort to negotiate and implement such an agreement would be substantial, and a management entity would want significant margins on its efforts for such a brief period. Consequently, the cost to the state would be greater than simply continuing to bear the losses implicit in the present arrangement until final disposition can be arranged. For any period of less than two years between completion of preparations for sale and the anticipated negotiation of sale, SOMALAC should explore the alternative of granting greater autonomy to the current senior management of EIC, along the lines that have been introduced this year, and continuing to operate remaining assets until a sale is effected.

Management contracts should be sought for mills which are likely to remain unsold for more than two years. The maximum advantage to be gained from such an arrangement is that a contractee can be compensated, in part, according to performance; however, before this can be carried out, personnel and price policy issues need to be addressed.

The disposition of the proceeds of asset sales should be determined in advance. The retirement of liabilities associated with EIC operations should have high priority. These proceeds can be used to reduce the overall liabilities of the remaining SOMALAC structure.

Steps to be Taken to Effect Sale of the Assets of EIC

The main section of the report discusses a series of steps necessary for the sale of EIC assets or, barring that, entry into a management contract for the operation of unsold mills. These steps are as follows:

1. Identify assets to be sold and their condition.

2. Identify non-saleable assets, particularly accounts receivable, and decide how to dispose of them.

3. Establish the probable range of value for saleable assets.

4. Determine legal aspects of debts, their current value, and how they will be settled.

5. Establish clear title, or identify liens or pending claims against real estate, and develop plan to remove these latter.

6. Identify any pre-emptive rights or other privileges which may have legal force with respect to the acquisition of EIC assets.

7. Determine the status of personnel and their legal rights with respect to employment and dismissal.

8. Identify the facilities available to personnel for retraining or other forms of reentry, and develop a program for notification, dismissal and assistance.

9. Identify lots of assets for sale, and the policy with respect to breaking up lots.

10. Establish acceptable terms of sale.

11. Establish criteria and procedures for the evaluation of offers.

12. Identify team of specialists charged with facilitating sale.

13. Identify decision making authority and processes.

14. Establish means of offering for sale.

15. Identify sources of financing that may be available to prospective buyers.

16. Solicit offers.

17. Conduct evaluation process.

18. Negotiate sale with selected bidder, including effective dates and terms of sale.

19. Obtain formal approval for the proposed sale.

20. Establish transitional arrangements, particularly with respect to use of assets and provisions for security.

21. Complete legal documentation, and satisfaction of conditions precedent.

22. Complete the transfer or liquidation of EIC assets not sold as part of mill complexes.

The Need for Assistance to Complete the Work Program

This report defines specific tasks that remain to be performed in respect of a number of the implementation steps. It would not be realistic to expect this work to be accomplished, within a reasonable time frame, by a management team that is simultaneously responsible for the operations of EIC and the other divisions of SOMALAC. The consultants strongly recommend, therefore, that the government and the Board of SOMALAC appoint a senior team of specialists to carry out the work plan that can lead to the final disposal of EIC assets. This team is further discussed in respect to the actual sales process in Step 12. However, there remains a great deal of preliminary work to be done, as well, on real estate, other assets and personnel. Qualified staff should be committed to these tasks on a full-time basis.

While it may be useful from time to time for the team to be able to call on expatriate specialists, the fundamental need is for decisive leadership and for expertise in respect of labour, real estate and corporate law in Madagascar.

1.0 INTRODUCTION

As part of its policy of liberalization of the economy, and particularly its efforts to restructure the agriculture sector, the Government of Madagascar (GOM) has decided to offer the rice mills and related assets of the Établissement Industriel et Commercial (EIC) of SOMALAC for sale to private parties. The present report is intended to assist the GOM in this effort by identifying the measures to be taken to effect privatization.

1.1 Summary of Terms of Reference

The Terms of Reference for the development of implementation plans for the enterprises of SOMALAC were set out in December 1989 following a meeting of government, donor and consultant representatives.[1] In January 1990, the Honorable Andrianoelison José wrote to USAID to clarify the Terms of Reference with respect to the GOM's decision to proceed with the sale of EIC mills and to use management contracts for transitional purposes or in the event of failure to sell any of the mills.

The instructions from the Minister and subsequently from other Ministry officials led the consultants to change the order of the elements in the December 1989 Terms of Reference, and to proceed as follows:

i) Definition and delimitation of the assets to be disposed of, with evaluation of applicable prices in each case (piecemeal sale and separate provisional management of assets).

ii) Detailed study of the legal separation with a view to piecemeal sale.

iii) Definition of a process for accelerating the legal separation: conditions and methods.

iv) Evaluation of the consequences of the legal separation in the following terms: institutional, property, financial and social (particularly as regards the fate of current personnel).

v) Examination and implementation of management contracts during the transition period for each rice milling unit (separate management of assets).

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[1]This report represents the completion of the final phase of assistance financed by USAID and carried out by Abt Associates and Deloitte and Touche. Earlier phases included a diagnosis of the condition of the enterprise (Société d'Aménagement du Lac Alaotra; Une évaluation de l'Etablissement industriel et commercial (EIC) de la SOMALAC dated December, 1988) and the subsequent identification of alternative courses of action to address the problems identified.

vi) Precise definition of the reciprocal commitments of each party (SOMALAC and purchasers), particularly in the case of management arrangements, with respect to maintenance and restoration of facilities to working order on a regular basis.

1.2 How Work was Approached

This assignment has been conducted on three fronts:

i) A field team visited Lac Alaotra in mid-July, 1990, to examine EIC facilities, review current financial information, and interview managers of EIC and local officials. The team consisted of M. James G. Brown of Deloitte & Touche, a senior agribusiness specialist who was Team Leader for the earlier phases of the work with EIC, and Mlle Elsie Rasolohery of the Cabinet Ramaholimihaso Amanandraibe, which had previously conducted complementary judicial work for another of SOMALAC's operating enterprises, EIP.

ii) The consultants made extensive use of work conducted in earlier phases of the EIC study, and relevant portions of the work with EIP.

iii) Assumptions and prices with respect to valuation were developed initially in consultation with the Director of the Technical Department of EIC, and subsequently cross-checked with other rice milling specialists in Europe and the United States.

The main body of the report is presented for the most part as an implementation plan for the sale of EIC assets, with the required steps being used as titles under which to present our findings and set out specific measures to be taken. Details of work, such as the analytical basis for asset valuation, are presented in the Appendices. A similar approach is taken to discuss the matter of management contracts.

2.0 FINANCIAL ASPECTS

(Steps 1 to 4)

Although EIC does not exist legally, SOMALAC has established separate accounts for the activities associated with each of its enterprises, including EIC. The Balance Sheet of EIC as of April 30, 1990, with comparison to the previous year, is presented in summary form in Table 1.

The Income Statement for 1989/90 and 1988/89 is summarized in Table 2. The accounts on which these statements are based are as yet unaudited, but the external auditors are expected to complete their review of the 1989/90 accounts in August.

The Balance Sheet presents the following general picture:

i) Total assets have declined steadily over the past three years.

ii) Fixed assets have been depreciated to the extent that their book value is only 38% of their acquisition cost.

iii) The value of fixed assets is equivalent to only 17% of the amount of medium- and long-term debt.

iv) The value of total assets amounts to only 47% of the amount of total debt.

v) In contrast to capital of FMG 733 million, EIC has a negative net worth of FMG 1,266 million.

vi) Cumulative transfers made to other parts of SOMALAC are equivalent to the difference between capital and net worth.

If the sale of EIC's assets were to realize only their book value, the proceeds would be insufficient to retire existing liabilities. In fact, if current assets, including doubtful accounts receivable, were to yield their full book value, fixed assets and equipment would have to net more than six times their book value to settle existing debts. The significant factor not reflected in this statement is that, because of their advanced level of depreciation, EIC's assets have a greater value in operation than is reflected in their book value. It is this going concern value on which the hope must be based to settle debts and, perhaps, to generate some surplus to reimburse the state a portion of its investment in EIC.

Table 1

SOMALAC - EIC

Balance Sheet 1987/88, 1988/89 and 1989/90

	Gross	Depreciation/ reserves	Net	Net	30/4/88 Net
FIXED ASSETS					
Preliminary expenses	17,528	17,528	0	0	0
(Externally financed)	224,900	145,067	79,833	104,993	112,998
Equipment and tools	114,511	41,310	73,201	84,652	96,103
Transport equipment	110,389	103,757	6,632	20,341	16,895
(Self-financed)	1,368,389	1,207,715	160,674	369,096	564,705
Real property	144,803	144,803	0	0	0
Land	11,750	0	11,750	11,750	11,750
Buildings	69,001	54,846	14,155	15,825	17,494
Equipment and tools	341,073	241,972	99,101	123,393	130,043
Transport equipment	769,570	740,252	29,318	208,724	397,397
Fixtures	13,025	13,025	0	0	0
Office furn. and equip.	17,260	12,817	4,443	7,497	7,114
Constr. work in progress	1,907	0	1,907	1,907	907
Total Fixed Assets	1,610,817	1,370,310	240,507	474,089	677,703
CURRENT ASSETS					
Inventory and in process	43,276	43,276	0	0	0
Supplies	290,000	0	290,000	291,268	364,866
Packaging	329,676	119,043	210,633	141,594	184,642
Products	222	8	214	149	59,722
Advances	0	0	0	16,521	0
Long-term receivables	458,943	174,102	284,841	305,243	618,129
Misc. receivables	216,606	123,009	93,597	64,804	97,581
Quick assets	16,461	0	16,461	19,982	1,042,639
Total Current Assets	1,355,184	459,438	895,746	839,561	2,367,579
Accrued assets	785	0	785	721	0
Grand Total	2,966,786	1,829,748	1,137,038	1,314,371	3,045,282

LIABILITIES			
Equity	733,030	687,757	410,658
Capital stock	0	0	0
Endowment fund	522,543	535,274	1,117,932
Reserves	0	0	0
Carry-over	152,483	(707,273)	(1,612,655)
Operating result	58,004	859,756	905,381
Grants for equipment	22,390	22,390	157,201
Reciprocal accounts	(2,021,559)	(2,045,087)	(1,802,626)
DEBTS			
Funded debt	1,995,193	2,286,000	3,776,167
Medium and long-term	1,400,000	2,000,000	3,276,611
Short-term	595,193	286,000	499,556
Operating debt	312,450	304,138	443,421
Accounts payable	38,614	13,547	112,643
Personnel	48,223	39,593	34,588
Social institutions	3,822	4,012	4,012
State	221,791	246,986	292,178
Miscellaneous debts	95,535	59,171	59,244
Total Debts	2,403,178	2,649,309	4,278,832
Accruals	0	0	1,215
Grand Total	1,137,039	1,314,369	3,045,280

Table 2

SOMALAC - EIC

Operating Statement 1988/90 and 1989/90

EXPENSES	89/90	88/89
Raw material	3,795,257	3,028,906
Other procurement	305,743	376,598
Changes in inventory	57,394	181,016
Materials and supplies	22,801	24,888
Subtotal	4,181,195	3,611,408
External services	125,589	310,120
Sub-contracting	3,681	9,421
Rentals	81,690	210,668
Maintenance and repairs	30,759	56,234
Insurance premiums	9,459	33,164
Miscellaneous	0	633
Other external services	191,706	322,546
External personnel	856	1,210
Honoraria and commissions	144,688	150,551
Publicity and public rel.	4,202	2,483
Transport of personal goods	25,148	102,750
Travel/missions/hospitality	3,331	4,957
Post and telecommunications	12,457	8,397
Bank charges	1,024	52,198
Taxes and duties	4,141	4,684
Personnel expenses	459,492	446,214
Salaries and wages	398,716	392,390
Benefits	60,073	53,474
Other payroll expenses	703	350
Other operating expenses	0	519,928
Depreciation	235,064	269,384
Reserves	162,328	293,900
Financial expenses	55,439	262,002
Interest on loans	0	151,342
Bank interest	55,439	110,660
Extraordinary expenses	51,650	309,267
For management	51,439	78,276
Valuation of assets		2,733
Taxes on income		2,410
Other exceptional expenses		222,537
Others	211	3,311
Total Expenses	5,466,604	6,349,453
Operating Result	57,496	859,758

REVENUE	89/90	88/89
Sale of finished products	4,874,028	4,821,483
Sale of by-products	205,139	232,174
Rendering of services	162,857	199,538
Sale of merchandise	0	18731
Inventory	71	(60,241)
Total Revenue	5,242,095	5,211,685
Other operating revenue	69,677	57,995
Recovery from reserves	187,206	636,216
Financial revenue	9,812	11,960
Extraordinary gain	15,310	1,291,355
Management	1,723	273,280
Transfer of assets	856	6,704
equip au res.	12,731	11,370
Others	0	1,000,001
Total	5,524,100	7,209,211

2.1 Step 1: Identify Assets to be Sold and Their Condition

The saleable assets of EIC consist of buildings, machinery, equipment, vehicles, land, houses, inventory, paddy, milled rice and byproducts. There are no intangible assets in the form of goodwill or long-term sales contracts. Financial assets such as accounts receivable and prepaid items should not be offered for sale, but collected or otherwise settled by SOMALAC, so that prospective buyers need only be concerned with the condition and worth of tangible assets.

2.1.1 Overall Assessment

At their peak, EIC mills could produce about 200 tons of rice per day, equivalent to the processing of more than 50,000 tons of paddy in a six-month season. However, today, their age and present level of deterioration would prevent them from processing more than half of that volume. In fact, only Ambongalava was operational at the time of our visit (July 1990). With recent improvements to that site, its two lines now appear to be able to handle 15,000 tons of paddy or more in a season. Significant start-up repairs and replacements would be required before milling could begin at either Manakambahiny or Amparafaravola.

The age of all the mills is reflected in the design of some equipment; for example, large diameter stone mills, which are difficult to calibrate, and central shaft power systems are still being used instead of independent electric motors. The deterioration of frames and drive systems has resulted in constant alignment and balance problems.

Of the five mills in the three locations, only the two at Ambongalava are complete and operational at the present. These have been rebuilt over the last two years, primarily using equipment and materials available within EIC, and the skill and facilities of the mechanical and electrical shops. The Schule line is in excellent condition in relation to its original design, while the Lewis line has been redesigned and automated, incorporating Japanese dehullers, and has been much improved over its original design. Nevertheless, the age of many of the components of these lines will adversely affect their resale value.

Parts and components have been removed from the line at Manakambahiny and those at Amparafaravola - officially, to rehabilitate the lines at Ambongalava - but theft has also been a source of loss. Design problems at Manakambahiny include the single primary power shaft, which reduces capacity flexibility, and increases the minimum power requirements to operate the mill, and the minimum quantity of paddy to justify start-up. A buyer might, in fact, consider dismantling this line and using the components to establish up to three smaller mills. Alternatively, if paddy supplies were adequate, conversion to independent electric motors for major components would increase flexibility and reduce power requirements over time. This latter option might require FMG 100 million in new investment, but would reduce power consumption by as much as 50%.

At Amparafaravola, the Huckoff line is also hampered by the problems created by a single primary power shaft and recurrent alignment problems.

The average depreciation on all assets, most of which have an economic life of 10 to 20 years, is over 60%, and many of the chattels such as vehicles are fully depreciated. While these figures are not a reflection of real value, they do point to the fact that most assets are showing signs of wear and will not command a selling price anywhere near their replacement cost. The exception is the land on which the factory complexes, houses and offices are located. These properties remain on the books at their original acquisition cost, which is only a fraction of their present value.

The consultants have examined most of EIC's major assets, and have reviewed official asset lists. There are several issues to be addressed in order to accurately identify the assets to be offered for sale: revise the list and value of assets; separate assets used jointly by more than one enterprise; and, reassign assets among enterprises to ensure the most saleable lots of assets around mills.

2.1.2 Revise the List and Value of Assets Assigned to EIC

The current list of assets in the schedules to the balance sheet is not accurate. It fails to record sales transactions involving assets, transfers to another enterprise of SOMALAC, or cases of reconstruction of assets which should have been capitalized. There are other cases in which adjustments have not been made to the accounts to reflect the destruction or disappearance of an asset. Appendix A, Table A-1 illustrates some of the factors which result in the present asset list being overstated. Other factors, such as inflation, devaluation, and rehabilitation would push actual value in the opposite direction.

A detailed inventory of EIC's assets, together with valuation, must be completed before the mills are offered for sale. The current plan to have Rindra (coincidentally SOMALAC's auditor) conduct a reappraisal of the assets of each enterprise is timely, and it will give the owners a correct, detailed list of assets. However, the consultants strongly recommend that, for the appraisal of EIC assets, a technician familiar with rice milling, and the three mills in particular, be assigned to work with the appraiser. The present Technical Director, and occasionally his designate, would be well-qualified for this work. Only in this way, can EIC be sure that the value assigned to particular assets will reflect their worth in an on-going rice milling operation.

In addition to appraising the assets in place, the valuation should identify and cost additional parts that would be required to make all five milling lines operational. This valuation should be based solely on restoring the existing system and capacity; no restructuring or expansion should be anticipated in this exercise.

2.1.3 Separate Assets Shared by More than One Enterprise

The concern has been expressed in the past that there would be a problem separating assets that are shared by more than one enterprise. This is not, in the consultants' opinion, a significant problem, as such shared assets are few, and they are not essential to the operation of any of the three mill complexes. Therefore, they need not be included in the lots of assets that should be the focus of sales efforts (see Step 9). In due course, the Directorate General and the auditors may consider an exchange of assets of equivalent value among enterprises as a means of resolving this issue.

2.1.4 Reassign Assets Among Enterprises

In some cases, the assignment of office and housing space to EIC's balance sheet was based on current occupancy, or the competing demands of other enterprises. As a result, the office and housing space attributed to EIC is not necessarily that which is closest to the mill sites, or otherwise the best-suited for sale as part of the mill complexes.

Coincident with the revaluation exercise referred to above, the Directorate General of SOMALAC should exchange and reassign housing and office facilities, to ensure the best location of these assets in relation to other groups of assets to be offered for sale. This exercise should not result in an increase or decrease in the space or value of the assets of EIC. During the transition period, informal arrangements should be worked out among enterprises so that this change in assignment of assets need not require the relocation of personnel or functions.

It should also be noted that prospective buyers may wish to include more or less of the housing and office facilities in the lots of assets they wish to purchase. SOMALAC and the state should be flexible in this respect.

2.2 Step 2: Identify Non-Saleable Assets, Particularly Accounts Receivable, and Decide How to Dispose of Them

EIC has no organizational or pre-paid expenses which remain unamortized at this time. Its only financial assets other than bank accounts are:

i) advances equal to a small share of paddy purchases, which should be either offset by paddy deliveries or converted to receivables by the end of the current fiscal period; and

ii) accounts receivable.

All tangible assets, even obsolete spare parts and fabrication stock will have a sales value, if only as scrap. Therefore, the only assets of EIC which are not readily saleable are its accounts receivable.

As Table A-1 in Appendix A indicates, collection of a large portion of accounts receivable is doubtful, and some provisions have already been made. There is a real danger that word of the cessation of EIC activities will encourage more debtors to default, and those who are delinquent will continue to neglect their obligations. The consultants therefore recommend that the status of all accounts receivable be updated, and that a mail and visit program be initiated as soon as possible to improve collection. A separate task force should be appointed within the accounting and administration service of EIC for this purpose, with representation from the accounting service of the Directorate General.

The government and the Board of SOMALAC should also agree on the assignment of receivables that remain uncollected at the date of cessation of EIC activities. The simplest arrangement, in the near term, would be that these revert to the consolidated accounts of SOMALAC. Thereafter, they would be treated like other SOMALAC financial assets as that enterprise is restructured.

2.3 Step 3: Establish the Probable Range of Value for Saleable Assets

In the final analysis, the value of an asset or group of assets is that amount which a buyer is willing to pay to acquire it. However, it is important for the orderly sale of assets that the seller establish a reasonable expectation with respect to price, and that a strategy be agreed upon for action in the event that a reasonable price is not forthcoming.

There are four traditional measures of value. Each serves a different purpose but, together, they give a range of values within which a seller can normally establish a reasonable expectation:

- Book Value — The purchase value of assets, less accumulated depreciation.
- Salvage Value — The estimated proceeds from the sale to buyers who intend to dismantle the assets for alternative use.
- Going-Concern — The present value of the net benefit stream that could be generated by operating the subject assets.
- Replacement Cost — The cost of buying/constructing a similar facility at current prices.

Among agro-industrial enterprises such as EIC, which have been in operation for many years, it is common to find that book value is much lower than the value that can be realized from the sale or operation of the concerned assets. Similarly, salvage or scrap value will be low in relation to operating value because of the costs associated with disassembly and relocation, and because of the percentage of capital cost (plumbing, electrical and mechanical works, and ancillary equipment) that is associated with the particular configuration and location of the liquidated plant.

On the other hand, replacement cost will tend to be higher than the value that could be expected from sale or operation, not simply because of the wear and tear, which can be readily estimated, but because of changes in technology, economic conditions, and the cost of capital equipment since the facilities were originally constructed.

Unless the investment was poorly conceived in the first place, or economic or political conditions have materially changed, the greatest value of a package of assets is almost always to be realized through some form of continued operation, or through sale to a party which plans to operate the facilities.

Over and above these general considerations, there are other factors which will enter into the assessment of value. If the performance of the facilities has been at or near its rated levels, then a good estimate of value can be made by discounting a projection of historical financial data. However, it often happens that the physical and financial potential of a package of assets is not realized because of factors such as inadequate raw material supply, poor management, political intervention, labour problems or market constraints. Furthermore, minor changes in the package of assets through small additional investment may also change performance. When any of these factors are present, valuation must be based on some assumption about their continued constraint on performance, or about changes that are to be incorporated in the projections.

In the case of EIC, all of the aforementioned constraints have been present to some extent, and some have been instrumental in the poor financial performance of the enterprise. Nevertheless, it is the conclusion of this report that the best value will be realized by parties which continue to operate the three rice mills in question. To estimate what value the Government of Madagascar might expect to receive from the sale of these assets, the consultants have had to make certain assumptions about the extent to which these constraints can readily be removed by new owners. In the following paragraphs, a value is estimated for each of the four methodologies, including going-concern, and the key assumptions are presented. The supporting tables for these figures appear in Appendix A.

2.3.1 Summary of Value Estimates

Book Value: The book value of fixed assets, vehicles and equipment, as of April 30, 1990, was FMG 240.5 million (Table 1). However, this figure is based on an asset list which is not current; it does not reflect losses, damage or reconstruction which have taken place in recent years. An accurate figure for book value must await the outcome of the Rindra study of EIC assets begun in August. In the interim, the consultants have estimated a value based on sample studies of errors and omissions in the list of assets appended to the balance sheet.

The result of these adjustments is to reduce book value by between 21% and 23%, depending on the assumptions about the value of assets classified as "hors service". The consultants shall assume the reduction to be only 21%. Rehabilitation, particularly at the Ambongalava site, has not been capitalized. Although it is worth much more in terms of productive capacity, the consultants estimate the actual cost of labour and parts to have been about FMG 30 million. It should be noted that land is carried on the books at its purchase price, and the buildings at Amparafaravola and Manakambihiny have been fully depreciated. With these adjustments, the consultants estimate book value for the fixed assets to be FMG 220 million.

Salvage Value: The consultants estimate that the salvage value of most of EIC's equipment and machinery is between 15% and 25% of its original purchase price. These figures assume that it is the buyer's responsibility to disassemble, pack and move the purchased equipment. While the consultants have estimated values of between 30% and

80% for tangible current assets, it is expected that quantities of these assets at the time of sale would be much lower than at April 30, 1990. It is beyond the scope of the present team to estimate commercial/industrial land values in the Lac Alaotra Region. In Appendix A, the consultants have used appreciation since date of acquisition of 400% on buildings, and 600% on land. These figures should not be used without verification by a competent authority. These assumptions are presented in the supporting table, Appendix A, Table A-5.

The consultants estimate a salvage value of FMG 289.3 million for the fixed assets as of April 30, 1990, excluding land and buildings. A preliminary estimate of salvage value including land and buildings is FMG 1,013.5 million.

<u>Replacement Cost</u>: The consultants estimated replacement cost in two ways: first the insurance appraisal figures for 1989 were converted to full value by adjusting the useful life to 100%; second, the cost of several mills constructed in East Africa and South Asia in the last 10 years was examined, and adjusted for international inflation since construction and for differences in capacity. In all cases, the resulting values were within the range of FMG 8.0 billion and FMG 9.6 billion. Therefore, the estimated replacement cost, mid-1990, for capacity of 200 tons of paddy per day would be approximately FMG 9 billion.

<u>Going Concern Value</u>: Discounting the net cash flow before payment of long-term debt, based on recent EIC performance and a 15% discount rate, results in a present value of FMG 2,427 million. However, to arrive at a going concern value that reflects other realistic considerations, a number of changes were made to the revenue and expenses, as well as the discount rate, as follows:

i) An efficient operator could increase throughput to 20,000 tons without additional investment.

ii) An efficient operator could reduce operating costs by 25% without additional investment.

iii) Investors are very unlikely to undertake agricultural operations unless the prospective return is much more than the cost of capital. The consultants conservatively use 25%.

iv) There are additional risks associated with investing in the mills of EIC. Bidders will anticipate difficulties in securing clear title to real estate, and problems in resolving residual personnel issues. More generally, local political intervention may be seen as a constraint by most prospective buyers. These additional risks will be reflected in a further increase in the discount rate. The consultants assume a discount rate of 35%.

Appendix A, Table A-7, presents the discounted revenue and expenses on which the values are based. The unadjusted present value of a 10-year projection of 1990 estimated operations is FMG 2,426.8 million, using a discount rate of only 15%. This is approximately equal to the total outstanding debts at 30/4/90 of FMG 2,403 million. A more realistic discount rate of 25% reduces Net Present Value (NPV) to FMG 1,726 million.

Incorporating adjustments i) through iv), above, the consultants estimate that a prospective buyer would value the operations at about FMG 4,200 million as a going concern. A summary of value estimates is presented in Table 3 below.

Table 3

Summary of Value Estimates

		FMG million
Book Value	Reported at 30/4/90	240.5
	Adjusted	220.0
Salvage Value	Excluding land & buildings	289.3
	Including land & buildings	1,013.5
Replacement Cost		9,000.0
Going Concern	As is	1,726.5
	Improved management & volume	4,200.0

Conclusion

It is clear from the foregoing that selling the main assets of EIC as going concerns is the most attractive alternative. The estimated going concern value of FMG 4.2 billion represents the price at which a prospective buyer would be indifferent as to whether an offer was accepted or not. If the assumptions the consultants have proposed reflect accurately the attitude of prospective buyers, then a price below FMG 4.2 billion would be of interest to them. Beyond that, individual bidder's assessment of risk and the level of effort required to achieve the improvements, would determine their individual price limits.

In conclusion, the state could reasonably expect to realize between FMG 3 billion and 4 billion from the sale of EIC assets. To go beyond this level of estimation would require much more comprehensive interviews and field work than were conducted for the present study.

To put price tags on individual groups of assets such as each of the rice mills, several factors will have to be considered, such as the present condition and the direct investment costs which would be required to bring the unit into production, and the value of assets which would simultaneously have alternative uses.[2] Recommendations in this respect should be prepared by the staff appointed to oversee the sale.

If the sale of EIC assets does, in fact, net more than FMG 2.4 billion, a surplus will be available after debts are settled. This surplus would represent the real value of the "patrimoine" of EIC. While it is of course the state and the Board of SOMALAC that will determine the allocation of this surplus, possible applications include supplementary assistance to personnel displaced by the sale, and reimbursement to the Treasury for past subsidies for the purchase of vehicles and equipment.

2.4 Step 4: Determine Legal Aspects of Debts, Their Current Value, and How They Will be Settled

Since EIC is not a legal entity and cannot be sold as a company, its liabilities will remain a charge on SOMALAC. While it is assumed that the proceeds from the sale of EIC assets would first be used to retire the debt attributed to EIC, a policy and procedure need to be established to ensure that:

i) the proceeds from the sale of EIC assets are, in fact, used as the government wishes; and

ii) any remaining liabilities are correctly entered into the books of SOMALAC, transferred to other parties, or written off by the government.

Table 4 presents the liabilities of SOMALAC as at April 30, 1990.

While the relevant commercial laws will determine to a great extent the ranking of debt, the Board of SOMALAC, together with representatives of the state, should also determine in advance how accounts are to be handled which are equal before law. One would normally expect taxes and government fees to have first priority; followed by secured debt of commercial banks and other third parties; then, unsecured debt owed to third parties; and finally, the amounts owed to the state in the form of loans.

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[2]For example, Ambatundrazaka is fully operational, but its location does not readily suit it to complementary activities. On the other hand, Amparafaravola requires some investment to become operational, but its compound is conveniently located for complementary agricultural service activities. Manakambahiny requires major investment to realize much of its rated capacity, but it is located at the rail head and has a number of good general purpose buildings. On this basis, one could think in terms of 50%, 25%, and 25% of the total value, respectively, being earned by the sale of Ambatundrazaka, Amparafaravola, and Manakambahiny.

Table 4

Liabilities as of 30/4/90

	FMG '000
Medium and long-term (more than one year)	1,400,000
Medium and long-term (less than one year)	0
Short-term liabilities	595,193
Sub-total	1,995,193
Suppliers	38,614
Personnel	48,223
Social institutions	3,822
State	221,791
Miscellaneous creditors	95,535
Total accounts payable	407,985
Total liabilities	2,403,178

3.0 REAL ESTATE ASPECTS AND OTHER CONSTRAINTS TO SALE OF ASSETS

(Step 5 and 6)

3.1 Step 5: Establish Clear Title, or Identify Liens or Pending Claims Against Real Estate, and Develop Plan to Remove these Latter

During the consultants' investigations, it became apparent that many of the real estate acquisitions during the early period of the SOMALAC monopoly were not formally settled. In some cases, this is a simply matter of recording surveys and titles to bring municipal records up to date. However, there are other cases in which liens and other claims recorded against titles have not been settled, and still others in which separation or consolidation of parcels would be desirable prior to sale.

It is important to note that the consultants see this area as one of the most serious impediments to the sale of EIC assets at the present time. Urgent attention by staff and experts is required if the sale of mills is not to be seriously delayed. There is also the real risk that sale without adequate attention to these issues could result in protracted legal wrangling and major costs to the government.

The results of our inquiry and a summary of the properties included in EIC's balance sheet are presented in Appendix B.

The legal problems which need to be solved by SOMALAC are of two types:

- The first is proof of ownership of the various parcels of land on which EIC plants are located.
- The second concerns the mortgages encumbering the former Murat properties.

3.1.1 Proof of Property Rights of SOMALAC

SOMALAC claims to be the owner of the "Françoise" property as a result of an assignment granted by a Mr. Chatel. In support of its claim, SOMALAC should produce the transfer document, duly registered, enacted with Mr. Chatel. It must be noted as well that the "Service des domaines" (land registry) of Ambatondramaka will not proceed with the transfer of title to SOMALAC without having received a "Certificat de mise en valeur" (certificate of valuation). Once the lien to the property has been recognized, an entry will be made in the land register, and a copy of the relevant page will be delivered to the new owner.

Establishing the title in SOMALAC's name, would officially sanction its right of ownership to the lands of Rizerie III, and would allow it to carry out the disposition of these lands. In effect, the Malagasy legislature makes the title to land permanent and unassailable.

3.1.2 The Mortgages Encumbering the Former Murat Properties

The mortgages taken by the Banque nationale pour le commerce et l'industrie (BCIM) on June 13, 1978 are properly registered and have not been cancelled up to the present day. Consequently, the creditor fully retains the prerogatives conferred on it by the registration of its liens, unless the mortgage has been paid off. In this case, it is always possible to request the release of the mortgage.

As long as the mortgage has not been stricken off, it remains valid. The creditor could always exercise its right of preference and its right of pursuit in the sense that it could seize and force the sale of the assets no matter who holds them, and be paid from the proceeds of the sale in priority over other creditors.

The rights of the owner are thus limited. In effect, a mortgaged building can only be given up with difficulty. Nevertheless, the law allows, among the grounds for dissolution of a mortgage, the following:

- The renouncement by the creditor of this right; this is infrequent in practice, but the creditor may give up a mortgage on a particular building in return for other securities.

- The thirty-year prescription, granted judicially and registered on the title, in accordance with Article 82 of the edict of October 3, 1960.

The mortgages held by the BCIM have not lapsed and remain valid, since they date from June 13, 1978. It would therefore be desirable to verify the present situation in regard to SOMALAC.

Considering the time allotted to the consultants, it was not possible to carry out the investigations necessary for an in-depth analysis of the problems. It would have been particularly desirable, to obtain an inventory of SOMALAC's properties from the "Service des domaines et du Patrimoine Foncier" (land registry and land resources department). The consultants' contribution is, therefore, only a starting point for a more extensive analysis of the problems relating to the real property situation of SOMALAC.

3.2 Step 6: Identify Any Pre-emptive Rights or Other Privileges Which May Have Legal Force with Respect to the Acquisition of EIC Assets

This is primarily an issue with respect to real estate. During this brief study, the consultants identified several incumbrances of this nature. Some of these problems are discussed in greater detail in Appendix B. There is at least one case of a contractual commitment between the ex-manager and his management personnel, on the basis of which a pre-emptive right to acquire the mill at Amparafaravola is now claimed by the former management. While the consultants see no evidence of claims against other types of assets arising from the terms of sale or from subsequent external services, this should be verified by SOMALAC's accounting department before any assets are offered for sale.

As the plans for termination of EIC activities near completion and the GOM prepares to have this fact publicly known, it would be useful to publish a statement of intent to sell assets of EIC as a means of ensuring that any claims are registered prior to sale.

4.0 PERSONNEL ASPECTS

(Steps 7 and 8)

4.1 Step 7: Determine the Status of Personnel, and Their Legal Rights With Respect To Employment and Dismissal

It is critical to the sale of EIC's assets that the rights of each employee be established sufficiently in advance that the financial and administrative requirements of changes, including termination, can be met and disputes minimized. Findings concerning the status and rights of personnel are presented in Appendix C and summarized below.

According to information obtained from the personnel department, the EIC division of SOMALAC currently employs 274 people, of whom 212 are classified "permanent" and 62 are on "contract". The "permanent" employees are those who have a contract with SOMALAC of indeterminate duration. The "temporary" or "contract" employees are under a contract of fixed duration.

The EIC also employs so-called "seasonal" workers. These are often warehouse or truck handlers, who are paid by the ton or by the day. These seasonal workers do not have a written contract, unlike the permanent and temporary employees who are registered and listed on a computer printout. The consultants were unable to determine the number or rate of recruitment of seasonal workers.

The terms of employment for these three categories of employees are, in fact, very different. The consultants analyzed the legal and social implications arising from this situation, to determine the rights of all EIC personnel in the event of lay-offs.

In many cases, the current designation of individual EIC personnel as Permanent, Contractual and Seasonal does not conform to the definitions explicitly or implicitly contained in the "Code du Travail" (labour code) based on the actual pattern of employment. Specifically, the pattern of employment for many contractual and some seasonal personnel qualifies them for treatment as permanent and contractual personnel, respectively. It is this status, together with length of service, which determines the rights of the employee in the event of termination of employment.

SOMALAC should start now to clarify and document the actual terms of employment for each employee by examining individual employment records, comparing them to the actual pattern of employment, and drawing up contracts which reflect actual employment. Inconsistencies in classification and compensation should be removed in the same exercise.

The other important factor in determining the cost of satisfying employee rights on termination is unused vacation time. The large number of EIC's personnel who have unused vacation time poses two potential problems for the enterprise: 1) those who are terminated are entitled to compensatory payment; and 2) those who might be asked to stay

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for a transition period or indefinitely, might choose to take their leave en masse, leaving the enterprise unable to function at a critical juncture.

SOMALAC needs to determine the unused leave of each staff member. In the short term, as a cost control measure, personnel should be instructed to take leave unless their presence is essential to the off-season needs of the enterprise. Personnel needed over the transitional period of EIC operations should be asked to agree to a leave plan drawn up by SOMALAC to prevent critical absences.

4.1.1 Determination of the Rights of Employees in the Event of Lay-offs

The restructuring of the EIC will have important consequences on the employees, notably a reduction in personnel. As well, the Malagasy legislature has acted to protect the rights of employees affected by such an event. A reduction in personnel may occur in two situations:

- In the case of an ongoing enterprise, the employer may be forced to resort to lay-offs in order to restructure the operation. The employer is the judge of what means are necessary to save the business. For example, if a single worker can carry out the functions of two, it is considered legitimate to lay off one of the two.

- In the event of the transfer of an enterprise, any employment contracts remain in effect between the new employer and the personnel of the enterprise. This is the principle of maintenance of contracts set down in Article 27 of the "Code de travail". But this principle, which merely prevents the automatic termination of a contract of employment, does not prohibit the employer, once the transfer has taken place, from dismissing employees in order to reorganize the business.

In the case of EIC, the size and composition of personnel is not appropriate to the nature of the procurement, milling and marketing operations (Ref: diagnostic report). If the enterprise were to continue, the first hypothesis would apply, namely a valid reduction would have to occur.

The decision has been taken to wind up the affairs of EIC. Since the "enterprise" does not legally exist, it cannot be sold; therefore, the second hypothesis does not apply in the strict sense. Nevertheless, it can be concluded on the basis of interviews with prospective buyers of EIC's assets, that none would entertain making an offer if they risked incurring obligations with respect to the present personnel. The consultants therefore conclude (despite the ambiguity of the law with respect to whether it is the old or new owner who is responsible for the cost of dismissal of personnel) that, in this case, SOMALAC must carry out a dismissal and meet the cost of employee rights, as a cost of winding up the affairs of EIC.

While the technical and economic reorganization of the enterprise is considered a legitimate reason for breaking a contract of employment, the employer is required to respect the rules pertaining to dismissal, notably:

- the principle of notice (to the employee),
- the prior notification of the Inspector of Labour,
- severance pay.

Provision for Notice: The terms and period of notice depend on the seniority and the category of the employee (Decree No. 64.162 of April 22, 1964).

1. Seniority

Regardless of the number of years of service in the enterprise, notice of termination is required by the employee or the employer initiating the action. This requirement can neither be removed nor relinquished. Malagasy law has even set the notice required for a period of service of less than 8 days (in this case, 2 hours). Further, the law does not require that the period of service be continuous. The varying length of notice is thus a function of the employee's loyalty to the enterprise.

The seniority of EIC personnel varies between 7 months and 27 years. Eighty percent of the current employees have between 7 and 27 years of service with SOMALAC. Table 5 shows the results of the survey carried out by the consultants regarding the length of service of certain EIC employees.

2. Professional Categories

The EIC's personnel is classified by departments known as "cost centres". The majority of the personnel consists of production personnel, falling into the category of labourers, who work in the production, warehousing and shipping departments of each plant. The remainder of the employees are attached to the head office and to the administrative departments.

Presently, the salaries of SOMALAC's personnel follow a scale based on an index corresponding to each professional category. The personnel may be classified into the five professional groups defined by the Decree of April 22, 1964. Table 6 presents the required notice of dismissal (Article 3 of Decree 64.162), according to the five categories of workers.

Table 5

Sample of Length of Service of EIC Employees

1)	**Management Personnel** ("B" and "C" level cadres) (Acronyms in parentheses refer to the French names of the departments)	
	• Head of administration and accounting department (SAC)	14 years
	• Head of administrative office (SAC)	19 years
	• Head of credit and planning department (SAC)	7 years
	• Head of paddy purchasing department (SAP)	28 years
	• Head of section (SAP)	16 years
	• Head of national sales department (SVN)	18 years
	• Controller of purchases (SAP)	27 years
	• Head of technical division, production department (SPI)	18 years
	• Foremen (SPI 1)	20 to 25 years
2)	**Supervisors and Administrators**	
	• (OPS - OP28 - 5A)	6 to 25 years
3)	**Production Personnel**	6 to 24 years

Table 6

Notice According to Seniority and Professional Group

Seniority in the enterprise	Professional Group 1	2	3	4	5
Less than 8 days	2 hours				
Less than 6 months	1 day	8 days			
Less than 1 year	8 days	15 days	1 month	1.5 months	3 months
More than 1 year	10 days	1 month	1.5 months	2.5 months	4 months
More than 3 years	Additional 2 days per year of service				
More than 5 years	Additional 2 days per year of service, up to an overall limit of: 1 month	1.5 months	2 months	3 months	6 months

Prior Notification of the Inspector of Labour: In the event that an economic and technical reorganization results in lay-offs, Article 38 of the Labour Code requires the employer to give prior notice to the Inspector of Labour and to draw up the list of affected personnel in consultation with the delegates, if any, or personnel representatives. The order of dismissal must take into account, within each professional category, the following criteria:

1) length of service in the enterprise,

2) professional merit (technical competence and conscientiousness),

3) family responsibilities.

As regards professional merit, the incompetence of an employee constitutes, in principle, a valid motive for dismissal, notably when the employee's output is inadequate or he/she is manifestly incapable of fulfilling the assigned functions. The assessment of an employee's job performance is left entirely to the discretion of the employer. The use of this provision to improve the performance of the enterprise is not excluded.

Severance Pay: Under the terms of Article 36 of the Labour Code, unless more favourable provisions are made in an individual contract or collective agreement, any worker laid off as a result of a reduction in personnel or cessation of operations is entitled to a severance payment calculated as 5 days of salary for each complete year of service, subject to a maximum of 3 months' salary.

The legal problem which confronts public enterprises like SOMALAC is determining who will take responsibility for severance payments. In the present case, the consultants have assumed that unless SOMALAC (and, more generally, the state) accepts responsibility for dismissal of employees, it is unlikely that EIC's assets will be sold, except by liquidation.

In any case, no matter what legal structure succeeds SOMALAC, the personnel presently employed by EIC and the other divisions will benefit from the provisions of the labour code.

4.2 Step 8: Identify the Facilities Available to Personnel for Retraining or Other Forms of Reentry, and Develop a Program for Notification, Dismissal and Assistance

To help people affected by the impact of the liberalization policy of state enterprises, the state has created a Program of Social Actions and Support to Economic Management (PASAGE). This program comprises a redeployment fund and a fund for reentry and retraining for employees of public enterprises included in a list drawn up in advance by the Malagasy government together with the World Bank. To the consultants' knowledge, the list of enterprises benefitting from these funds has not been officially published. The responsibility for deciding which enterprises will be eligible for the PASAGE program lies with the Treasury, based primarily on the financial situation of the enterprise concerned.

To the extent that SOMALAC personnel might be eligible for PASAGE assistance, and a situation may arise requiring the settlement of workers' rights (severance pay, notice, paid vacations), SOMALAC will need to draw up a detailed list of the potential beneficiaries with a breakdown of their entitlements.

SOMALAC should also consider setting up assistance programs of a less formal nature, including such practical elements as:

- Special Leave for employment interviews;
- a reference desk for information on prospective employment opportunities;
- information on training opportunities;
- credit, investment and technical information for those considering pursuing their own enterprise;
- interlocutor service between laid-off personnel and employers and lenders;
- preferential sale of EIC assets to personnel demonstrating the ability to make effective use of them.

5.0 ADMINISTRATION OF THE SALE OF ASSETS

(Steps 9 to 21)

5.1 Step 9: Identify Lots of Assets for Sale, and the Policy with Respect to Breaking Up Lots

In recognition of the fact that the greatest value would be realized if EIC assets were sold on a going-concern basis, the three rice mills represent the three basic lots of EIC assets.

Each rice mill can be considered to have equipment, land and facilities that are essential to its operation; some that are desirable to its operation under different sets of conditions, and some that are not useful for its operation. In other words, there is a core of land, civil works and equipment that must remain together if the going concern principle is to be respected in sales efforts. There is also room for discretion on the part of the buyer and seller with respect to other assets presently assigned to these mills. Examples would include vehicles, administrative and residential buildings, and redundant equipment.

One should be prepared to defer to the interests of the buyer in the final composition of lots of assets. However, the process of grouping of assets should begin well before sale, and could be accomplished as follows:

a) The Accounting Department of SOMALAC should take the list of EIC assets, as revised and revalued in late 1990 by Rindra, and divide them into four groups: three groups for those assets located in or near each of the three mills, and one group for assets associated with EIC or SOMALAC headquarters.

b) The Technical Director of EIC, together with other senior specialists, should verify the list for each mill, and designate each asset as either essential, optional, or of un-related status, based on the continued operation of the mill.

c) These lists should then be returned to SOMALAC's Directorate General to permit SOMALAC to keep track of all assets during the sales period.

d) These lists should also be given to prospective buyers, to enable them to identify the items available for sale in a particular lot, to serve as a basis for counter-proposals by bidders.

These lists need not contain values, but some technical description would be useful.

5.2 Step 10: Establish Acceptable Terms of Sale

Typically, the terms to be settled in a sales transaction include price, value to be paid on date of contract, interest and period to apply on payment of the balance of the purchase price, security offered by the buyer in respect of the deferred portion of the purchase price, responsibility for incidental expenses relating to the sale, and the timing and conditions for transfer of title for the concerned assets.

In the case of EIC assets, there are several terms of sale to be considered: understandings with respect to the removal of assets not sold as part of mill lots; the impact of the proposed operations on the employment and agricultural production aspects of the regional economy; the distribution of equity in the assets among local and national communities. In general, these terms are of two types: those that affect the efficiency of future exploitation of the assets, and those that are of a socio-economic nature. If the sales effort is to be successful, and the evaluation of bids is to be fair, these factors should be considered ahead of time, and criteria should be set to determine acceptability of offers.

Price — Set lower limits for lots, based on the information obtained in Step 4. Take into account market conditions at the time of sale, and the political and labour uncertainties of the region in setting these limits.

Down Payment — Since most of the liabilities to be paid out of the proceeds of the sale are sunk costs, cash on date of sale is not as critical as it would be if the liabilities were comprised of debts that still had a regular service schedule. Therefore, the question of down payment should be treated primarily as an indication of capability and good faith on the part of the bidder. The state should also bear in mind that liquidity is a limiting factor in investment in Madagascar today. Down payment expectations should therefore be modest to reduce the risk that a qualified buyer might subsequently experience a working capital shortage.

Finance Terms — These terms, particularly the rate of interest, should not differ from prevailing rates in the financial sector. Setting special credit terms complicates the management of the financial sector, creates privileged classes of borrowers and transactions, and generally leads to inefficient resource allocation. If the state wishes to create an incentive for the sale of these assets, flexibility in setting the price or down payment would be more appropriate.

Collateral — Chattel or real estate mortgages on the assets in question should be the minimum security required for term financing. It may also be appropriate to ask for a lien on other assets of the buyer, depending on the nature of the buyer's business and the sale price agreed upon in relation to the estimated value of the assets.

Incidentals — Such costs as title search, deed registration, vehicle registration, land surveys, final inspection of facilities prior to taking possession, and legal services may be required for each sales transaction. The authorities responsible for the sale should have identified these, in advance, and determined how they wish to have them met. This may become a matter of negotiation, but incidental costs should be explicitly recognized by both parties.

Titles — Establish when, and under what conditions the title to assets will be transferred to the buyer. This will depend on the nature of the assets and the terms of sale. However, conditions must be clearly set out at the time of sale.

5.3 Step 11: Establish Criteria and Procedures for the Evaluation of Offers

The consultants recommend that the criteria for evaluating bids for mill packages include the following:[3]

- price;
- suitability of the grouping of assets being bid;
- conditions proposed with respect to purchase;
- proposed transition, with attention on minimizing the disruption of purchasing, milling and marketing operations;
- proposed terms of payment;
- credit worthiness of the bidder;
- experience of the bidder in rice milling;
- bidder's knowledge of Lac Alaotra;
- impact of bid on employment in the region;
- impact of the bid on market opportunities for rice growers in the region;
- impact of the bid on the distribution of ownership of assets in the region by locals, nationals, and others; and
- impact of the bid on the well-being of competent personnel of the enterprise

[3]Criteria for smaller lots of independent assets such as vehicles or scrap steel should be much simpler, focussing on price and the credit worthiness of the bidder.

The procedure for evaluation will depend, to some extent, on the method of soliciting buyer interest (see Step 13). If competing bids are invited, a means of comparison will be required. If individual offers and direct negotiation are to be accepted, then the evaluation bids must be judged against set standards with respect to each of the above factors. In either case, those responsible for the sale must decide, in advance, the relative importance of each of the factors, and the minimum value or conditions required for each factor. The best way to formalize this process is to develop an evaluation sheet which lists these factors. Their relative importance is then expressed as a percentage of the total possible points that could be awarded to a bid. Those responsible for evaluation can assign values to a bid on the basis of how well it responds to the expectations for each factor. The bid with the highest combined value would become the "Best Evaluated Bid".

Whether or not this evaluation sheet is actually used to compare competing bids, it will serve to guide the evaluation of any given purchase proposal. It will also help identify the factors on which counteroffers should be based, if original offers are not entirely acceptable.

Another important aspect of the selling process is determining who will be responsible for the analysis and evaluation of bids, and who will make recommendations to the state concerning acceptance, rejection or counteroffers. The present team is not prepared to make recommendations on this issue; however, officials should take into consideration the potential buyer's competence in the business of rice milling and trade, and familiarity with the assets in question.

5.4 Step 12: Identify Team of Specialists Charged with Facilitating the Sale

The legal, administrative and marketing aspects involved in selling EIC's assets will require substantial effort and special skills. Despite best intentions, SOMALAC's management and Ministry personnel will not be able to accomplish these tasks within a reasonable time frame while performing their regular duties.

The consultants recommend that the representatives of the Board of SOMALAC and the Ministry form a Steering Committee, together with representatives of other agencies responsible for implementing the liberalisation strategy. This Committee would ensure the adoption of an implementation plan and assign tasks to competent officials.

The work which falls outside the normal scope of SOMALAC's staff and the Ministry should be assigned to a special Task Force consisting of two or three full-time specialists working with the administrative and managerial personnel of SOMALAC and EIC. If the implementation plan is to be accomplished within a reasonable time frame, a timetable should be adopted at the outset and include specified dates for decision making by authorities who are not part of the Steering Committee or the Task Force.

5.5 Step 13: Identify Decision Making Authority and Processes

It is not the present team's intention to make recommendations concerning the decision making authority for sale of EIC assets. Useful precedent will be found in the recent sale of other public enterprise assets in the agricultural sector, but whatever the composition of the decision making panel, guidelines should be clearly established before the selling process begins. This will minimize delays and convey an impression of purpose and clarity to instill prospective buyer confidence.

There are additional reasons to set out the decision making process before selling begins. Each participant will know ahead of time what is expected of him/her, the scope of their discretion and responsibility, and the time frame in which they are to act. Buyers will also take the prospect of acquiring EIC assets more seriously if they see that the decision making process has been well planned.

5.6 Step 14: Establish Means of Offering for Sale

Word-of-mouth concerning the pending sale of EIC assets has already resulted in some expressions of interest by prospective buyers. However, a more formal process should be considered to ensure that most serious prospects are given the opportunity to bid. On the other hand, the consultants do not recommend the use of an open competitive bidding process for the sale of all lots. In fact, some serious buyers choose not to enter an open competition, preferring to deal individually with authorities.

The consultants recommend the following general approach:

i) Formal competitive bidding, whether in writing or at auction, should be used for the sale of assets which have a generally recognized value, and for which there will be few or no sales contingencies. This would be the case for vehicles, scrap or surplus steel and building materials, land, and individual pieces of milling or shop equipment.

ii) Individual solicitations of interest should be used for the sale of the rice mills. Identify six to ten prospective buyers, write to them inviting expressions of interest, and pursue the most encouraging responses on a personal basis. (A representative of the state and SOMALAC should be designated for this purpose.) To minimize criticism, authorities should provide the same letter of invitation and the same follow-up information to any serious enquirer not on the original mailing list.

Before any approach is adopted, authorities should confirm that it conforms to general regulations concerning the disposal of state-owned assets.

5.7 Step 15: Identify Sources of Financing That May be Available to Prospective Buyers

Typically, it is the responsibility of the bidder to locate financing and to present the best portrayal of credit worthiness. However, the rice mills of EIC are not readily saleable as they stand, in view of their performance history and the risks associated with labour, paddy supply and local political intervention. Therefore, in order to effect a satisfactory sale, it may be necessary for the seller to help locate financing for the bidder. This assistance will be less critical in the sale of lots of assets such as vehicles and surplus equipment. However, in this case, the seller should be aware of sources of financing to be able to confirm a buyer's declarations about his/her source and cost of capital. The seller should also facilitate the sale by promptly providing any documentation required by the buyer's creditor.

5.8 Step 16: Solicit Offers

Implement the solicitation plan adopted in Step 14.

It may be difficult for authorities responsible for this process to recognize that they are, in fact, performing a marketing task. The inclination will be to defend the property of the state against exploitation, but this could be fatal to the sales effort. Newspaper and other public announcements for the sale of independent assets should provide enough information to assist prospective buyers to decide whether or not to respond. Letters concerning the mills should be sufficiently candid about operations and conditions to convey the serious intent of the seller to enter into negotiations on an individual basis. Follow-up to responses should be informative, and authorities should be readily accessible to prospective buyers.

Announcements should contain dates by which responses are requested, and should identify how additional information can be acquired.

5.9 Step 17: Conduct Evaluation Process

Implement the evaluation process adopted in Step 11.

5.10 Step 18: Negotiate Sale with Selected Bidder, Including Effective Dates and Terms of Sale

Effective dates and transition arrangements for the rice mills will be critical to avoid any loss during the harvest collection period (May to about October). This means not only that the owner's control of the facilities needs to be unencumbered during that time, but other dates must also be anticipated. For example, credit applications for funds to buy paddy need to be submitted before the end of December of the preceding year. The creditor will need proof of the rights and capacity of the applicant to operate the mill to repay that credit the following season. SOMALAC may be required to provide documentary evidence of negotiations in process or, in fact, execute a contingent lease of the mill in question to satisfy the lending agency.

5.11 Step 19: Obtain Formal Approval for the Proposed Sale

Implement the decision making process adopted in Step 14.

5.12 Step 20: Establish Transitional Arrangements, Particularly with Respect to Use of Assets and Provisions for Security

Reference has been made in Step 18 to the importance of transitional arrangements for both the buyer and the seller. Avoiding losses during the harvest collection period is one element to be considered in planning the transition. Two other elements to be considered include the need to stipulate responsibility for each of the many administrative and documentary steps, and the financial cost of delays in executing formalities once financial commitments have been made.

5.13 Step 21: Complete Legal Documentation, and Satisfaction of Conditions Precedent

With reference to the issues raised under **Step 5**, it is useful to emphasize the importance of registering the transfer of titles once a sale has been completed, as well as any liens that may be offered as part of the financing for the sale.

5.14 Step 22: Complete the Transfer or Liquidation of EIC Assets not Sold as Part of Mill Complexes

Independent assets can be sold individually or in small lots. For vehicles, authorities should make sure the title is available for inspection on the date of sale. Unsold assets should be transferred to the balance sheet of another SOMALAC enterprise, to the Directorate General, or to another public enterprise which may have a need for the particular item. In this latter case, the transfer price should be book value or less, since there is evidently no market for the asset in question.

6.0 DEVELOPING A MANAGEMENT CONTRACT FOR UNSOLD MILLS

6.1 Introduction

In the event that any of the rice mills do not attract a suitable buyer, the government has decided to exercise the option of entering into a management contract with a private sector party for the operation of that mill. This arrangement could also be effective as a transition measure in the event that a mill must be operated for one or more harvest collection periods while sale formalities are completed.

In this section, the consultants set out the process which should be followed to enter into such an agreement and the elements of the agreement. It should be noted that many of the preliminary measures required for the sale of assets, also apply to management contracts. A firm contracting to operate a facility will need to know what its rights are with respect to the management of real estate and personnel. In addition, the assets must be correctly identified and valued if financial compensation for the managers is to be related to the effective exploitation of those assets. A correct list of assets is also essential for physical inventory control purposes.

The advantage of a management contract lies in the ability of technically and managerially strong managers, whose objectives are unambiguous, to improve the financial and physical performance of the enterprise. It is therefore important to clarify the role of the Industrial and Commercial Division (EIC) and the performance of the Board prior to negotiations. Similarly, the relationship to other SOMALAC enterprises should be stipulated. A final set of accounts should be prepared as close to the date of the contract as practical, so that the potential contractors will be aware of the base line from which their performance will be judged. This preliminary work is discussed in further detail below. A draft "Invitation to Bid" is presented in Appendix D.

6.2 Preparatory Work Required Prior to Award of Contract.

The following factors deserve special consideration prior to negotiating a management contract:

1. Definition of the Role of EIC

   Although not directly mandated, EIC has followed the practice of purchasing its paddy at or above the announced floor price or the prevailing price, whichever is higher, and selling its rice at or near the announced intervention price, despite higher prices in the open market. Neither of these practices is conducive to sound commercial management of EIC's assets. Of late, EIC has been unable to procure enough paddy to operate its mills at reasonable capacity. Further, with low selling prices, it has been unable to maximize its revenues. If financial performance is to be a factor in assessing the contracted management, the government must permit the contractor to operate along commercial lines, with a minimum of interference

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regarding purchasing and selling prices. Only then, will the contracted management be able to obtain the expected level of profits.

It should be noted that EIC moved closer toward commercial considerations during the last harvest collection period. The remaining issues are more administrative than philosophical. In either case, autonomy in day-to-day price setting will be essential to sound performance.

2. Providing Current, Accurate Accounts

It is imperative that prior to awarding a management contract, both SOMALAC and the contractees are aware of the exact financial standing of EIC. Failure to take this important step will make it difficult to measure the performance of the contractees, and possibly lead to ongoing disputes. It is recommended that the prospective contractee engage an independent accountant or auditor to verify the accuracy and methodology of the EIC accounts. The revised list of assets being prepared by Rindra should likewise be available to the contractee prior to negotiations.

3. Establishment of Clear Responsibility and Authority

As owners of the EIC assets and as developers of the region, SOMALAC and the state would continue to have an interest in how the mills are run. However, this interest must be expressed in the context of agreement to overall operating strategies and annual work plans and budgets. Contract managers must have complete freedom to operate the mills within those guidelines.

Communication should be facilitated by appointing the senior representative of the management team as an ex officio member of the Board of SOMALAC.

4. Planning How to Compensate For Poor Financial Condition

EIC is financially weak. Even with separate legal identity, it may be unable to raise adequate funds to purchase the paddy required to operate its mills at efficient levels. If the mills are to operate efficiently, SOMALAC and, perhaps, the government will probably need to act as Borrower and Guarantor or, in fact, provide additional capital in the form of a short-term loan in the first year.

5. Providing For the Availability of Foreign Exchange

Management will seek assurances of adequate and timely availability of foreign exchange to ensure the importation of necessary spare parts and equipment. As an alternative, the government could agree to the export of some rice; the proceeds would be deposited to the enterprise's account and made readily available to the management for operating needs.

6. Making Difficult Organizational Decisions

Staff reductions will be essential, and it would not be appropriate to leave this difficult task entirely to the new management. In general, such actions should be taken prior to the transfer of management responsibility, to enable the incoming team to focus on current and future operations.

7. Care and Maintenance of Equipment and Facilities

It is important to discuss this expense item in detail during negotiations, as it is a potential source of abuse and disagreement. A satisfactory arrangement would include agreement on the following: an annual operating budget which includes a maintenance provision; criteria to be used to determine when unscheduled maintenance is required; a list of equipment requiring repair or investment at the time of contract negotiation; and independent inspection of equipment and facilities from time to time by a representative of the Board.

6.3 Elements of the Management Contract

The specific content and format of the management contract will be determined by Madagascar law and the results of negotiations between SOMALAC and the management entity. However, to ensure optimum results from this relationship, there are a number of elements which should be included in the contract.

1. Statement of Purpose and Scope of Contract

This statement will define the intent of the contract. While more detail will appear in subsequent sections, it should set the spirit of the agreement which can be used to govern the interpretation of other clauses, and for communication with third parties as to the nature of the relationship between the Board and managers.

2. Activities to be Managed

This section should identify the operational and support activities of EIC for which management is being contracted. For example, these activities may include the purchase of paddy in designated areas, the transport and stocking of that paddy, and operation of the mill(s) at (identify location), the latter to include ancillary equipment and facilities associated with that mill, and finally to market the resulting rice and byproducts (within the limits set out in point 5, below).

Responsibility and authority will be subject to the restrictions set out in the agreement (see point 5, below), and are subject to compliance with other contracts that are binding on the enterprise at the time of the agreement.

3. Key Personnel and Other Inputs to be Provided by Managers

Although the contract should be based principally on output performance, it should identify key personnel and other basic inputs, and stipulate how SOMALAC's views will be sought on future additions or replacements.

4. Financial Resources Available for Operations

Ideally, the contract would identify lines of credit, other short-term financing, and additional equity and term credit available to the managers for the enterprise's working capital and investment needs. If this is not possible, there should be a statement outlining SOMALAC's responsibilities to assist in securing external financing, and the fact that performance clauses in the contract are contingent upon the availability of adequate capital.

5. Authority and Reporting Relationships

Authority delegated to the managers should be specifically described in at least the following areas:

i) The document on which authority is based should be identified - usually this will be an annual budget and work plan approved by the Board.

ii) Authority to contract with third parties for the purchase of materials and supplies, the purchase of capital goods, the sale of outputs, the purchase and sale of services (including labour negotiations), and authority to incur debt for general operating purposes and to invest surplus funds. It is unlikely that the Board would delegate unlimited power in these respects, but the limits should be stated.

iii) Authority to employ, terminate and alter the compensation of personnel. Again, the limits of this authority should be stated. It will be in the interests of the contracting parties to address the problem of the level and quality of personnel prior to signing the contract.

iv) Arrangements for routine reporting to the Board and the Director General, frequency of meetings with the Board, process for resolution of disputed decisions, frequency of review of the work plan and budget.

6. Performance Targets

Performance targets should be readily measurable, and they should be related to the goals of the enterprise as stated in the contract. Two aspects should be identified: 1) basic targets, and 2) increments above or below those levels for which premiums or penalties will apply. Basic performance targets should be specifically stated in the contract.

7. Monitoring and Reporting Arrangements

This element may be adequately covered under authority and reporting relationships (see 5 iv, above). However, the agreement should state the scope and frequency of reports to be submitted by managers to the Board; the manner in which questions and concerns arising from these reports are to be handled; and, conversely, the Board's obligations to report any developments of concern to the managers of the enterprise. The management company should be allowed to have a qualified representative examine any components of SOMALAC's accounts which affect the financial statements of the EIC facilities being managed.

8. Compensation

To realize the greatest benefits from a management contract, the Board should insist on a compensation package that is based at least, in part, on performance. However, managers interested in bidding for an EIC contract will recognize that the enterprise's performance is not entirely dependent on the quality of their efforts. They will usually insist on the payment of most costs, irrespective of performance. It is therefore likely that the management contract will have a three-part compensation formula: personnel costs, other reimbursable costs, and performance-related payments.

i) Personnel costs

These will include related costs such as travel, accommodation, and non-salary benefits. This is to be a reimbursable item, so it should be defined in detail in the agreement. To the extent that the new managers substitute for personnel of the enterprise, this is a replacement cost. However, in most cases, the level of effort and the level of skills will result in a significant net increase in the cost of management personnel for the enterprise. The justification will lie in improved financial performance.

ii) Other reimbursable costs

This will normally be a relatively small category which will include facilitating expenses such as local transportation, communications, contract administration and headquarters support of the management team.

iii) Performance-related payments

These payments will be based on the performance factors set out in the contract and discussed in 6, above. In the three-part compensation formula, they represent the profit element for the managers. The performance element should begin only above a base level of performance, and it may be appropriate to have one or more break-points in the rates of payment.

The compensation clauses should also set out the timing and method of payment.

9. Duration

There are three considerations in determining the appropriate duration of a management contract for EIC facilities:

i) The level of effort and extent of preparatory activities. Management firms will not be interested in a contract that does not provide adequate time to recover the up-front costs incurred in negotiating and starting up the work. If it is to be a caretaking arrangement for a year pending sale, a comprehensive proposal should not be solicited. Otherwise, a three-year period should be the minimum. Provisions should be defined whereby either party can terminate the agreement for non-performance of the other party during the three-year period.

ii) Condition of the enterprise. If the purpose of the contract is to effect significant change in the condition of the facilities being managed, the duration of the contract will need to be longer than if the contract is a caretaker arrangement for an enterprise that functions well.

iii) The compensation arrangements. If the payment formula includes a major performance component, and a period of time is necessary to improve the performance of the enterprise, the managers will insist on a contract of longer duration. As the results of their efforts begin to show on the books of the enterprise, they will be financially rewarded despite the lack of profits in the early years. In view of the intent to phase out the operations of SOMALAC and, in particular, the activities of EIC, this approach is not advised. The performance element of compensation should not be based on a factor which will be slow to recover such as net income, but rather on factors such as volume of paddy processed or income from current operations which are quick to respond to improved management.[4]

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[4]Other specific performance indicators could include:

- quantity of paddy purchased, the market share from Lac Alaotra, and the annual rate of growth in purchases;
- quantity of rice sold, the average sales price, and the annual rate of growth;
- the extraction rate, the milling capacity utilization and the down-time at each mill;
- the quantity and quality of each type of rice produced and its average selling price;
- the reduction in staff;
- the annual increase in profit with return on equity improving to ---% by 199-;
- the annual improvement in the current ratio (current assets to current liabilities).

10. Remedies

Finally, both parties to the management agreement need to recognize that, even with the best of intentions and ability on both sides, events will not always go according to plan. The contract should set out the circumstances under which each party is entitled to seek either a change in the conduct of the other party or the amendment, suspension or cancellation of the contract. These clauses are important in themselves, but they are also a good exercise to ensure that the Board, the Ministry and the managers have thought through the types of contingencies that may arise during the course of the contract.

APPENDIX A

EIC

FINANCIAL DATA AND PROJECTIONS

The condition of EIC, as of April 30, 1990, is presented in Table 1 of this Appendix, and the results of its operations in the 1989/90 season appear in Table 2, page 5. To prepare financial projections for the purpose of estimating the value of EIC assets, the following approach was taken:

i) Convert 1989 performance to a 1990 projection using 15,000 tons of paddy and the cost projections of the Directorate General.

ii) Do the same using the projections of EIC which provide the breakdown of fixed and variable costs.

iii) Prepare definitive 1990 projection based on reconciliation of i) and ii).

iv) Revenue projections were based on the product yield mix of 1989 and prices of 1989 + 30%, which is equivalent to the 1990 price trend that was in effect during the field work of the present team.

v) Assumptions concerning discount rate and risk factors are presented in the text.

The reader may wish to note that the discount rates believed to be realistic are sufficiently high that flows beyond 10 years have little effect on present value. In the interests of expediency, the consultants have assumed no reinvestment during the ten-year period and, correspondingly, no residual value at the end of the period. The combined effect of these assumptions on NPV would be negligible using a 35% discount rate.

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Table A-1

SOMALAC - EIC

Balance Sheet 1987/88, 88/89 and 89/90 - Assets

	30/4/90 Gross	30/4/90 Depreciation/ reserves	30/4/90 Net	30/4/89 Net	30/4/88 Net
FIXED ASSETS					
Preliminary expenses	17,528	17,528	0	0	0
(Externally financed)	224,900	145,067	79,833	104,993	112,998
Equipment and tools	114,511	41,310	73,201	84,652	96,103
Transport equipment	110,389	103,757	6,632	20,341	16,895
(Self-financed)	1,368,389	1,207,715	160,674	369,096	564,705
Former Murat property	109,553	109,553	0	0	0
Former RIZAM property	35,250	35,250	0	0	0
Land	11,750	0	11,750	11,750	11,750
Buildings	69,001	54,846	14,155	15,825	17,494
Equipment and tools	341,073	241,972	99,101	123,393	130,043
Transport equipment	769,570	740,252	29,318	208,724	397,397
Fixtures	13,025	13,025	0	0	0
Office furn. and equip.	10,140	7,294	2,846	4,616	3,794
Home furnishings	7,120	5,523	1,597	2,881	3,320
Constr. work in progress	1,907	0	1,907	1,907	907
Total Fixed Assets	1,610,817	.,370,310	240,507	474,089	677,703
CURRENT ASSETS					
Inventory and in process	43,276	43,276	0	0	0
Supplies	290,000	0	290,000	291,268	364,866
Fuel and lubricant	6,290	0	6,290	14,882	25,304
Spare parts	187,782	0	187,782	127,823	334,245
Construction material	26,399	0	26,399	32,956	0
Miscellaneous supplies	69,412	0	69,412	111,486	0
Twine	117	0	117	4,121	5,317
Packaging	329,676	119,043	210,633	141,594	184,642
Finished products	218	4	214	149	31,365
Byproducts	4	4	0	0	28,357
Advances	0	0	0	16,521	0
Long-term receivables	458,943	174,102	284,841	305,243	618,129
Clients/tied accounts	96,117	0	96,117	103,694	404,443
Doubtful clients	336,042	174,102	161,940	164,454	0
Social institutions	0	0	0	0	0
Personnel	12,204	0	12,204	22,077	13,845
State	14,580	0	14,580	15,018	199,841
Local government	0	0	0	0	0
Miscellaneous receivables	216,606	123,009	93,597	64,804	97,581
Misc. accounts receivable	58,719	0	58,719	29,844	84,419
Doubtful accounts receivable	157,887	123,009	34,878	34,960	13,162
Liquid assets	16,461	0	16,461	19,982	1,042,639
Securities	0	0	0	0	0
Bank deposits	12,969	0	12,969	10,984	1,004,413
Cash	3,492	0	3,492	8,998	38,226
Internal transfers	0	0	0	0	0
			0		
Total Current Assets	1,355,184	459,438	895,746	839,561	2,367,579
Accrued assets	785	0	785	721	0
			0		
Grand Total	2,966,786	1,829,748	1,137,038	1,314,371	3,045,282

Table A-2

SOMALAC - EIC

Balance Sheet 1987/88, 88/89 and 89/90 - Liabilities

LIABILITIES	30/4/90	30/4/89	30/4/88
Equity			
Capital stock	733,030	687,757	410,658
Endowment fund	0	0	0
Reserves	522,343	535,274	1,117,932
Carry-over	0	0	0
Operating result	152,483	(707,273)	(1,612,655)
Grants for equipment	58,004	859,756	905,381
Against inventory	22,390	22,390	157,201
Against fixed assets	0	0	141,292
Reserves for risks/expenses	22,390	22,390	15,909
Reciprocal accounts	0	0	0
Initial contribution	(2,021,559)	(2,045,087)	(1,802,626)
With CEN	(749,131)	(749,131)	(749,131)
With EIP	(1,514,343)	(1,440,306)	(1,063,459)
With EAE	67,019	84,903	(17,396)
	174,896	59,447	27,360
DEBTS			
Funded debt			
Med. and long-term (more than 1 year)	1,995,193	2,286,000	3,776,167
Med. and long-term (less than 1 year)	1,400,000	1,400,000	2,000,000
Short-term	0	600,000	1,276,611
Bank credit	595,193	286,000	499,556
Bank overdrafts	286,000	286,000	499,556
Bank debts	60,580	0	0
Internal transfers	248,613	0	0
Advances	0	0	0
Operating debt	0	0	0
Accounts payable	312,450	304,138	443,421
Personnel	38,614	13,547	112,643
Social institutions	48,223	39,593	34,588
State	3,822	4,012	4,012
Miscellaneous debts	221,791	246,986	292,178
Miscellaneous creditors	95,535	59,171	59,244
Other creditors	95,535	49,453	49,526
	0	9,718	9,718
Total Debts			
Accruals	2,403,178	2,649,309	4,278,832
	0	0	1,215
Grand Total			
	1,137,039	1,314,369	3,045,280

Table A-3

SOMALAC - EIC

Balance Sheet - % of Total Assets

	30/4/90	30/4/89	30/4/88
FIXED ASSETS			
Preliminary expenses			
(Externally financed)	7.0%	8.0%	3.7%
Equipment and tools	6.4%	6.4%	3.2%
Transport equipment	0.6%	1.5%	0.6%
(Self-financed)	14.1%	28.1%	18.5%
Former Murat property	0.0%	0.0%	0.0%
Former RIZAM property	0.0%	0.0%	0.0%
Land	1.0%	0.9%	0.4%
Buildings	1.2%	1.2%	0.6%
Equipment and tools	8.7%	9.4%	4.3%
Transport equipment	2.6%	15.9%	13.0%
Fixtures	0.0%	0.0%	0.0%
Office furn. and equip.	0.3%	0.4%	0.1%
Home furnishings	0.1%	0.2%	0.1%
Const. work in progress	0.2%	0.1%	0.0%
Total Fixed Assets	21.2%	36.1%	22.3%
CURRENT ASSETS			
Inventory and in process	0.0%	0.0%	0.0%
Supplies	25.5%	22.2%	12.0%
Fuel and lubricant	0.6%	1.1%	0.8%
Spare parts	16.5%	9.7%	11.0%
Construction material	2.3%	2.5%	0.0%
Miscellaneous supplies	6.1%	8.5%	0.0%
Twine	0.0%	0.3%	0.2%
Packaging	18.5%	10.8%	6.1%
Finished products	0.0%	0.0%	1.0%
Byproducts	0.0%	0.0%	0.9%
Advances	0.0%	1.3%	0.0%
Long-term receivables	25.1%	23.2%	20.3%
Clients/tied accounts	8.5%	7.9%	13.3%
Doubtful clients	14.2%	12.5%	0.0%
Social institutions	0.0%	0.0%	0.0%
Personnel	1.1%	1.7%	0.5%
State	1.3%	1.1%	6.6%
Local government	0.0%	0.0%	0.0%
Miscellaneous receivables	8.2%	4.9%	3.2%
Misc. accounts receivable	5.2%	2.3%	2.8%
Doubtful accounts receivable	3.1%	2.7%	0.4%
Liquid Assets	1.4%	1.5%	34.2%
Securities	0.0%	0.0%	0.0%
Bank deposits	1.1%	0.8%	33.0%
Cash	0.3%	0.7%	1.3%
Internal transfers	0.0%	0.0%	0.0%
Total Current Assets	78.8%	63.9%	77.7%
Accrued assets	0.1%	0.1%	0.0%
Grand Total	100.0%	100.0%	100.0%

Table A-4

SOMALAC - EIC

Analysis of Assets

	30/4/90	------30/4/90- 4/90-----	
	Gross (1)	Depreciation/ Reserves (2)	Net (3)
FIXED ASSETS			
Preliminary expenses	0.6%	100.0%	0.0%
(Externally financed)	7.6%	64.5%	35.5%
Equipment and tools	3.9%	36.1%	63.9%
Transport equipment	3.7%	94.0%	6.0%
(Self-financed)	46.1%	88.3%	11.7%
Former Murat property	3.7%	100.0%	0.0%
Former RIZAM property	1.2%	100.0%	0.0%
Land	0.4%	0.0%	100.0%
Buildings	2.3%	79.5%	20.5%
Equipment and tools	11.5%	70.9%	29.1%
Transport equipment	25.9%	96.2%	3.8%
Fixtures	0.4%	100.0%	0.0%
Office furniture and equip.	0.3%	71.9%	28.1%
Home furnishings	0.2%	77.6%	22.4%
Const. work in progress	0.1%	0.0%	100.0%
Total Fixed Assets	54.3%	85.1%	14.9%
CURRENT ASSETS			
Inventory and in process	1.5%	100.0%	0.0%
Supplies	9.8%	0.0%	100.0%
Fuel and lubricant	0.2%	0.0%	100.0%
Spare parts	6.3%	0.0%	100.0%
Construction material	0.9%	0.0%	100.0%
Miscellaneous supplies	2.3%	0.0%	100.0%
Twine	0.0%	0.0%	100.0%
Packaging	11.1%	36.1%	63.9%
Finished products	0.0%	1.8%	98.2%
Byproducts	0.0%	100.0%	0.0%
Advances	0.0%		
Long-term receivables	15.5%	37.9%	62.1%
Clients/tied accounts	3.2%	0.0%	100.0%
Doubtful clients	11.3%	51.8%	48.2%
Social institutions	0.0%		
Personnel	0.4%	0.0%	100.0%
State	0.5%	0.0%	100.0%
Local government	0.0%		
Miscellaneous receivables	7.3%	56.8%	43.2%
Misc. accounts receivable	2.0%	0.0%	100.0%
Doubtful accounts receivable	5.3%	77.9%	22.1%
Liquid assets	0.6%	0.0%	100.0%
Securities	0.0%		
Bank deposits	0.4%	0.0%	100.0%
Cash	0.1%	0.0%	100.0%
Internal transfers	0.0%		
Total Current Assets	45.7%	33.9%	66.1%
Accrued assets	0.0%	0.0%	100.0%
Grand Total	100.0%	61.[illegible]	38.3%

1. Percentage of total assets by category.
2. Depreciation as percentage of assets of each category.
3. Net book value as percentage of assets of each category.

Table A-5

SOMALAC - EIC

Estimate of Salvage Value as of April 30, 1990

	---------- 30/4/90----		---------			
	Gross	Depreciation/ Reserves	Net	Basis of value	Estimated Salvage Value	Excluding Land and Buildings
FIXED ASSETS						
Preliminary expenses	17,528	17,528	0	0	0	0
(Externally financed)	224,900	145,067	79,833		44,774	39,254
Equipment and tools	114,511	41,310	73,201	Gross x 0.15	17,177	17,177
Transport equipment	110,389	103,757	6,632	Gross x 0.25	27,597	27,597
(Self-financed)	1,368,389	1,207,715	160,674		968,716	250,003
Former Murat property	109,553	109,553	0	Gross x 4.0	438,212	0
Former RIZAM property	35,250	35,250	0	Gross x 4.0	141,000	0
Land	11,750	0	11,750	Gross x 6.0	70,500	0
Buildings	69,001	54,846	14,155	Gross x 1.0	69,001	0
Equipment and tools	341,073	241,972	99,101	Gross x 0.15	51,161	51,161
Transport equipment	769,570	740,252	29,318	Gross x 0.25	192,393	192,393
Fixtures	13,025	13,025	0	Gross x 0.15	1,954	1,954
Office furn. and equip.	10,140	7,294	2,846	Gross x 0.15	1,521	1,521
Home furnishings	7,120	5,523	1,597	Gross x 0.15	1,068	1,068
Const. work in process	1,907	0	1,907	Gross x 1.0	1,907	1,907
Total Fixed Assets	1,610,817	1,370,310	240,507		1,013,490	289,258
CURRENT ASSETS						
Inventory and in process	43,276	43,276	0	0	0	0
Supplies	290,000	0	290,000		98,100	98,100
Fuel and lubricant	6,290	0	6,290	Gross x 0.8	5,032	5,032
Spare parts	187,782	0	187,782	Gross x 0.3	56,335	56,335
Construction material	26,399	0	26,399	Gross x 0.6	15,839	15,839
Miscellaneous supplies	69,412	0	69,412	Gross x 0.3	20,824	20,824
Twine	117	0	117	Gross x 0.6	70	70
Packaging	329,676	119,043	210,633	Gross x 0.6	197,806	197,806
Total Current Assets	662,952	162,319	500,633		295,905	295,905

Table A-6

SOMEX Appraisal - 1985, With Updates

Ambatondrazaka
(FMG '000)

	Capacity	Res.life	Value
Warehouse 1	2800 m2	0.65	145,600
Warehouse 2	2267 m2	0.65	110,516
Warehouse 3	2260 m2	0.65	111,150
Warehouse 4	203 m2	0.6	5,481
Warehouse 5	200 m2	0.6	5,400
Warehouse 6	175 m2	0.3	1,995
Schule mill building	760 m2	0.6	29640
Hukauff/Lewis	-		
mill building	1200 m2	0.6	46800
Schule line		0.5	153,000
Hukauff line		0	0
Lewis line		0.5	171,000
Total		1985	780,582

Summary
Appraisal Changes Since 1985
(FMG '000)

	Ambaton.	Manakamb.	Amparafar.
1985	780,582	663,632	618,444
1986	1,020,399	859,132	834,668
1987	1,705,011	1,443,342	1,406,302
1988	1,729,056	1,474,380	1,425,152
1989	1,955,698	1,603,747	1,559,790
		annual % change	
1986	30.7	29.5	35.0
1987	67.1	n/a	68.5
1988	1.4	n/a	1.3
1989	13.1	8.8	9.4
		% of 1985 Value	
1986	130.7	129.5	135.0
1987	218.4	217.5	227.4
1988	221.5	222.2	230.4
1989	250.5	241.7	252.2

Manakambahiny
(FMG '000)

	Capacity	Res.life	Value
Warehouse 1	2285 m2	0.65	111,394
Warehouse 2	2250 m2	0.65	109,688
Warehouse 3	375 m2	0.65	19,013
Warehouse 4	250 m2	0.6	7,500
Warehouse 5	250 m2	0.3	3,000
Former silo	1350 m2	0.65	65,813
Delivery area	169 m2	0.65	4,943
Mill building	688 m2	0.6	26,832
Warehouse 6	455 m2	0.65	19,224
Warehouse 7	550 m2	0.3	9,075
Maintenance shops	700 m2	0.65	22,750
Warehouse 8	450 m2	0.3	7,425
Warehouse 9	469 m2	0.25	5,276
Heating plant building	219 m2	0.25	2,464
Generator building	187 m2	0.2	1,795
Warehouse 10	150 m2	0.2	1,440
Weigh station	25 m2	0.75	3,000
Hukauff line		0.6	243,000
Total		1985	663,632

Amparafaravola
(FMG '000)

	Capacity	Res.life	Value
Warehouse 1	1600 m2	0.6	62,400
Warehouse 2/mill building	975 m2	0.6	38,025
Warehouse 3/mill building	3013 m2	0.65	146,884
Generating plant	398 m2	0.65	12,935
Schule line		0.5	153,000
Hukauff line		0.6	205,200
Total		1985	618,444

Table A-7

Alternative Cost and Benefit Projections

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
I. Based on estimated 1990 production (15,000 t)										
Revenue	5,392,845	5,392,845	5,392,845	5,392,845	5,392,845	5,392,845	5,392,845	5,392,845	5,392,845	5,392,845
Expenses	4,909,294	4,909,294	4,909,294	4,909,294	4,909,294	4,909,294	4,909,294	4,909,294	4,909,294	4,909,294
Net	483,551	483,551	483,551	483.551	483,551	483,551	483,551	483,551	483,551	483,551
Present value of operation:										
For 15% return on investment	2,426,831									
For 25% return on investment	1,726,520									
II. Based on 1990 costs, 20,000 t production										
Revenue	7,190,460	7,190,460	7,190,460	7,190,460	7,190,460	7,190,460	7,190,460	7,190,460	7,190,460	7,190,460
Expenses	6,336,360	6,336,360	6,336,360	6,336,360	6,336,360	6,336,360	6,336,360	6,336,360	6,336,360	6,336,360
Net	854,100	854,100	854,100	854,100	854,100	854,100	854,100	854,100	854,100	854,100
Present value of operation:										
For 15% return on investment	4,286,530									
For 25% return on investment	3,049,567									
III. Based on increase over 2 years to 20,000 t; 25% cost reduction										
Revenue	5,392,845	6,291,423	7,190,000	7,190,000	7,190,000	7,190,000	7,190,000	7,190,000	7,190,000	7,190,000
Expenses	4,909,294	5,645,688	4,752,000	4,752,000	4,752,000	4,752,000	4,752,000	4,752,000	4,752,000	4,752,000
Net	483,551	645,734	2,438,000	2,438,000	2,438,000	2,438,000	2,438,000	2,438,000	2,438,000	2,438,000
Present value of operation:										
For 15% return on investment	9,181,027									
For 25% return on investment	5,994,278									

APPENDIX B

EIC

LEGAL STATUS OF LANDS

On the basis of documents provided by the Head of the Property Department of SOMALAC and information extracted from the land registers of the "Service des domaines et du patrimoine foncier" of Ambatondrazaka, the consultants were able to:

1) identify the properties attributed to EIC,

2) situate the rice mills which occupy these properties,

3) identify the legal problems.

B.1 Identification of Properties Attributed to EIC

The lands belonging to EIC were identified from an inventory of real property of SOMALAC, which indicates the title number, the location and the surface area. A correlation was established between the information in this inventory and that contained in the land registers of the "Service des domaines et du patrimoine foncier" of Ambatondrazaka. This allowed the identity of the true owners to be established, as well as the existence of any liens registered on the titles of the properties.

Table B-1 describes the properties presently attributed to EIC. These descriptions were established by examining the certificates of registration and of legal status produced by the "Service des domaines et du patrimoine foncier". However, these documents are dated February 5, 1987; the consultants cannot be certain that they are up-to-date. For this reason, it would be desirable to obtain certificates of recent date in order to verify that the information contained in them is current.

B.2 Location of Rice Mills

The EIC presently operates three rice mills:

1) the mill at Ambongolava known as "Rizerie I", situated on the so-called SOMALAC property;

2) the buildings and installations at Manakambahiny, known as "Rizerie II", situated on the following properties;

   - the property known as "Domaine de Manakambahiny"
   - the property known as "Rizerie de Manakambahiny II"
   - the property known as "Rizerie de Manakambahiny".

Table B-1

<u>Properties Attributed to EIC</u>

NAME OF PROPERTY	TITLE NUMBER	AREA	LOCATION	CURRENT OWNER	PREVIOUS OWNER	GHTS REGISTERE ON TITLE
SOMALAC property	1754-K	1 385 ha	East of Ampasikely Canton of Amparafaravola	SOMALAC	Societe de Plantations du Lac Alaotra	None
Manakambahiny estate	697-K	56 a 45 ha	Near the Manakambahiny station	SOMALAC	MURAT	BCIM mortgage for FMG 110 million
Manakambahiny rice mill	698-K	=2.5 ha	Near the Manakambahiny station	SOMALAC	MURAT	BCIM mortgage for FMG 110 million
Managambahiny II rice mill	695-K	7.5 ha	Manakambahiny	SOMALAC	MURAT	BCIM mortgage for FMG 110 million
"Francoise" property	2242-K	?	Amparafaravola	Etat Malagache	Chatel	Provision right of ownership of Soc. Rizerie d' Amparafaravola

3) the mill at Amparafaravola known as "Rizerie III", situated on the so-called "Françoise" property.

B.3 Examination of the Legal Status of the Properties

The legal status of the properties listed in the preceding Table are examined here, with reference to the rice mills which occupy the properties.

B.3.1 Rizerie I (Ambongalava)

The land on which the buildings and facilities of the Ambongalava mill are erected has officially belonged to SOMALAC since 1962. Transfer document No. 292 of March 26, 1962 between SOMALAC and the "Société des plantations du lac Alaotra, received by Mr. Ranarison, Notary at Antananarivo on March 28, 1962, is duly inscribed in the land register.

The title to the property is not subject to any lien. However, there is a problem with respect to the demarcation of the property. The factory at Ambongalava is located on a large property of many hectares, of which it occupies only a fraction of the total area. The certificate of registration and of legal status dated February 6, 1967 states that the limits of the property will be determined after the process of subdivision currently under way. A recent legal certificate should be obtained, stating whether or not this process has taken place.

It should be noted as well that the area of approximately 1385 ha is mentioned in the inventory of property, and not in the legal certificate of February 6, 1967. In view of the situation, the lands actually occupied by the facilities of Rizerie I should be demarcated, as the unoccupied area has apparently been allocated.

B.3.2 Rizerie II (Manakambahiny)

The buildings and improvements of the Rizerie of Manakambahiny are constructed on the properties referred to by title numbers 693-K, 698-K and 697-K. These are the former Murat properties. The transfer of the title for each property was duly effected to the name of SOMALAC on June 13, 1978 for a price of 118,000,000 FMG each.

A contractual mortgage of 110,000,000 FMG, including a restrictive clause forbidding the dissolution of the movable property was taken on June 13, 1978 by the BCIM and registered on the titles of the three properties mentioned above; this mortgage has not been cancelled to the present day.

It would be desirable for the appropriate department of EIC to make all necessary efforts to clarify this situation, in particular by requesting the creditor, currently the Bankin Ny Indostria, to state its official position with respect to these mortgages; the more so since these mortgages affect all the former Murat properties, which are under 14 separate titles.

It would also be appropriate to verify the status of these debts in the accounting records in order to determine whether the creditor has been paid off or not. Such a verification could result in a request to release the mortgage if the amount of the outstanding debt is not large.

B.3.3 Rizerie III (Amparafaravola)

The rice mill at Amparafaravola is situated on the former Chatel property. The title of the property has not been transferred to SOMALAC, but remains in the name of the Malagasy state, with the notation of a provisional right in the name of the "Société Rizerie d'Amparafaravola" (RIZAM). It would be interesting to re-examine the facts in order to understand the ins and outs of the legal problem presented.

By virtue of the deposition of a dossier for the process of transferring an administrative deed on March 26, 1966, the Malagasy state assumed the ownership of the so-called "Françoise" property.

By virtue of a bill of sale dated December 28, 1964 and approved on March 26, 1966, the state transferred its liens to the "Société Rizerie d'Amparafaravola" (RIZAM), subject to the resolutive condition of the exploitation of the lands. The notation of the provisional rights in the name of RIZAM was duly registered on February 14, 1967.

On September 12, 1967 a commission composed of a surveyor from the Topographic Service, a rural Mayor and a representative of the Agriculture Service issued a certificate declaring that the "Françoise" property had been exploited, and recommending therefore the granting of clear title to RIZAM.

This certificate of exploitation was held in the file of the "Françoise" property at the land registry of Ambatondrazaka, who considered the document to be of no value, as since 1967, no transfer to RIZAM was carried out.

SOMALAC claims to have properly acquired the lands of the rice mill at Amparafaravola, as a result of a transfer granted by RIZAM. SOMALAC was not able to produce the deed of transfer, on the grounds that the document is in the hands of a Mr. Dejean, now living in Reunion, liquidator of the affairs of Mr. Chatel, the former owner of the lands.

In order to officially effect the transfer of the title to the name of SOMALAC, the land registry of Ambatondrazaka requires the deed of transfer to be produced, and that SOMALAC, considering the provisional lien of the "Société Rizerie d'Amparafaravola", produce a new, valid certificate of valuation.

Aside from the problems of transferring the title, the property is subject to a bank mortgage registered on April 3, 1968 by the "Banque nationale pour le commerce et l'industrie" (BCIM) for 1,600,000 FMG. This mortgage has not been cancelled to this day.

In addition, SOMALAC claims to have been granted, free of charge, title to the lands on which the Rizerie d'Amboagary was located. This rice mill in the region of Moramanga also belonged to Mr. Chatel. The transfer of this property is supposed to have been effected simultaneously with the transfer (not free of charge) of the "Françoise" property at Amparafaravola. The deed of this donation is not in the possession of SOMALAC, but supposedly remains in the hands of Mr. Dejean.

The consultants were not able to gain access to the title or surveys concerning the property at Amboagary. Furthermore, there is no indication as to the surface area and exact location in the land inventory of SOMALAC. According to the head of the Property Department of SOMALAC, this information is contained in the records of the land registry of Moramanga.

APPENDIX C

EIC

CURRENT PERSONNEL SITUATION

The working relationship presently existing between the EIC and its personnel is governed by Edict ("ordonnance") No. 75.013 O/IM of May 17, 1975, concerning the labour code ("Code du travail").

The consultants have set out below:

- an analysis of the contractual framework of the employer-employee relationships
- the determination of the rights of the employees of EIC in the event of lay-offs. (A discussion of this issue can be found in section 4.1.1 of this report.)

C.1 Analysis of the Contractual Framework of Employment

This analysis focuses essentially on the conditions of employment, and the problem of unused paid vacations.

C.1.1 Conditions of Employment

1) Contract employees

a) Problem statement

Temporary or contract workers are generally recruited after drawing up a contract specifying the following: duration of employment, function, professional category, minimum index of classification and salary, in accordance with Article 22 of the labour code. The employee is hired from a given date to a given date, for a period of six months to one year.

When the specified expiry date arrives, all contracts of temporary workers are systematically renewed by the personnel department of EIC. A new document, containing the same clauses as the initial contract, is drawn up and signed by the employee and by the Directorate General or the Director of EIC.

b) Legal analysis

This systematic renewal reveals that contracts of fixed duration have never been terminated on the expiry date by either party, but have run on for a period of up to five years.

A study of computerized documents shows that, in fact, the great majority of contract personnel has 3, 4 or 5 years of service with the enterprise. These persons must be considered to be permanent employees, since under Article 23, Line 2 of the labour code, [translation by the consultants]:

> "Any contract of employment of fixed duration may be renewed. However, two successive renewals of a contract, without interruption of work, transform the contract into a contract of employment of indefinite duration."

This article is enacted with the intention of protecting employees against employers who wish to make indefinite-duration contracts appear as fixed-duration contracts in order to escape the requirements for advance notice or compensation in case of sudden termination.

With the exception of a few persons recruited in January 1980 for a period of six months, the so-called contract personnel of EIC, in reality, have the status of permanent personnel, and are subject to the rules protecting employees with contracts of indefinite duration in case of dismissal.

2) <u>"Seasonal" workers</u>

a) Problem statement

The recruitment of "seasonal" workers does not involve the personnel department but is done, as required, directly at the plant on the decision of the Chief of the Technical Division, who informs the administrative officer of the unit.

The exact number and the length of service of the "seasonal" workers in the plant are not known. Furthermore, regularity is not monitored. The managers state, in fact, that some of the "seasonal" workers have worked continuously or intermittently over a period of time. Others, however, come to the plant on a very irregular basis.

The problem is that, in reality, the term "seasonal" covers very heterogeneous situations.

b) Legal analysis

It is not useful, in this case, to expound on the notion of "seasonal" workers without first considering the contractual relationships which should actually exist between these "seasonal" workers and EIC.

c) The notion of "seasonal" workers

This term is not recognized by the labour code, but Malagasy law has not been silent on the situation of workers paid by the piece, the hour or the day.

The consultants have attempted here to first define the notion of "seasonal" workers, then enumerate the legal texts concerning this category of workers.

As the term indicates, the "seasonal" workers are employed for a "season", in other words, temporarily. Considering the nature of the activities of EIC, these "seasonals" would be recruited during the harvest collection period. At the end of this period, the "seasonals" return to their other activities. Having worked for the enterprise for a well-defined period, these persons would have been entitled to a contract of employment of fixed duration, corresponding to the period for which their services were specifically solicited. Thus, they are actually temporary or contractual workers.

Malagasy law considers workers who are subject to the provisions of the labour code to be, "Those persons paid by the task or by the piece, who habitually perform work for an enterprise, without regard to whether there exists between them and the employer a legal relationship of subordination, nor whether they work under the direct and permanent supervision of the employer or its appointees (...)" (Article 1 of the labour code; translated by the consultants). The code specifies, as well, in Article 24 that "workers hired by the day, and occupied intermittently during at least 6 consecutive months for the same employer and for an average of at least 20 days of work per month, are bound by a contract of employment of indefinite duration". Intermittent work refers to a situation in which the periods of work are separated by periods of inactivity. The contract of intermittent employment is a contract of indefinite duration which, by its nature, entails an alternation of periods of work with periods of no work.

In view of these legal texts, it is necessary to first carry out a census of the so-called "seasonal" workers in EIC, then find out the length of service of each such employee in each plant in order to identify their real contractual links with the organization. The result of this investigation will determine the rights of these employees in the event of reductions in personnel.

d) The contractual links which should actually exist between EIC and "seasonal" personnel

Among the so-called "seasonal" workers, there are those who may be considered to be linked with EIC by an employment contract of indefinite duration, as a result of their length of service (six months of service in the same enterprise, even if the job was occupied intermittently).

There are also those who may be described as true seasonal (or casual) workers: those who are paid by the hour, the day or the piece, recruited on demand, and who work very irregularly. By means of a check-in system, it would be possible to monitor the number of hours worked, the regularity, and over the medium-term, the length of service.

Finally, there are those who are recruited for a fixed period of time for well-defined purposes according to the level of activity of the enterprise.

In any case, it would be desirable that a contract of employment in accordance with the provisions of Article 22 of the labour code be drawn up between EIC and each member of the personnel, as there are within this division employees having very different status.

C.1.2 Unused Paid Vacations

Some employees of EIC have not taken annual vacations, and have even accumulated them from year to year. Paid vacations should, in principle, be granted annually. However, the law allows the accumulation of paid holidays for a maximum of 3 years (Article 88, line 4 of the labour code). In other words, if an employee has not taken his paid vacations during 4 successive years, he loses the benefit of the first year's vacation and has only the right to an indemnity corresponding to the period of lost vacation.

This accumulation of vacations is an exception which confirms the rule, as it must be expressly agreed to by the employee concerned. Thus, the employer is required to grant statutory vacations to its employees, who are obliged to take them in kind. The renunciation of the vacation on the part of the employees would be illicit; by the same token, the substitution of a compensating indemnity in lieu of a vacation is forbidden.

The problem of paid vacations not taken by the personnel of EIC will present itself to the employees as well as to the employer in the event of the re-opening of the establishment. Those employees whose contract of employment will be terminated on the initiative of the employer, as a result of a reduction in personnel, are entitled to a compensating indemnity in lieu of vacation (Article 89, line 3 of the labour code). Those employees whose contract of employment will be maintained may legitimately demand to take their vacations during the period prescribed by law.

Considering the large number of employees who have accumulated paid holidays, it would be desirable for the management to take the necessary measures to resolve the situation, in order to protect the rights of the employees.

To avoid a mass departure for vacation which would be detrimental to the operations of EIC, it would be appropriate to arrange for staggering the vacations.

APPENDIX D

EIC

DRAFT INVITATION TO BID FOR A CONTRACT TO MANAGE THE INDUSTRIAL AND COMMERCIAL OPERATIONS OF SOMALAC

This Appendix consists of an outline for the contents of an invitation to submit proposals for a management contract, and a draft covering letter for the invitation.

D.1 Outline of Contents

D.1.1 Background

- Purpose and scope of the invitation
- Present condition of EIC, particularly the facilities to be managed
- Major factors that have contributed to the present condition

D.1.2 Instructions to Bidders

- Formal invitation to submit proposal
- Follow-up information available for interested parties.
- Dates addresses etc., for submission of proposals.

D.1.3 Outline of Proposal Requirements

Proposals in response to this invitation should be submitted in two parts, in separate sealed envelopes: A Technical Proposal and A Financial Proposal. Cost will be a factor in the evaluation of proposals. However, financial proposals will only be opened for those bidders whose technical proposals exceed a threshold value based on the criteria set out below. Financial proposals are expected to consist of a combination of cost re-imbursement and performance-related compensation. Evaluation of financial proposals will favour those which reflect a genuine interest in participation in the risk and profit of the enterprise.

The technical proposal should contain sufficient detail, clearly presented, to enable the government to ascertain the following:

i) The experience and qualifications of the prospective firm to undertake the SOMALAC assignment.

ii) The approach to be taken in the development of the business plan and annual budgets. Bidders should note that the successful firm will be expected to present a draft business plan and annual operating budget to the Board by ____________________ for review and approval.

iii) The bidder's assessment of the prospects for improved financial performance, and the key measures to be taken to achieve these results.

iv) The bidder's proposals on the marketing of rice including thoughts on parts of the Madagascar market to be targeted, and the focus of export efforts.

v) The composition of the management team that would be used for SOMALAC operations, including the overall level of effort, the designations of resident positions to be filled on a full-time and part-time basis, and the provision for short-term technical and managerial support from the firm's headquarters.

vi) The names and curricula vitae of the members of the proposed resident team.

vii) Proposals concerning the issues of labour management, particularly the matter of staff reductions.

viii) Bidder's proposals with respect to other issues of government policy which impinge on the potential commercial performance of SOMALAC.

Financial proposals should contain sufficient information, clearly presented, to permit evaluation of the following:

i) The quantities of inputs, such as person-weeks of effort, to be supplied, together with unit costs.

ii) The aggregate of costs for which reimbursement will be sought in each year of the contract (a provision for physical and price contingencies is acceptable).

iii) The proposed basis of revenue sharing, including specific measures to be used and the target levels on which compensation will be based.

The technical proposals will be evaluated using the following criteria:

- The firm's general experience in the rice sector, and its knowledge of Lac Alaotra (___ points);

- Demonstrated understanding of the conditions faced by SOMALAC at the present time and the process of rehabilitation in which it is engaged, particularly the adequacy of the bidder's approach to the proposed business plan and the relationship of the management team and the Board of SOMALAC (___ points); and,

- The qualifications and competence of the proposed resident management team (___ points).

D.2 Draft Covering Letter

Dear ________________,

The Government of Madagascar hereby invites proposals to enter into a management contract for the Industrial and Commercial operations of SOMALAC. This contract is part of an action plan which the government has adopted for the purpose of rehabilitating the rice industry and introducing private management to the sector. The World Bank is currently in the process of appraising a project which would, in part, provide financial support to this effort.

A brief background on the operations of SOMALAC appears in Part A of this announcement, followed by Instructions to Bidders, Part B, and an outline of bidding requirements in Part C. If you wish to consider submitting a proposal for the management of SOMALAC, you or your accredited representatives are invited to visit the facilities of the company and meet with senior officers during the period (Insert dates). This invitation should be accepted by appointment only.

For further information, please contact:

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____

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Sincerely,

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