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CONSULTANCY REPORT  
ON  
ORGANIZATIONAL STRUCTURE OF INTEGRATED POULTRY COMPANY  
FOR THE  
ASSISTANCE FOR PRIVATE POULTRY PRODUCERS IN BULGARIA  
PROJECT

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## SUMMARY OF RECOMMENDATIONS

After reviewing the "Analysis of the Bulgarian Poultry Industry" by U.S. Poultry Industry Expert R. H. Strickler, conferring with Bulgarian poultry expert Dr. N. Duneva; conferring with the Director and Deputy Director of the VITAPROT feed mill at Slavianovo (Pleven), the Director of poultry company AVES at Burgas, the Director of the "AKVILA" slaughtering plant at Aitos; meeting various municipal and state officials directly involved in the privatization process for each of the three plants; and discussing legal technical matters with attorneys directly involved in the existing companies about privatization process rules and or laws of business organization as now in place in Bulgaria, I make the following recommendations:

1. A single, integrated poultry company should be created to include breeding; chick production and placement; feed production and distribution; grower coordination and support; grower ownership in the company; slaughtering poultry operation; and product marketing.
2. The form of the organization should be a single Bulgarian shareholding company issuing two classes of stock and designed so ownership is shared by management, the workers, private farmers with growing contracts with the company, and outside investors.
3. The company should be created by privatization of three enterprises now owned either by the state or a municipality. These three organizations have been identified. Terms of the privatization arrangements should assure that the transition from state or municipally owned enterprises be made to private ownership in as smooth a manner as possible.
4. Financial needs should be determined and possible sources identified. Necessary economic and financial feasibility studies should be commenced in preparation for the process.

## I. INTRODUCTION

The purposes of this report are to:

1. Summarize the current status of relevant parts of the Bulgarian poultry industry;
2. Note the absolutely critical relationship between the privatization process and the emergence of a viable and potentially highly successful poultry industry in Eastern and Central Bulgaria;
3. Identify and describe those existing operations that show excellent performance, superior to nearly all other operations in the Bulgarian poultry industry.
4. Describe a privatization scheme leading to a combination of interests and operations for one integrated poultry company centered in Burgas, and
5. Describe the new organization, outlining its form, ownership, operations, financing, and advantages

## II. THE CURRENT STATE OF PRIVATIZATION

Recent changes in the Bulgarian economic and business system have been dramatic. From a centrally planned economy with heavy state ownership patterned after and closely coordinated at many levels with the Soviet system, Bulgaria has moved rapidly toward a market system based on private, individual ownership. The process is now that of transferring state owned enterprise into private hands. Part of the process is "restitution" by which property confiscated by the state during transformation to a communist system in past years is returned to previous owners. Many private, relatively small stores have been created by the restitution process.

"Privatization" is the term generally used to describe the system by which state or municipal enterprises are converted to private property. The procedure may but does not necessarily take place in two stages. The first step, if it occurs at all, changes the ownership form of the state-owned enterprise but transfers no ownership. The state-owned enterprise is converted to a sole proprietor company with sole ownership in the state.

For "converted" state enterprises and "unconverted" state enterprises, the second step is to transfer ownership from state to private hands. Generally, enterprises singled out for privatization are bid upon by prospective purchasers. The state may then accept or reject a bid and, if a bid is accepted, transfer ownership by one of several optional procedures. Payment for the enterprise is received by the state and funds are handled according to legal guidelines.

Enterprises may be owned by municipalities instead of the state, the case for one of three enterprises of interest in this project. While current privatization laws are the same for the state -

owned and the municipality - owned enterprises, each situation must be considered separately.

#### A. Current Laws and Regulations

Laws and some supporting regulations have been enacted relating to the two steps above mentioned. New laws describe conversion of state and municipal enterprises to state property sole proprietor companies. Laws also describe the process of privatization to its completion as a privately owned enterprise. Some regulations have been devised but none have been implemented. Consequently, considerable uncertainty exists with respect to what will actually transpire as the privatization integral to this project proceeds. At the same time, innovation may be possible during this experimental stage of the national privatization effort.

#### B. Current Progress

Privatization has proceeded in the case of small enterprises, especially restaurants and retail shops. Many of these are associated with the restitution process.

However, privatization of production enterprises has not proceeded as rapidly as many desire for a number of reasons, two of which are lack of legal guidance and lack of money in the Bulgarian economy to purchase productive enterprises of any significant size. As a consequence, privatization of the national productive resources simply has not taken place.

#### C. This Project

The successful completion of this project will be the vanguard of true privatization. As such, it will create a privately owned, market oriented business with excellent success potential to serve as a pattern and leader for other industries to follow. At the same time, it will test the ability and willingness of those committed to assist the fundamental transformation of the country's economy.

### **III. THE BULGARIAN POULTRY INDUSTRY**

The current structure of the poultry industry is a combination of the old centrally planned system, an emerging private production system, and economic and price conditions placing pressures on those parts of the industry operating at less than peak performance. This current project recognizes the current structure and its problem and will change parts of it. Only those items of most direct interest are discussed.

## A. Overall Industry Structure

Four types of operations comprise the Bulgarian poultry industry, although variations exist. The following description applies to the industry in regions relevant to the project.

1. *Poultry companies* The central coordinating function in the growing process is performed by "poultry companies." In a typical operation, the poultry company produces day-old chicks that are placed with private farmer growers. The poultry company supplies medicine, feed, and some other services in the growing period. Feed may or may not be "supplied" by the poultry company. In either situation, the private farmers purchase all feed used under arrangements that vary as described later. The poultry company retains ownership of the birds at all times. When birds reach maturity, the poultry company arranges for their pickup by the slaughtering plant. The poultry company sells the bird to the slaughtering plant and, by arrangements that differ among regions and poultry companies, pays the grower. Poultry companies are currently state-owned enterprises.

2. *Growers* Growers have facilities for raising the day-old chicks to maturity. They supply the labor and the care required in that process. Some growers are full-time poultry growers producing chickens at four cycles per year. Many, however, only grow poultry for supplemental cash. Many growers also only take chickens for growout in Spring and Fall, declining to produce during Winter and Summer. These disparate groups pose different opportunities and, more importantly, problems for an effective poultry production system.

Growers are typically responsible for costs of day-old chicks, feed, medication, electricity, labor, and construction of their broiler houses. As noted later, a successful growout system has been introduced by the poultry company of interest to this project in which feed and chicks are supplied on credit, with their costs subtracted from total payment at grower settlement.

It should be noted that production has also taken place on state farms. However, because of their design and production expenses, private farmers can produce at substantially less cost.

3. *Feed mills* The most critical factor in efficient and profitable production is the feed. Chicken feed is a mixture of ingredients and the mix determines growth rate and feed-to-meat conversion ratio. Feed mills are currently state-owned enterprises that operate independently of poultry companies.

4. *Slaughter houses* These currently state-owned enterprises perform the physical conversion from live chickens to final product and, in addition, they purchase the live chickens from the poultry company and sell the product domestically and, if appropriate, into international markets. Thus, the slaughter houses are now the final marketers of poultry products to wholesale and retail outlets and to exporters or foreign purchasers.

## B. Economic Status of the Industry

Although the components of a successful poultry production industry exist in Bulgaria, the industry is presently depressed. Many, if not most, private growers are not now producing poultry because prices received do not cover their costs of production given current production practices, feed composition, hybrids used for broilers, and market conditions. Poultry companies, with exceptions, and slaughter houses, with exceptions, are generally heavily in debt and are operating at less than full capacity, many at less than 50 percent of capacity. Many companies and slaughter houses are expected to go bankrupt. One of the largest poultry plants, originally designed to include hatchery, slaughter houses and feed mill, has ceased to function primarily because of indebtedness from Iraq whose assets became unavailable for payment during the Gulf conflict. This plant near Pleven was designed to be the largest poultry operation in the Balkans.

In general, about 40 percent of the industry capacity is idle.

Domestic consumption of chicken is down dramatically from "normal" times in which chicken is the preferred meat. Domestic consumption has been at 24 kilograms per person during "normal" conditions about 5 years ago. Currently it is at 12 kilograms per person and experts suggest it could drop to 8 kilograms per person unless prices, particularly relative to pork, are not improved.

The international markets have likewise suffered in recent years. Of major importance has been serious decline in Russian markets because of Russia's cash shortage and inability to make purchases even though their need for poultry products from Bulgaria is great.

The result of these conditions has been loss of income producing opportunities by thousands of private poultry growers, many of whom, certainly the better ones, have invested in poultry houses and associated facilities and, importantly, have made commitments to engage in private entrepreneurship with its demands and risks.

## **IV. PROBLEMS IN THE POULTRY INDUSTRY**

Current problems in the poultry industry are not insurmountable nor are they permanent. Specifically, they are such that specific, planned actions can build at least one successful, profitable enterprise that will support a considerable number, if not a high proportion, of poultry growers in Bulgaria. To identify these actions, some specifics of industry problems should be identified.

Problems to which specific actions can be directed are two - fold. First, market and entrepreneurship knowledge, philosophy, and motivation have not developed to a point where the integrated steps necessary for poultry production function adequately. They are, however,

within immediate reach. Second, and closely related to the coordination problems, quality feed production and hybrid development needed for cost effective poultry production are not adequate.

Two examples of the market and entrepreneurial problems demonstrate the situation. As noted following, production of good chicken feed is the single most important key to successful poultry production in Bulgaria (as it is everywhere in the world). With few exceptions, one of which is described later as part of the proposed poultry production unit, feed mills have insufficient incentive to produce quality feed. They are not economically tied to their product's performance. As a consequence, their ingredient mix decisions are based heavily on total ingredient cost reduction rather than on what is required for quality feed production. Feeds are mixed with what ingredients are available and those that can be produced with least cost because feed mills will (1) sell feed under any circumstance and (2) sell at a given price without regard to feed quality. Little or no effort is made in quality control or feed improvement research.

No current market or legal mechanisms exist to correct this situation and it is a major hindrance to efficient poultry production. This situation can be solved immediately by creation of an integrated poultry unit.

A somewhat similar situation exists in the processing plant industry level. In this case the problem is one of inadequate marketing incentives because little true marketing activity was previously required. A related problem is that the system does not operate so as to make the processing business one that passes price and demand signals back down the production chain.

The second set of soluble problems at the industry level relates to production, particularly poultry feed.

In summary, two feed-related facts indicate the role good feed plays in poultry production. At the outset it should be noted that approximately 70 percent of the total cost of growing a broiler to slaughter size is cost of feed. Thus, every gram of feed not absolutely necessary for final production is a costly burden of the private grower and the industry as a whole.

The feed conversion ratio relates the total weight of feed required to produce a given final weight of poultry meat. The industry in Bulgaria now requires about 3 kilograms of feed to produce one kilogram of meat. This is higher than it should be. A ratio of 2 kilograms or less of feed for one kilogram of meat is possible with proper feed and the correct hybrids. Given the feed cost's contribution to total production costs, the detrimental results of the lower ratio are clear.

A second measure of poultry production is the time required to achieve a certain live bird weight. Currently, in the Bulgarian industry, producers require about 60 days to achieve a weight of 3.3 pounds. In the U.S., producers achieve 4 pounds in 44 days. A shorter growing time leads to more production cycles per year and higher total bird production and profits for

producers.

## **V. POTENTIALS IN THE POULTRY INDUSTRY**

The problems at the industry level related to low domestic consumption and diminishing foreign markets, particularly with Russia, are viewed as temporary and correctable by poultry industry and marketing experts consulted. Domestic consumption is expected to increase (1) with increased economic stability as the monumental and rapid change from centrally planned and state controlled economy progresses and (2) with greatly improved consumer poultry prices brought about by planning, production, and marketing efficiencies.

Export is expected to revive as international economic conditions stabilize, as new barter arrangements are made with cash-poor importers, and active marketing efforts are instituted.

Elements of the existing poultry industry show great promise. However, they will be realized only if rapid and well-designed actions are taken. Such action will depend on the initiative and performance of individual participants. When a poultry production unit is created and operated to overcome industry coordination problems and poultry production deficiencies, the unit will realize considerable success in Bulgaria relative to other poultry production systems and will begin revitalizing processes within the industry. With such an industry leader, a substantial number of farmers will grow poultry profitably and consumers will enjoy quality poultry at a better price. Exports will increase, probably dramatically, along with the associated benefits to Bulgaria's balance of payments.

## **VI. CREATING A SUCCESSFUL POULTRY PRODUCTION UNIT**

### **A. General Requirements**

A successful poultry production system must recognize requirements suggested above and must be of a business form such that:

1. The requirements are implemented automatically as a part of the enterprise without resort to complicated or uncontrollable outside business arrangements.
2. The business form itself contributes to efficient operations.
3. The business form assigns economic incentives effectively and correctly to all subunits and participants within the system.
4. Capital and financing requirements are defined and flexible, yielding current capacity needed and establishing a structure that will allow for future changes, special arrangements such as joint ventures with other domestic or foreign firms,

and growth in business and the industry as a whole.

5. The structure must fit within the fundamental changes to a market-based economy now occurring in Bulgaria, with immediate response to the privatization process.

### B. An Integrated Poultry Production Unit

The desired poultry production unit can best be achieved with a single corporate business that integrates the essential stages of poultry production from hatchery to sale of processed poultry products, including growout arrangements with private farmers who have a direct ownership stake in the poultry unit's performance. Such an integrated system has been used successfully in other poultry producing sectors and, in fact, all poultry in the United States is produced with such an integrated system. The resulting efficiency has transformed the industry into such an efficient one that poultry price decreases made possible by cost reduction have brought about major changes in domestic consumption relative to beef and pork. It should be specifically noted, however, that this recommendation is not made simply to copy the U.S. system. Conditions in Bulgaria strongly suggest such integration irrespective of its success elsewhere under greatly different circumstances.

## **VII. NEED FOR AN INTEGRATED SYSTEM**

Why should a poultry unit in Bulgaria be an integrated system at the present stage of the industry, economy, and financial system? Following are reasons such a system is suggested. More specific examples are given later in the description of the recommended unit. Reasons include:

1. The need for close technical coordination of production stages that affect all other stages in the production process.
2. The requirement for control over technical and operational aspects of all stages of the production to assure efficiency and quality.
3. The requirement that incentives to engage in desirable practices and utilize the best practices are assigned properly.
4. The desirability of distributing benefits of a successful production process at all stages to those who have contributed to the production process.

## **VIII. FOUR ENTERPRISES IDENTIFIED**

As noted in the review of the Bulgarian poultry industry, the stages of poultry production

are now located in separate enterprises. They are largely unintegrated except for the contractual relationship that may exist between the poultry company and private farmers. (Private farmers as a group are the "forth enterprise" although they are not a single entity and are not presently organized in any formal business.)

Extensive research in Bulgaria by Mr. R.H. Strickler, a poultry industry expert with lifelong involvement in the U.S. poultry industry, identified three outstanding enterprises now in operation, each associated with one of the essential stages of poultry production. His recommendation is that a single integrated poultry production unit should include these three enterprises. This is also the recommendation of Dr. N. Duneva, a Bulgarian poultry expert.

The three enterprises, described below, have several important characteristics in common.

First, all are currently successful and are not in financial trouble as are most other similar enterprises throughout Bulgaria. Thus, their combination in whatever form does not begin with the burdens facing other possible participants in the industry.

Second, all are characterized by dynamic, excellent management (the major contribution to their success in the face of general industry downturn). Mr. Strickler placed this characteristic highest on a list of desirable attributes.

Third, all have good to excellent facilities and full production potential with little or no capital requirements.

Fourth, the present work force in each is of high quality and generally balanced in number with efficient production practices.

Fifth, all three enterprises, now state or municipally owned, are amenable to, and in fact eager for, privatization. Relevant state and municipal units have been receptive.

Finally, management of all three facilities recognize the potentials of privatization and formation of a more integrated poultry production unit. All are capable of making the business a successful transition to market-oriented, privately owned entrepreneurship.

#### A. The Poultry Company

As the relevant part of the industry is now organized, the central coordinating enterprise in poultry production from hatchery to live birds ready for slaughter is the poultry company. The poultry company identified as the lead enterprise for the creation of an integrated poultry production company is AVES, located near Burgas. AVES's General Manager is Mr. P. Panayotov.

*1. Method of Operation* AVES engages in two separate activities. It conducts the usual

functions of a poultry company and, in addition, owns layers and egg production facilities capable of producing about 30 million eggs per year for final consumption market. The physical facilities are separate.

Broiler production begins with a breeder flock which produces eggs for hatching into day-old chicks for growout. Present facilities and breeder flocks produce 20 million eggs per year.

AVES has technologically advanced hatchery facilities capable of producing 10 million chicks per year. Day-old chicks are placed by AVES with private farmers (growers) in the Burgas region. Hatching eggs produced but not hatched are marketed to Middle Eastern countries. AVES actively seeks to sell or hatch all hatching eggs produced, with sales of hatching eggs is not usually desirable as a market.

Chicks are grown to maturity by private farmers. AVES retains title to the birds at all stages of the growout process. The growing arrangement terms are in the form of a contract between AVES and each individual private farmer.

AVES supplies day-old chicks to the private farmer. One of the most significant of the AVES-grower arrangement is how feed is supplied. AVES purchases farmers' entire supply of feed and delivers it to the farmer with no initial advance from the farmer to AVES. The effect is that AVES extends credit to the farmer, thus reducing the farmer outlay substantially during the growout cycle.

Private farmers supply the broiler houses, labor, electricity, and medication. AVES supplies day-old chicks and feed, although the ultimate cost of chicks and feed rests on the grower.

At maturity, AVES arranges live bird pickup and transportation to a slaughter house. AVES sells live birds to the slaughter house at a negotiated price. Ninety percent of AVES's sales are made to AKVILA, a well-located slaughter house in Aitos, near Burgas and AVES. The usual circumstance is that AVES sells all its birds to AKVILA, but during the past year a temporary price advantage was gained by sale of several days' production to another slaughter house.

Sixty days following live bird sale to the slaughter house, AVES settles with its growers. It reduces the final payment by charges for chicks and feed supplied. A small "commission" (4 - 6 percent) is charged in addition to chick and feed costs to reflect services performed by AVES. This is justified because AVES supplies the feed at cost and wishes to recover costs of arrangements, storage, delivery, etc. The 60-day delay in payment, first instituted by AVES to preserve production by private farmers in the Burgas region, gives AVES short-term financing for providing feed on credit for the subsequent production cycle.

*2. Facilities and Capacity* AVES is currently operating at less than capacity in its hatching egg, stock egg, and hatching activities. It currently has about 300 private farmers

under contract, with a maximum of 650 in the region.

AVES employs 310-320 workers in all its facilities.

AVES requires no immediate capital improvements to continue its present operation. However, facilities now under construction will increase its consumer egg production to 40-45 million eggs per year. In addition, conversion to new bird hybrids with the formation of an integrated poultry production unit will require expenditures for the breeder flock.

## B. The Slaughter House

The slaughter house identified as the second desirable part of the new integrated system is AKVILA, located in Aitos near Burgas. Its General Manager is Mr. Minchev.

*1. Method of Operation* AKVILA purchases live birds from poultry companies, absorbing the cost of live bird transportation from farm to plant. The plant slaughters the birds and produces several products. The principle product is whole, frozen chickens. The plant can also produce smoked chickens and chicken sausages.

AKVILA markets its final product in domestic and export markets. It purchases live chickens at a price determined by negotiation. The price at which whole frozen chickens are sold domestically is regulated somewhat indirectly by a limit of eight percent profit by the slaughter house, although some creativity seems to be possible in calculation. A floor on international sales prices (\$1,100 per ton) has been exceeded in recent sales to Russia and, in the opinion of those engaged directly in international marketing, seems to present no obstacles for international marketing.

AKVILA purchases about 95 percent of its live bird requirements from two poultry companies, about half coming from AVES.

*2. Facilities and Capacity* AKVILA facilities include a slaughter house operating on an assembly line basis, a freezing facility, and frozen bird storage, including significant new space now being added.

AKVILA has a slaughter capacity of about 1,000 tons per month, 45-50,000 birds per day, or about 6,250,000 birds per year. This calculation is based on a single work shift. In the past, two shifts have been used, but never three. Thus, its total capacity at full operating speed is considerable. At present it is operating at about 50 percent capacity.

Equipment is about 12 years old. The main equipment was renovated in 1989 and needs little maintenance. It should operate for at least two more years at full capacity without replacement. No new equipment is required for increased production to full capacity, although frozen storage capacity may be reached because of market conditions. Such capacity is currently

being expanded.

An assembly line for cuts, with a capacity of 1 1/2 ton per hour, is not now operating because no market exists. Sausage processing capacity of 3 1/2 ton per day is not fully used for lack of market, and chicken smoking equipment is likewise not fully utilized.

AKVILA employs 160-165 workers to run at the present 50-60 percent of capacity. Mr. Minchev estimates full production would require 200-215 workers.

### C. The Feed Mill

VITAPROT, a feed mill near Pleven, combines new and excellent facilities, excellent management, and a desire to produce good quality poultry feed. Its General Manager is Mr. Kostov.

*1. Method of Operation* Ingredients for feed mill use are purchased from several sources at negotiated prices. The final feed mix is determined by reference to good industry practices and actual production experimentation. Selected private growers use feed mixes and report on its performance. Feed mix responds to farmer demand and the automated equipment used at VITAPROT makes possible immediate customized mix upon demand. The plant can and does produce pelletized feed, the most desirable feed form.

VITAPROT sells to private farmers on a cash basis. Price is determined generally by calculating expenditures for raw materials, other expenditures, and depreciation. About 15 percent is then added for profit, although this may be reduced to 10 percent.

*2. Facilities and Capacity* VITAPROT has a total capacity to supply about 1,300 private farmers with all their feed needs. It is currently operating at 30 to 50 percent capacity, primarily because of the financial failure of the extremely large nearby poultry plant which it was designed to serve. It would need little capital investment to increase its production to nearly full capacity.

The feed mill was built in 1989 and incorporates excellent automation technology, including laboratory equipment to test ingredients purchased and feed mixes produced. No new equipment will be needed in the foreseeable future.

VITAPROT employs 90 workers and estimates it would need only 10 more to produce at full capacity. Some employees are currently used to improve some storage facilities when not needed in the mill, given low production levels.

#### D. Private Farmers

Broiler growout in the Burgas region is done through contracts between private farmers and poultry companies. Those of immediate interest for this project are those growing for AVES, although new groups may become involved as a new poultry production unit makes the most efficient use of its collection of resources and as it develops new domestic and foreign markets.

*1. Method of Operation* The contract arrangement was noted in the description of AVES. Prior to signing an agreement, the farmer can calculate feed costs, other costs and price to be received. Costs include: day-old chicks, feed at cost from AVES, medication and veterinary services, labor electricity and the cost of the broiler house. The farmer calculates costs and the price to be received from AVES and makes a decision on whether to accept and grow a batch.

*2. Facilities and Capacity* The average producer in the Burgas region grows about 7,000 birds per cycle. Units of 15,000 exist but are rare.

"Full time" producers grow four cycles per year, and are limited to that number by the length of growing time, now about 60 days from day-old chick to slaughter size. Average production is thus 28,000 per year.

Without further capital investments, each producer can increase production by about 15 percent. Production periods will be reduced upon creation of the new poultry unit and introduction of new hybrids. Growout period can be reduced from 60 to less than 50 days (44 is possible), and the same facilities can be used to grow at least one more batch per year than is possible at present.

Of course, total private farmer capacity can be increased by addition of private farmers to the industry. However, a large proportion of those currently prepared to grow are now not actively growing birds and can be reemployed as needed.

### **IX. THE PROPOSED STRUCTURE**

The fully coordinated system as suggested above can be achieved by a single business enterprise integrating all parts of the production process except for actual growing which would be performed by independent private farmers whose relationship to the integrated company is defined by grower contracts and ownership interest in the integrated company.

The proposed structure of the integrated poultry company is described. A description of the proposed structure is followed by a discussion of the privatization process required to achieve the structure. Finally, an overall description is given of its capacities and operation. A subsequent section addresses difficult and peculiar financing aspects of such a structure given

its genesis in the privatization process.

The new poultry company (COMPANY) will be a combination of the three best components as identified previously.

1. COMPANY will include all assets, management, and employees of AVES, and will perform all functions currently carried out by AVES.
2. COMPANY will include all assets, management, and employees of the slaughter house AKVILA.
3. COMPANY will include all assets, management, and employees of the feed mill VITAPROT at Pleven.

#### A. Bulgarian Stock Company

COMPANY will be organized under Bulgarian commercial law as a Bulgarian stock corporation. Under the appropriate Bulgarian commercial laws, COMPANY can issue two classes of stock.

1. "Titled" stock with identified ownership and carrying the right to vote. Voting is based on one vote per share of stock and more than one share can be owned by one legal person. This class of stock corresponds to common stock in U.S. corporations.
2. "Privileged" shares signify investment in the company but carry no right to vote. This class of stock corresponds to preferred stock in U.S. corporations although some significant uncertainties exist about certain shareholder rights.

Shares of stock carry rights to participation in COMPANY's profit, although dividends need not be declared and may be paid in shares of stock.

The following recommendations should be subjected to considerable review and discussion by at least three groups. Management of each organization should be given early opportunity to assess the impacts of the recommendations. Lawyers and others involved in the mechanical aspects of all processes from COMPANY formation through privatization to finance should give their opinion. Finally, those who may be asked to invest in COMPANY will have comments and concerns deserving careful consideration.

#### B. Authorization and Distribution of Shares of Stock

COMPANY will authorize both titled and privileged shares of stock. Three purposes are

served by stock issues: (1) Control of the COMPANY by voting rights distribution, (2) distribution of profits based on stock ownership, and (3) built-in flexibility and growth potential including mechanisms to engage in joint ventures of various kinds for the overall benefit of COMPANY and the industry.

The practice in Bulgarian law is to place a considerably greater amount of detail in the articles of incorporation than is done in the U.S. As characteristics of COMPANY are discussed, it will be necessary to explore the way they should be implemented under commercial law relating to Bulgarian shareholding businesses.

### C. Titled Shares of Stock

COMPANY should authorize 100,000 shares of titled stock representing control of COMPANY. The final distribution, once all titled shares are issued, is as follows:

1. *Management* Twenty-five percent of titled shares are reserved for management. This substantial proportion is in recognition of the critical role senior management plays in the success of COMPANY. Current management of the three enterprises has demonstrated its abilities and must be preserved for COMPANY to realize its role in a privatized, market-oriented poultry industry.

2. *Employees* Twenty percent of "titled" shares are reserved for employees. This recognizes the important role of motivated employees in COMPANY as well as the possible rights of employees established by the privatization process.

3. *Private Farmers* Twenty-five percent of the titled shares are reserved for private farmers with growing contracts with COMPANY. This reservation recognizes the critical role private farmers play in the privatization process and interest they have in the successful operation of COMPANY. It also recognizes the fact that they are at present unorganized and need an effective voice in how COMPANY is run.

4. *Other Investors* The remainder of the titled stock, 30 percent of COMPANY's total, will be available for purchase by other investors. To avoid disproportional control by one person, ownership will be limited to five percent of all titled shares by any one individual.

Concern has been expressed about the mix of persons entitled to participate in COMPANY's control under this arrangement. Business firms in a highly competitive and rapidly changing industry cannot function by committee decision. Some method must be devised to make COMPANY operate effectively given the diversity of ownership interests. Possibilities have not been explored but arrangements such as management contracts, legally binding assignments of roles played by parties, or other means for proper governance and management should be considered early in the privatization process. The balance of social and business considerations should be addressed carefully and sensitively given the economic and political

realities under which this project evolves.

#### D. Privileged Shares of Stock

COMPANY should further authorize 900,000 shares of privileged stock. The primary role of this class of stock is (1) distribution of profits to those with an investment interest in COMPANY, (2) a mechanism to permit private farmers to share in COMPANY's profits, and (3) a way investors can recognize increases in COMPANY's value.

Ownership of shares of privileged stock can be less restricted than titled stock. However, the role of participants in COMPANY should be reflected in a few rules.

*1. Private Farmers* Twenty-five percent of the privileged shares should be reserved for private farmers having growing contracts with COMPANY.

*2. Management and Employees* Ten percent of the privileged shares of stock should be reserved for management and employees. The purpose of this reservation is to give management and employees a share of COMPANY's gains in a way that provides incentives for productivity.

*3. Other Investors* The remainder of untitled shares can be purchased by investors or used by COMPANY as payment for additional assets, including capital contributions to joint ventures with other companies or individuals.

#### E. Share Issue and Valuation

The unique way in which COMPANY will come into existence will influence heavily the methods used to place shares of stock in the hands of COMPANY owners and will also influence the valuation of shares initially and subsequently. The following reflects a suggestion of how share distribution might be accomplished.

*1. Titled Shares* Because titled shares represent both control and rights to profits, their valuation, initial distribution, and subsequent transfer may be limited or regulated.

Upon the completion of the privatization process, management and employees would be required to purchase their shares of titled stock. If possible in the privatization process, some should be given directly to management as "sweat equity." This provides some initial capitalization and, more importantly, guarantees a definite source of control for COMPANY prior to expansion of titled stock ownership.

Valuation of titled shares would be fixed to reflect the proportion of initial assets received by COMPANY in the privatization process and the management and employee numbers associated with each of the three enterprises privatized into COMPANY. Proportions involved

and the portion of total COMPANY shares represented by titled shares should result in a reasonable cost per share.

Titled shares could not be transferred and could be repurchased by COMPANY only at original face value and upon termination of shareholder's qualified status except in the case of other investors.

2. *Privileged Shares* Because privileged shares must reflect market value to recognize increases in the value of COMPANY, they must carry the right to be sold at a market-determined price.

Initial and subsequent issuance by COMPANY would be at a "market price." If no market price is established, the price could be established by COMPANY by reference to its total asset value adjusted for inflation and the expected income that could be received by stock ownership.

Owners could sell their stock at any negotiated price. To facilitate markets in absence of a national stock exchange system, COMPANY may devise a system to record offers to buy and offers to sell with the sole purpose of putting potential buyers and sellers in contact with each other.

Some concern has been expressed about the legal rights to transfer these shares freely. If necessary, extensive use of articles of incorporation provisions should establish rights needed to implement transferability rights.

#### F. Method of Operation

COMPANY will perform all steps necessary to produce and market processed poultry activities include the following:

1. Select hybrids suitable for peak poultry production.
2. Purchase and care for parent breeders.
3. Produce eggs and hatch them for growout.
4. Contract with private farmers to grow chicks to maturity.
5. Place day-old chicks with private growers.
6. Produce chicken feed suited to peak production.

7. Purchase feed ingredients.
8. Mix and deliver feed to private farmers.
9. Collect mature birds and transport them to slaughter house.
10. Slaughter, process and freeze chickens.
11. Develop markets, marketing programs, and new products.
12. Market final product.
13. Conduct research necessary to identify birds and techniques best suited to peak performance.
14. Finance private farmers through delayed cash receipts for chicks, feed, and other supplies.
15. Coordinate product output with market demand and storage capacity.
16. Coordinate live bird production with slaughter needs.
17. Coordinate grower placement with live bird needs.
18. Coordinate hatchery operations with chick placement needs.

#### G. New Capacities

Capacities of COMPANY after its organization and completion of privatization process reflect the cumulative added capacities of components. In addition, opportunities exist for expansion of some activities to make the most effective use of facilities, and other facilities may be utilized to round out needed resources and respond to new opportunities as they arise.

1. Hatching egg production. Present facilities can produce 20 million hatching eggs per year.
2. Hatching capabilities. Present facilities can hatch 10 million day-old chicks per year.
3. Hatching limits of 10 million per year can be overcome by renting other hatching facilities. This, in fact, is desirable because day-old chicks cannot be transported to private farmers for a long distance without an increase in mortality rate.

4. **Grower support.** Current hatching capacity can provide day-old chicks to 300-350 growers of average size (for the Burgas region) operating on a four cycle per year system. Hatching egg production can support approximately double that amount and hatching facilities nearer grower groups can be rented as needed.
5. **Number of private farmers.** Private farmers can produce as much poultry as can be utilized by COMPANY. A favorable price-cost ratio resulting from, among other things, shorter growing periods and better feed to meat ratios will bring presently idled producers on line.
6. **Production per private farm.** With fixed broiler houses, average production per private farmer is approximately 7,000 birds per cycle with four cycles per year. However, better hybrids and the proper feed mixes to be introduced by COMPANY can lead to a five cycle per year system, effectively increasing the same producer's capacity from 28,000 birds per year to 35,000 birds per year.
7. **Feed production.** Current feed production at VITAPROT is sufficient to supply all poultry producers with pelleted feed--the desired form. Maximum production is 500 thousand tons per year. The facilities can produce any mix of feed needed for poultry production. Excess production capacity not required by COMPANY's own growers will be marketed to other private farmers on a cash basis. Transportation equipment is adequate to ship feed wherever needed if demand is coordinated as it would be in COMPANY.
8. **Slaughter facilities.** The processing capacity (as now producing frozen birds and limited further processed products) of the slaughter plant (AKVILA) is 1,000 tons per month. In birds, this is approximately 45 - 50,000 per day, or 12 million birds per year. Freezing facilities now under construction will provide substantial storage space for frozen products, thus permitting AKVILA to respond to variability in market conditions and frozen product assembly needed for large unit shipments into foreign markets.

## **X. THE PRIVATIZATION PROCESS**

Key to every aspect of this project is the privatization process, the mechanism by which state and municipal enterprises are transformed into private enterprises owned and controlled by individuals. It has become the driving and guiding force in this project.

The privatization process will determine (1) if the project can be done, (2) if so, how steps must be put together, and (3) what results are dictated by privatization rather than by other economic, business, personal, and financial forces. General rules have been defined for the privatization process, agencies to whom applications are addressed and who carries out activities associated with the process have been identified, direct discussions with the municipality of

which AVES is part have yielded a list of steps to be followed and useful terms of privatization exchange have been discussed.

Privatization laws and associated regulations are just now being developed. Requirements or guides in the law have not been used and innovative approaches to privatization have not been tested.

Privatization begins with identification of state or municipal owned enterprise. The law provides such enterprises can be converted to state property sole proprietor companies. Enterprises do not, however, need to be so converted before privatization can take place.

Each of these enterprises in the project is of a different status:

- ▶ AVES is an enterprise owned by the municipality of Kamenovo.
- ▶ VITAPROT is a state enterprise that has been converted to a state owned sole proprietor company with 14,900 shares of stock.
- ▶ AKVILA is a state enterprise that has not been converted. It was recently placed on a list of 27 enterprises to be privatized by year's end.

The privatization process may be initiated in several ways. The state or municipality may initiate on its own, management may propose privatization, or workers can propose privatization. Privatization intentions have been announced for AKVILA. After discussions with the municipality of Kamenovo a tentative decision was made to have AVES propose privatization by letter to the municipality when the ACDI report on the project is completed. Conditions may, of course, change rapidly.

A few things must be done prior to the bidding process. A survey of legal aspects of the enterprise is conducted to determine ownership, etc. This is conducted by lawyers for the state or municipalities. The debts, financial, and economic state of the property is assessed. The enterprise is evaluated by licensed evaluators.

AVES was recently evaluated and indications are that a straightforward update will be sufficient to bring the evaluation current. VITAPROT and AKVILA would need evaluations and requests for evaluations should proceed with the privatization process.

The state or municipality will decide upon privatization and will decide upon bidding terms, then terms of bidding will be announced.

Bids are then submitted by interested parties. It appears a wide variety of proposed terms and conditions can be included in the bids.

New regulations require that five to ten percent of the evaluation total be submitted with

the bid. The general rate is ten percent, with lesser percentages being possible for certain employee bids. The deposit is returned if the bid is not accepted or is applied to the price if the bid is accepted.

One factor may complicate the bidding process. Workers are given preferential treatment to participate in bidding and receive preferential share prices. Preferences depend upon time worked, leading to worker payments of up to 10 percent less than the nominal value. A tender by a worker representative can receive up to a 30 percent discount. These rules are under current discussion by the Government. Possible participation by worker groups associated with the three enterprises is at present unknown.

A bid may be accepted or the state or municipality may refuse to accept any bid. If a bid is accepted, documents describing conditions are given to the successful bidder and payments for the company commence according to agreed-upon terms.

The law gives several alternatives for payment. The method that appears the most attractive is similar to an installment sale. Payments are made periodically until the final agreed upon price has been paid under terms agreed to in the bidding process. Full ownership is then transferred to the purchaser.

In the period during which payments are made but prior to final transfer of title, COMPANY will exercise almost all rights and obligations of ownership. Specifically, COMPANY will have complete rights to control all operations and retain all profits, generated in its business.

One important issue to be addressed and subjected to tactical and strategic planning as part of the privatization process is possible equity issuance by the state or municipality that does not require immediate payment by stock recipients. Management, employees, and private producers are in no position to make payments for equity interests received. While the full range of possible arrangements to address this problem has not been explored, several patterns may be suggested. Other alternatives should, of course, be explored.

First, the state or municipality privatizing the enterprises may simply give equity interests free of obligation as a recognition of roles recipient groups have played in bringing these successful enterprises to their present status despite poor experiences of comparable organizations in Bulgaria.

Second, arrangements may be negotiated that do not require immediate satisfaction of equity recipients' obligation in cash but allow payment over time. For example, application of dividends on capital stock applied to the purchase price may present a feasible payment system.

Third, equity recipients may receive loans directly from one or more third parties to enable them to purchase stock as individuals.

Fourth, a financial arrangement may be devised in which a third party, such as a trust or trustee financial institution, may be established or used initially to pay on behalf of the equity recipients. The trust could be phased out by collecting dividends on capital stock it holds in trust for equity recipients in exchange for stock whose title is to be transferred to the final stock recipients.

The third and fourth scenarios would require close participation by an outside lending source.

## XI. FINANCIAL STRUCTURE

The genesis of COMPANY in the privatization process, a new phenomenon for most economic and business enterprise systems, requires a somewhat new view of financing. In broad terms, the financial structure of a business enterprise recognizes and defines the claims upon assets used for productive purposes. Usually, the creation of these claims arises at the same time the assets are created and the capacity to produce begins.

The privatization process is, in some ways, quite different, although assets and claims upon them still exist and must match. When COMPANY is formed and the three existing, operating enterprises are privatized into it, all productive assets are in place. These assets and associated productivity exist but the usual sequence of creation of assets and creation of claims against assets has not been followed.

COMPANY will commence its activities with obligation to the municipality and state as determined in the bidding process and agreements about terms of payment. This obligation is to make payments toward purchase of the three enterprises.

From a practical, although not necessarily strictly financial or accounting principle, claims on COMPANY's assets by its own shareholders should develop only according to the proportion of total purchase price paid at any one time. For example, investment in COMPANY at the 1/3 point in the payment scheme need only reflect issuance of 1/3 of its total stock authorization. In this manner COMPANY will have time to develop its value to investors and investable funds will have a chance to develop in the Bulgarian economy.

Immediate capital demand will reflect three needs.

First, COMPANY must be formed and must engage in the bidding process. Formation should not be an expensive proposition. However, recent regulations require that 10 percent (or less in the case of certain employee bids) of the evaluated price of the state or municipal enterprise be deposited with the bid. COMPANY will need this amount of money to bid. When accepted, the deposit is applied to the price of the enterprise. Negotiation may permit a delay or reduction of early payments to reflect the up-front deposit. The exact amount needed must be determined at the time bids are submitted but can be estimated prior to that time. Enterprises

are valued as part of the privatization process and it is that value upon which the deposit amount is based.

Second, COMPANY will need some working capital for its first year of operation. However, it should be kept in mind that all three organizations are now operating and generating income for immediate capital needs, although they will need additional funds for the change in method of doing business. The exact amounts required have not been calculated, but the financial portion of a formal feasibility study will estimate such requirements.

Finally, some initial capital investments will be needed to convert some current practices and equipment to more suitable form. Examples are purchase of new hybrids, some transportation equipment, and purchase of new feed ingredients for the first year's use. These amounts also must be calculated after examination of each operation and planned activities.

## **XII. MARKETS AND MARKETING**

Correction of present unfavorable market conditions and resulting excess capacity at all levels in the poultry industry will be accomplished in four ways by COMPANY.

First, substantial cost reduction will be realized relatively quickly by replacement of present parent stock with more productive hybrids and the immediate implementation of a peak performance feed production program. For example, reduction in cost of production by improvement of the feed conversion ratio alone (from hybrid and feed improvement) can lead to a cost savings at the grower stage of twenty percent or more.

The impacts on markets, domestic and international, will be felt by reduction in product price. This reduction will be significant and will change the chicken-to-pork price ratio now having a major influence on chicken consumption.

Second, profitability at the private farmer level will increase and the supply of lower cost chickens will place COMPANY in an excellent marketing position. This profitability grows partly out of the feed cost reduction but also in the shortened growout period leading to more production cycles per year. Growers can realize 10 - 15 percent increase in the number of birds produced with the same facilities.

Third, domestic marketing programs will be introduced. To this point, little active marketing was conducted due to the nature of the planned economy. With a market economy, however, opportunities for imaginative marketing, branded products, and creative delivery systems will become available. These marketing activities along with the increase in per capital consumption brought about by lowered prices place COMPANY in an excellent position within the Bulgarian poultry industry.

Finally, development of the important export markets will be pursued vigorously. The

main potential customer, Russia, has an extremely high but currently ineffective demand for Bulgarian poultry. The marketing arms of organizations to be privatized into COMPANY have developed good contacts with Russia. This investment will be made to pay off as barter is extended to poultry exports. Current discussions, for example, are considering trade of poultry for coal. The traditional relationship between the Soviet and Bulgarian economies was Bulgarian import of raw materials for some of its very large manufacturing operations, a situation that may be capitalized upon.

Other markets considered by industry experts are Turkey and Greece. The location of COMPANY at Burgas, Bulgaria's major port, places it in an exceptional position with respect to exports throughout the Black Sea region.