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Consultancy Report

Agrowest Comprehensive Business Study

Agricultural Input Marketing Support - Hungary
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Agrowest Business Study

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Agrowest Kft

I. Overview

Vetomag Vallalat (VV) was the government monopoly which provided seeds and other inputs to state and collective farms. VV had a network of regional subcenters that was restructured into eleven limited stock companies (Kft) and a jointly owned Vetomag Trading Company (VK). Eight of these limited stock companies (Kft), including Agrowest, became independent seed production and distribution companies. The eight companies are called the seed group. VV is bankrupt and is being liquidated. Due to substantial debt obligations and declining markets the survival of the remaining Kfts, including Agrowest, is in doubt.

a. Ownership and Legal Status

The current ownership and capitalization of the company is about 63.4 million HUF (Appendix). The largest shareholder is OKHB, the state bank. VV previously owned the largest equity interest but took out a loan on its equity interest. VV found itself in a position of being unable to pay back its credit obligations to OKHB. The mortgaged shares have subsequently reverted back to the bank. Another large shareholder is an Austrian company, the Osterreichische Raiffeisen Warenzentrale GmbH, Vienna. The Austrian company owns 9.7 percent of the company. Agrowest is currently in the process of negotiating a complicated debt for equity swap. The status of the negotiations is unclear.

b. Production and Marketing

Agrowest (Kft), founded on November 29, 1989, is a limited stock company and a member of the seed group. The company's production and marketing operations cover three counties in Western Hungary, including: Vas, Veszprem and Zala counties. Agrowest is involved in seed production, purchasing, processing and distribution of the following seeds:

Fodder Seeds - red clover, crimson clover, white clover, common vetch, fodder and various lawn grasses;

Industrial Seeds - winter rape, fodder rape, mustard, and peas; and,

Cereals - spring barley, winter barley, oats, winter wheat.

A substantial portion of Agrowest's sales is in hybrid maize seed. There is

one regional hybrid seed corn processing facility in the area. This plant, which does not belong to Agrowest, has limited capacity and cannot fulfill the region's hybrid corn demand. As a result, Agrowest purchases hybrid corn from various parts of Hungary and from Pioneer.

The primary marketing and sale's activities of Agrowest are in the wholesale trade of agricultural seed. In Hungary, their customers include a small network of 650 shops and stores, private farmers, and numerous limited joint stock companies (former state farms). Agrowest also exports rapeseed and grass seed to the European Community, Austria, Turkey, and the former Soviet Union.

II. Production And Technology

a. Description of the Plant and Equipment

The operating equipment is housed in a four story concrete building that is fifty to sixty years old. The production facility houses three departments:

- o seed cleaning;
- o seed testing laboratory; and,
- o administration offices.

During the seed cleaning season, which lasts over a 10 month period, the plant runs two 10 hour shifts per day staffed by eight persons per shift. Agrowest cleaned forty-nine different crops during the 1992 production season.

The physical layout of the production facility imposes limits on efficient seed processing. Cleaning is carried out on four cleaning lines. One line cleans specialty crops such as grass seed. The other three lines are used for general seed crops. Two of the four lines can be combined for cleaning large lots. The clean seeds from the combined lines merge at a common sack off point.

The cleaning equipment is of European (primarily German) origin. Basic equipment and accessory items are adequate to clean the seed crops in a timely and efficient manner. The equipment is well maintained. An extensive list of Agrowest's cleaning equipment can be found in the Appendix.

b. Production Flow

Production flow starts at the farm level. Seed crops are combined and then either solar dried or taken directly to the plant. Seed that is combined in

excess of 12-13 percent moisture must be dried to 12-13 percent moisture to prevent heating which destroys germination.

When seed is ready for cleaning it is brought to Agrowest in bulk or bags. It is sampled upon arrival. Seed is then transferred into metal bins or stored in bags to await cleaning. A lot number is assigned to the seed. Some seed stored in bags is transferred to metal bins prior to cleaning. All seed is stored under cover prior to cleaning.

Seed lots to be cleaned are transported by forklift from storage to the plant. The four cleaning lines in the plant are equipped with a separate pit and bucket elevator. From the pit, seed is elevated to the third or fourth floor by bucket elevator. Aspirators are used to remove dust, chaff, light seed and inert matter. Screen machines, gravity tables, indent barrels, velvet rolls and magnetic machines are used during the cleaning process.

c. Quality Control System

Agrowest personnel sample the seeds by hand several times a day. Seed lot uniformity is critical to the seed cleaning business. Hand sampling is, however, not the most efficient method of obtaining uniform random samples. Without a uniform sample, the accuracy of sampling results are questionable. After each lot is sampled, tested and certified by the State, bags are sewn shut, tagged, and sealed. As a result, bags are left open for a period of four days awaiting the results of an official test. Open bags invite contamination from other seed origins or other sources.

The seed testing lab is the primary point of quality control. On the basis of purity test results changes are made in machine settings and screen size. Germination tests are run twice: as the seed enters the plant from the field; and, upon completion of the cleaning. A unique feature of the lab is the mini-cleaning equipment. Samples of raw seed are run through the equipment prior to the main lot being cleaned in the commercial cleaning plant. Problems can be detected and alleviated prior to cleaning the larger lot.

d. Production Resource Staffing

The production facility has 82 staff members. The cleaning plant staff consists of one foreman, his deputy, 18 production workers and cleaning staff. The warehouse staff is comprised three warehouseman and four additional personnel. The shipping and registry department consists of one group manager and six staff administrators. The seed lab staff consists of a department head and her deputy, four analysts, four samplers and one

administrator. The maintenance staff consists of seven persons. The staff is well trained and thoroughly professional.

e. Supply Contracts

- o Acreage is contracted at planting time with farmers to supply Agrowest with seed to satisfy current and potential sales contract.
- o In most cases, the entire production of a given acreage is purchased. This is preferable because extra seed is kept in Agrowest's inventory rather than allowing it to fall into the hands of their competitors.
- o Agrowest pays the certification fees for seed produced for replanting. Agrowest extracts a premium from sales to recover certification fees.
- o Seed produced for industrial use (oil, birdfeed) is not certified.
- o The grower contract explicitly details price, quality specifications, and payment terms.
- o The harvested seed is stored with the grower until called for by Agrowest.
- o Agrowest coordinates delivery from the farm to Agrowest.
- o Agrowest pays the freight from the growers warehouse to its plant.

f. Maintenance

A maintenance department consisting of seven people does exist. It solves all of the operational and maintenance problems. Problems which require special knowledge are solved by outside companies and services. Generally, the equipment is well maintained. Maintenance is performed throughout the year.

g. Strengths and Weaknesses

1. Strengths

- o The company is located in an area with climate conditions conducive to raising seed crops of high quality and quantity.
- o There is an effective quality control program in place.

- o Good quality of strategically important products (i.e. rapeseed).

2. Weaknesses

- o The physical layout of the plant is inefficient. Seed is handled too often by hand.
- o There is no program in place that provides data to determine the true cost of production.
- o Hand sampling is not uniform. Quality analysis results are questionable.
- o Leakage from machinery and equipment is excessive.
- o Lack of own capital for new investment.
- o Uncertain production costs due to inefficient cost accounting system.
- o It is not clear how the Turnover/Production Department is integrated into the production process.

f. Recommendations and Conclusions

Some recommendations for cost reductions and plant efficiency improvement are outlined below. These recommendations include:

- o Construct or renovate loading areas to receive raw seed in bulk form. This would speed up handling and reduce the number of times that seed is handled. Specialty seed and small lots should remain in storage bins or bags.
- o Move seed from bulk storage to cleaning by air rather than by fork lift. This would require minimal capital investment, but would substantially reduce labor costs. It reduces the number of times that seed is handled.
- o Bags should be sewn shut as soon as they are filled.
- o Seeds should be sampled by automatic sampler or by probe.
- o Spaces that allow leakage should be closed.

- o Any unusable or contaminated seed separated from the main lot should be piped to the main floor and disposed of immediately rather than being allowed to remain in open bags and then disposed.
- o Field personnel should fill out a log of their daily work related activities. From this log, costs of field work as a function of the total cost of production can be derived. An example of such a log is shown in the Appendix.
- o Greater emphasis should be made to understanding and calculating the actual cost of production. An example
$$\text{Cost of seed} + \text{fieldman's time/crop} + \text{cleaning cost} + \text{seed lab costs} + \text{certification costs} + \text{shipping cost} = \text{cost of production.}$$
- o Utilize internal reserves by restructuring the company's production and marketing functions. Remove the full time marketing person from the production department and develop a separate marketing and sales department.
- o The shipping and registry department could be reorganized by eliminating 2 or three positions with no loss in efficiency.
- o Understand each cleaned seed's cost and contribution margins and eliminate company's loss making activities.
- o Formal production group and job descriptions should be developed.

III. Financial and Accounting

Agrowest is experiencing a substantial decline in sales that will affect its ability to service debt during the second half of 1993. The company derives about 90% of its revenue from the sale of seed and grains, with about 10% of its revenue coming from its retail and warehouse operation. Agrowest has taken steps to reduce interest costs and debt loads. However, its current weak financial situation requires immediate restructuring of debt to reduce interest payments and prepare it for privatization.

a. Income Statement Analysis

The table below illustrates comparative income statements for June, 1992, December, 1992 and June, 1993. For the first half of the year, sales of 400

MHUF¹ included export sales of 87 MHUF. Total revenue is 20% less when compared to June 1992. Sales dropped 20.8% in 1992 to 945.7 MHUF from 1,194.2 MHUF in 1991. A times interest earned ratio (TIE), calculated by dividing earnings before interest and taxes (EBIT) by interest paid (70.8 MHUF/92.7 MHUF), was 0.76 in 1992. This means Agrowest is not generating sufficient revenue to cover interest payments and as a result, cannot cover its fixed costs. The company was profitable in 1992 due to an extraordinary gain from a favorable legal settlement.

¹ Million Hungarian Forints

	1992 (MHUF)	1992* (MHUF)	1993* (MHUF)	% Change 6/92-6/93
Revenue	945.7	529.7	408.4	-22.8%
Cost of Goods Sold	818.8	437.5	341.4	
Gross Margin	126.8	91.7	66.9	-27.0%
Gross Margin (%)	13.4%	17.3%	16.4%	
Cost of Sales	77.6	32.4	29.0	
Other Costs	25.7	4.3	2.8	
Operating Income	23.6	55.1	35.1	
Interest Income	47.2	0.1	0.3	
EBIT	70.8	55.2	35.4	-35.8
Interest Expense	92.7	48.5	41.8	
Extraordinary Items	32.8	3.3	0.4	
Profit Before Tax	10.9	10.0	(5.9)	
Taxes	5.6	0.0	0.0	
Net Profit	5.3	10.0	(5.9)	

* Results through June 30th.

An additional concern is the year-on-year decline in EBIT. At June, 1992 the TIE ratio was 1.1, but for June, 1993, it had declined to 0.85. Although Agrowest had a net profit of 10 MHUF for the first half of 1992, it had a loss of almost 6 MHUF for the first half of 1993. The results indicate a continuing decline in the performance of the company. If the drop in the company's financial performance is not abated Agrowest may fall into bankruptcy.

b. Balance Sheet

Through the end of 1992, Agrowest was a highly leveraged company, burdened by a debt to equity ratio of almost 6. Results have changed dramatically for 1993. As shown below, inventory levels have dropped to 117.1 MHUF at 6/93 from 257.9 MHUF at the end of 1992. It should be noted that the change from 6/92 is not as dramatic. Most likely, stocks are sold down during the first half of the year and then replenished with grain purchases in the late summer. Receivables maybe factored at 25% of value. Standardized or industry specific factoring rules do not currently exist in Hungary. In Agrowest's case, inventories should be valued at approximately 60 % of book value.

	12/92	6/92e	6/93e
Current Assets			
Cash	9.003	7.488	7.251
Accounts Receivable	161.508	232.341	150.571
Inventory	257.875	168.933	117.091
Prepaid Expenses	3.041	0	0
Total Current Assets	431.427	408.762	274.913
Fixed Assets (Net)			
Land & Building	6.026	6.056	5.995
Machinery and Equipment	11.085	14.502	12.488
Other	6.059	2.137	3.245
Intangibles	1.076	0.138	0.884
Financial Assets	3.292	2.876	3.292
Total Fixed Assets	27.538	25.729	25.904
Total Assets	458.965	434.491	300.817
Liabilities & Equity:			
Current Liabilities			
Accounts Payable	29.198	93.797	14.944
Bills of Exchange	35.800	32.720	0.000
Short-term Credit	267.430	168.228	209.510
Other	35.127	63.908	13.058
Total Current Liabilities	367.555	358.653	237.512
Accrued Liabilities	22.176	0	0
Long-term Debt	0	0	0
Provisions	1.474	0	1.474
Other Debt	0	0	0
Total Liabilities	391.205	358.653	238.986
Equity			
Capital	63.645	63.645	63.645
Retained Earnings *	2.157	2.190	4.120
Current RE	1.958	10.003	-5.934
Total Equity	67.760	75.838	61.831
Total Liabilities & Equity¹	458.965	434.491	300.817

A comparison of debt, liquidity and efficiency ratios for the end of 1992 and 6/93 shows varied improvement:

	12/92	6/93
Current Ratio	1.17	1.15
Quick Ratio	0.46	0.66
Receivables Turnover	6.3	4.3
Inventory Turnover	2.4	5.1

The current ratio, which is current assets divided by current liabilities, shows Agrowest's ability to repay its short-term debt in a hurry. The quick ratio is a tighter definition of liquidity than the current ratio. It is calculated by dividing cash and receivables by current liabilities. Agrowest has low liquidity, especially when considering the quick ratio. If the bank demanded immediate repayment of its loans to Agrowest, the company is not in a position to repay its loans.

Inventory turnover, which is cost of goods sold divided by inventory, indicates how quickly a company is able to rotate its stocks. A low number may indicate that the company is not selling its products fast enough and, as a result, has its cash tied up in its goods. Inventory turnover as of 6/93 has greatly improved. Seasonal conditions will affect the inventory turnover ratio because the company is expected to purchase grain crops in August and September. Moreover, year end 1992 inventory is almost 90 MHUF greater than June of 1992. The receivables turnover ratio, which is sales divided by receivables, shows that Agrowest has reduced its efficiency at converting receivables into cash. Agrowest's customer base has changed over the past few years contributing to its anaemic level of receivables. Fewer customers, or small farmers, have cash. Furthermore, the payment cycles are lengthening.

c. Management Information System

The improvement of the company's internal information system is just beginning. The company has carried out partial internal reorganizations. At present the information system produces the following:

- o volume of incoming material;

- o stock levels;
- o staff numbers;
- o company's revenues and expenses;
- o general data for the company; and,
- o staffing and wages.

There is however no routine quarterly income or balance sheet information available.

d. Financial Operations and Recommendations

Although Agrowest keeps track of its daily cash balances, the accounting department does not prepare a cash budget forecast at the beginning of the year. This is a valuable tool to anticipate cash short falls and surpluses. A simple recommendation is to take the production expenditures report prepared at the start of the year and combine that with a cash collections grid as shown below through June.

The cash flow example illustrated below is hypothetical and assumes a loan interest payments only. By matching cash collections with cash payments Agrowest will have a better idea of how much money is available to pay down debt or how much money it needs to borrow due to a cash short fall. In this example, the company will have to borrow money in January because there will be a cash short fall of 5 at the end of January.

The sales column shows how much the company may expect to sell. Collections on the sales are estimates because some are for credit. In January, sales were 100, but the company may only expect to collect 50 in January, 30 in February and 20 in March. The same procedure follows in February. Although sales are 200, one can expect to collect only 100 in February, 50 in March and 50 in April. The same procedure is followed for every month. This example can be extended to December.

Starting in January the expected collections for the month are totaled to obtain monthly cash income. In January, the company has 50. That is the total sum it can expect to collect. Expenses follow the same pattern. For each month, calculate the anticipated cash payments for materials, rent, and salaries. Total each column to obtain total cash expenditures for the month. For example, in

January materials were 20, purchases 15, rent 5, salaries 10 and interest on credit 15. These items total 65.

Subtracting expenses from cash collected, indicates whether the company had either a net inflow or outflow of money. In January, net cash is total collected minus total payments equalling a minus 15). The starting balance represents cash the company has on hand. Add this to the net cash figure to determine the companies ending balance. In January, the starting cash balance is 10. Adding this to net cash of -15 means the ending balance is -5. If the ending balance is negative, the company will have to borrow money to make up the short fall. In January, the company may have to borrow 5 to compensate for the deficit. The final balance is money borrowed plus the ending balance. Sometimes, a company will borrow sooner than it needs to because it anticipates interest rates may be rising soon. Borrowing decisions are made either for current or anticipated short term needs. Such decisions may be influenced by anticipated movements of short term interest rates. The ending balance for January then becomes the starting cash balance for February. This process is repeated for each succeeding month.

Month	Sales	Jan.	Feb.	Mar.	Apr.	May	June
January	100	50	30	20			
February	200		100	50	50		
March	150			70	40	30	10
April	150				100	30	20
May	125					75	25
June	125						50
Total Collected		50	130	140	190	135	105
Expenses:							
Materials		20	30	50	40	40	20
Purchases		15	25	35	5	5	5
Rent		5	5	5	5	5	5
Salaries		10	10	10	10	10	10
Interest		15	15	15	15	15	15
Total Payments		65	85	115	75	75	55
Net Cash In Flow		-15	45	25	115	60	60
Starting Cash Balance		10	0	40	65	180	240
Cash Deficit/ Surplus		-5	45	65	180	240	300
Credit Repaid		0	-5	0	0	0	0
Credit Received		5	0	0	0	0	0
Final Cash Balance		0	40	65	180	240	300

An important issue regarding Agrowest is the company's cost accounting system. Agrowest, for example, does not allocate any overhead to its warehouse and sales operations. Overhead is allocated using area occupied by the buildings or labor hours required to run the facilities.

Agrowest does not prepare balance sheets except for the year end reports. Income statements are available semi-annually. Both financial statements should be prepared on a quarterly basis to enable faster decision making based on financial results. A

monthly budgeted income statement should be prepared immediately. Actual results should be compared the expected results. This includes a comparison of profitability by product line throughout the year to understand which items are profitable. The availability of these reports allows management to act appropriately to changes in the economic and business environment. Moreover, it enables Agrowest to work with its bankers more effectively by informing them of financial troubles before they occur.

Agrowest's policy of selling seed to farmers on credit, paid for by product in-kind, is inappropriate. Although an interest charge is calculated, real cash losses may occur because less cash comes in to service the credit line. The company should sell its products for cash only, except under special circumstances. All credit sales should be against some form of collateral that is easily and quickly converted to cash, such as real estate, automobiles or other products in high demand. Prompt cash payment keeps revolving credit at a minimum and reduces interest payments. Furthermore, all delinquent accounts over thirty days should be contacted immediately, with a follow up visit 10-15 days later if no result is obtained.

Agrowest's international trade accounts for about 20% of its total sales. Due to the inherent risk associated with commodities in general and international commodity sales in specific, all transactions should be made with a letter of credit irrespective of any longstanding business relationship.

IV. Marketing and Trade

Agrowest plays a major role in supplying and distributing seed for cereals, corn hybrids, and industrial feed crops in three different western Hungarian counties. Its production, distribution and sales area covers more than 685,000 hectares. The region is well suited for turf and rape seed production due to positive climatic factors such as: medium quality soils, above average rainfall, and moderate temperatures. As a result of positive growing and environmental conditions, Agrowest has considerable natural advantages in seed growing and sales.

a. Sales Revenues

Over the past three years, Agrowest's customer base has fluctuated between 600 and 1,000 customers. The company's customer base consists of cooperatives, state owned farms, private agricultural trade companies, and private agricultural producers. Sales revenues over the 1990 to 1993 period have declined by 20% per annum. The average level of sales over this three year period was 1.1 MHUF.

Year	Sales Revenue
1990	1.146 MHUF
1991	1.194 MHUF
1992	0.932 MHUF
1993	0.60 to 0.70 MHUF

The company's declining sales revenues can be attributed to several factors, including:

- o Current economic changes and reforms in Hungarian agriculture resulting in 20% declines in agricultural seed demand. Marginal agricultural lands were removed from active cultivation due to ownership changes and financial problems. Approximately 15 % of agricultural lands were set aside during the past three years.
- o Private (joint stock companies) production systems such as KSZE, KITE and IKR strengthened their market positions in seed trade and production. These private production systems have vast international activities. They are funded jointly by cooperatives, state farms, banks and various agricultural producers.

The roles and functions of the private joint stock production systems can be more succinctly explained as follows:

- i. Bilateral and joint relationships with current and probable users of farm products. These relationships have existed for a long time and are strengthening.
 - ii. Teaching and training of modern organization and management practices to the agricultural community.
 - iii. Giving credit guarantees, extension contributions, producer contracts for crop yield repurchases, and other financial support for the agricultural community.
- o Breeding institutions initiated more independent and proactive involvement in the marketing and direct sales of their seeds. Some new

small scale trade companies have developed not only as active competitors but as seed buyers.

- o Government intervention revoked direct and indirect subsidies to the agricultural sector, reducing across the board farm input demand. The declining role of the Hungarian agricultural input market has reduced export market opportunities.

b. The Sales Product Mix

The principal changes in the company's sale's mix over the last three years include:

- o The proportion of cereals as a percent of total sales decreased from 15% to 10%. This decline was a direct result of increasing farm seed utilization and decreasing agricultural farm lands.
- o Corn seed sales declined from 35% to 13%. Corn seed sales declined from 414 MHUF in 1991 to 88 MHUF in 1993. Strong competition from several private companies resulted in a substantial loss of Agrowest's market share.
- o The ratio of feed crops has favorably been changed from 18% in 1990 (217 MHUF) to 34% in 1992 (317 MHUF). Crops such as turf, crimson clover, red clover, and red fescue are becoming increasingly important in Agrowest's sales product mix.
- o Industrial crop seeds have increased by a modest 10% over the past three years. The proportion of crop seeds to total sales is 40%. The level of industrial seed sales as a percent of total sales has stabilized at the 40% level.
- o Flower and vegetable seed sales have increased by 10% to 13% per annum over the past few years. Growing demand by small private farmers and hobby farmers has contributed to the robust sales.
- o The number of customers has increased significantly during the last three years. However, the amount and value of seed purchased per customer has actually declined. Sales to private traders and cooperatives are increasing while sales to state owned companies are decreasing.

Customers By Value of Purchase (1992)

	Category I (More than 10 MHUF)	Category II (5 to 10 MHUF)	Category III (1-5 MHUF)	Category IV. (Less than 1 MHUF)
Customer Profile	Seed Trade Companies (8)	Seed Trader Companies Cooperatives Private Farmers	Seed Trade Companies Cooperatives State Farms Small Scale Farm Suppliers Seed Producers Foreign Seed Trade Companies Private Consumers	Same as Category III.
Total Sales Value	243 MHUF	42 MHUF	126 MHUF	521 MHUF
Average Sale Per Customer	30 MHUF	7 MHUF	2 MHUF	77 Thousand HUF
Percent of Sales as A Function of Total Sales	26 %	4.6%	13.4 %	56%

c. Pricing Policy

Agrowest's pricing policy is heavily influenced by several factors including: demand, current cash flow requirements, and competitor prices. The Vetomag Trading Company (VK) developed an indicative price list but is under no obligation to comply with this list. An analysis of the company's prices and gross margins shows that there is substantial variance between products. The two leading product groups (feed and industrial crops) have passed the 30% price margin level. Among the varieties in these two leading categories, five have price margins of 40 % or more.

d. Marketing Strategy

Agrowest's marketing strategy is currently being revised. No strong marketing organization exists. In addition, the staff members that are involved in company marketing and sales practices have limited practical marketing knowledge. The company's sales and promotions activities are virtually nonexistent. The company's marketing efforts is applied almost exclusively to the domestic market. More than 40% of Agrowest's sales are in the domestic market. Export sales however, need a more sophisticated and sustainable marketing effort to be effective.

Agrowest can develop a midterm mission statement and image with special packaging and trade work policy. The object of this goal is to show strong service oriented identity and to obtain stronger market position. Agrowest's sales activities are based on historical habits. The company must be more aggressive in influencing consumer needs and assisting its consumers. A well designed logo and advertising campaign would be useful in establishing a well defined domestic presence and market share.

e. Margin Analysis

Agrowest produces 10 crops with a gross margin of 10% or less. Five of these crops (white clover, sunflower, millet, fescue and red top) are loss makers. Two crops (corn and oats) have gross margins exceeding 10 %. The total combined company sales from these crops is 281 MHUF representing 37 % of total revenues. Four crops (pumpkin oil, potato, oilflax, winter wheat) have gross margins exceeding 20 %. The total value of these crops is 63 MHUF representing 9 % of total revenues. Six crops (winter rape, rye, leguminous fodder crops, fodder barley, turfseeds, and pea) have gross margins exceeding 30 %. The six crops with the highest contribution margins contribute 47 % of the company's revenue of 352 MHUF.

Gross Margin By Seed Category

Product	Tons	Sales Revenue (Gross Margin)
White Clover	2.5	0.5 (-10%)
Feed Rape	6	0.3 60%
Winter Rape	34	0.4 30%
Oil Pumpkin	47	7 20%
Potato	82	2 20%
Corn	182	110 10%
Rye	204	3 30%
Oil Flax	600	13 20%
Millet	740	11 (-10%)
Legume Fodder Crops	814	70 30%
Oat	1,200	16 10%
Spring Barley	1,500	23 30%
Sunflower	1,900	26 (-10%)
Grass	2,100	155 30%
Winter Wheat	2,700	41 20%
Pea	5,200	99 60%
Total	17,300	580¹ MHUF

¹The projected revenue for 1993 is 750 MHUF. The difference is made up by more types of small volume products and retail sales. The average markup is approximately 20 percent.

f. Strengths and Weaknesses

1. Strengths

- o Agrowest is closely associated with 25 seed retailers and 830 customers. They are attempting to expand into regions that they have historically not been allowed to enter. The communication and information system has not been supported by computers in an appropriate way.
- o Agrowest sells good quality seed with a wide selection of varieties. They operate a retail store which facilitates contact and customer relations with locals, small growers and hobby gardeners.
- o Agrowest maintains a favorable market position in turf and rape seed production.
- o Agrowest possesses broad experience in the field of export seed production contracts with foreign seed trading companies especially rape and turf seed.
- o The company's product structure is favorable as the ratio of products with gross margins exceeding 30 % contribute to more than 47 % of the company's total revenue.

2. Weaknesses

- o Agrowest has no proper flow of information and research regarding current market conditions.
- o Agrowest has no solid trade image. A division of trade agents has not been organized.
- o Due to insufficient funds, Agrowest cannot compete with production companies that are able to finance input costs for growers especially in the production of cereals and corn hybrid seed.
- o Agrowest has no clear company organization and incentive for agents to complete their responsibilities more efficiently.

- o Agrowest displays no coordination or team work efforts among departments.
- o Contribution margins may be inaccurate due to inappropriate accounting procedures. It is not clear whether Agrowest allocates its labor costs efficiently across product lines. Furthermore, Agrowest does not keep fieldmen's logs. This will arbitrarily affect the relative contribution margins.
- o Agrowest has an uncertain and ambiguous relationship with VK with respect to ownership, trade and finance.

g. Recommendations and Conclusions

a. Short-term:

- o Increase export and promotion activity of seed production contracts in turf and rape seed.
- o Set up a market strategy to develop and identify advantageous opportunities. Agrowest should:
 - o Use a fieldmen's log and accurately record and allocate the labor to the correct product.
 - o Set up appropriate accounting rules that accurately allocate labor and overhead to each product.
 - o Determine correct contribution and gross margins.
 - o Develop a three tiered market strategy that evaluates how the sales strategy will change for products with low margins (up to 10%); medium margins (10 to 20%) and high margins (everything above 20%). Low margin products are commodities. A large volume of product must be sold to make money. Medium and high margin products require targeting specific customers and developing proprietary brands according to user specifications.
- o Increase domestic market share by building a dealership network and improving sales of the highest margin products.

- o Focus marketing and sales efforts on products with gross margins over 20 %. Currently, 56 % of the company's total product mix is derived from these high contribution margin products.
- o Fodder rapeseed has a considerably high gross margin (60%). It would be to the company's benefit to increase the volume produced and sold. Foreign and domestic fodder rapeseed demand is increasing.

b. Mid-Term:

- o Provide additional marketing responsibilities for product managers including developing annual marketing plans; setting up sales targets; and, developing promotional campaigns.
- o Initiate internal structural changes with the development of marketing and sales departments.
- o Organize short-term fundamental marketing and communication courses for the sales and marketing staff.

c. Long-Term:

- o Set up a computerized marketing information and sales data base for the primary products. The data base should include: price, quantity, purchase date, where shipped and other relevant data.
- o Research market possibilities for alternative product uses. Initiate a research and development program which will lead to the development of "brand" name proprietary seeds.
- o Identify market demand for the service of small scale cleaning. This will enable Agrowest to use their lab technology more efficiently.

V. Organization and Human Resources

The organizational structure of Agrowest is shown in the diagram on the following page. Current staffing requirements include 126 full time workers and 6 to 10 part time workers. Agrowest also has 56 persons marketing its seeds in three regions. These persons are paid on a commission basis. Of the current full time work force, 22 have college education and 65 have high school or Trade School. The work force is

highly educated and generally well-trained. The reduction in staff has been carried out deliberately, in accordance with changes in production tasks and poor financial performance.

a. Organization

Agrowest is divided into three main staff departments:

- o The engineering or production group. This group has four subdepartments including the Turnover Department, the Field Department; the Production Department; and the Cleaning Department.
- o The finance department. This group is separated into six smaller sub departments including, the Payroll Department; Financial Department; Accountancy Department; Administration; Computer Operations; and the Warden's House. Within this grouping is a corporate lawyer and security group. And,
- o The general management department. This group is composed of a general manager and two subdepartments.

b. Organization of Policy Making Group

In terms of power distribution and voting rights, the power distribution is as follows:

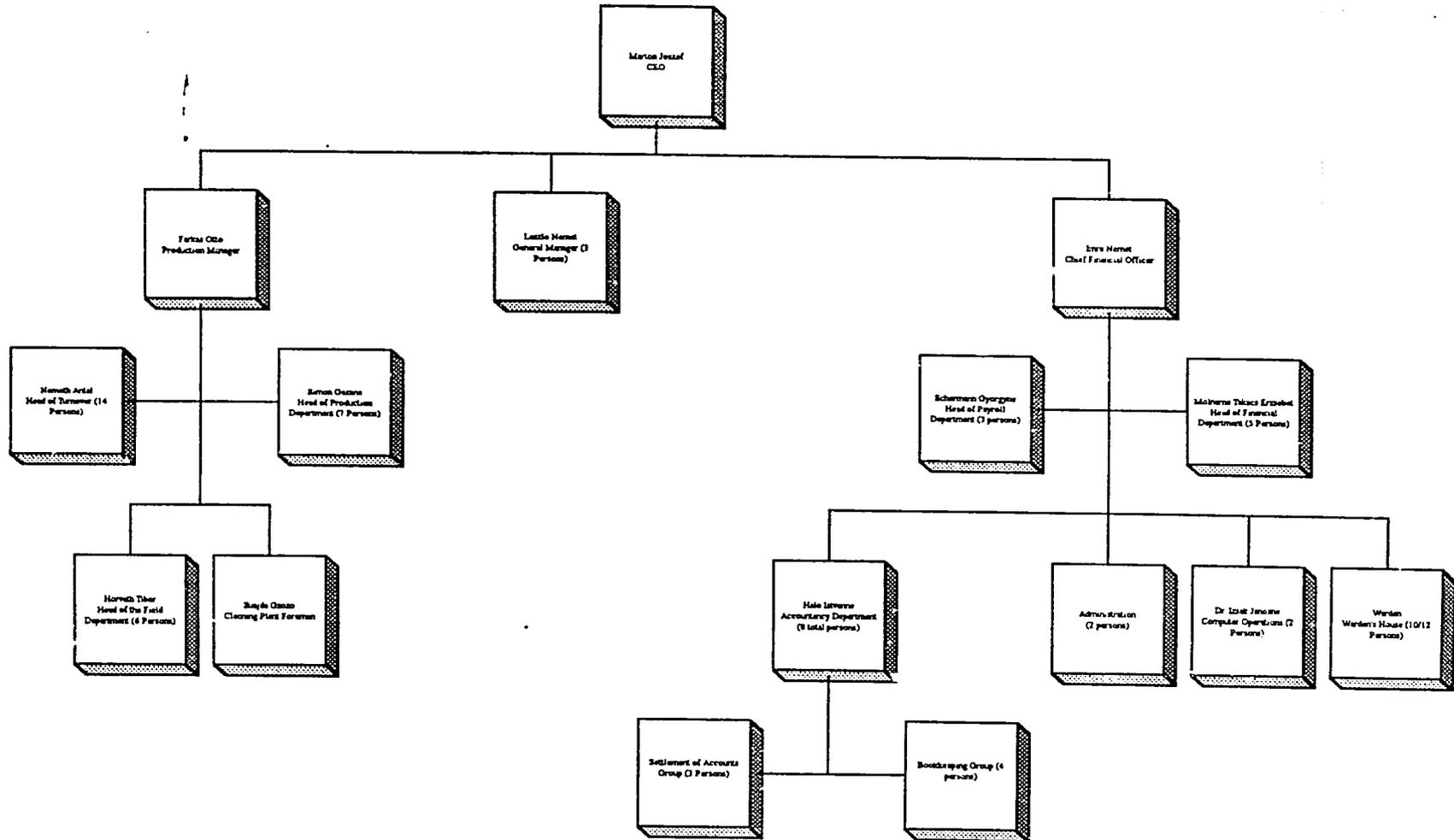
- o Company shareholders manage and vote on the general operation of the company.
- o The Supervisory Board controls the general management of the company. And,
- o The General Manager organizes and manages the daily operation and finances of the company.

Informational meetings are not held on a regularly scheduled basis, but on an as needed basis only. Managers and department heads generally hold meetings with their staff on a semiformal basis.

c. Employee Evaluations

The company has no formal employee evaluation system. Reviews are made

Agrowest Kft Organizational Chart



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by the individual department head. Pay increases are reviewed by the general manager. Because of Agrowest's poor financial position wages and salaries are frozen for the indeterminate future. The company does not have formal job descriptions for its employees.

d. Comparison of Wage Level

The wage level of the company reflects the regional average and is in line with other comparable companies.

e. Strengths

- o A well-trained and dedicated workforce.

f. Weaknesses

- o No formal employee evaluation system.
- o No formal job description for any of its employees.
- o No formal (separate) marketing and sales department. Marketing and sales personnel are segregated into groups with different managers in the production department.
- o No formal or ongoing employee training program.
- o Middle and higher level management lack expertise and competence in marketing and distribution functions.

g. Opportunities

- o Developing a formal marketing department with the objective of increasing sales and marketing efficiency.
- o Developing formal job descriptions and time sheets creating more efficient product cost analysis and increasing employee productivity..

VI. Conclusion

Any financial strategy for Agrowest will require restructuring of debt to reduce interest payments. However, a revolving credit line must still be maintained in order to finance the purchases of crops, supplies and other materials. Current plans under consideration include changing the revolving line of credit into a long term bond that

is convertible into equity may not be sufficient. For example, converting 200 MHUF⁴ into a long term bond of three years with an 8% coupon requires 16 MHUF. This is a savings of 44 MHUF over an average annual revolving credit line of 200 MHUF at 30% requiring a payment of 60 MHUF. If 44 MHUF is enough to purchase grain then Agrowest requires no further credit. However, if 70 MHUF is needed to buy grain, Agrowest still needs another 26 MHUF (70 MHUF - 44 MHUF).

Agrowest should consider the following actions:

Financial

- o Align with a company providing cash to convert revolving credit into a bond, the new creditor should also provide a revolving line of credit at little or no interest.
- o In order to minimize working capital needs, the new convertible bond should have a feature that capitalizes interest payments, increasing the amount of the bond. However, if the bond is converted into equity, Agrowest will be giving up a greater portion of the company. Choice of a business partner is very important.
- o An alternative method to arrange the credit line would be to collateralize it against receivables. Such a strategy could be acceptable to a friendly creditor. In this way, Agrowest shifts the collection burden to someone else. Collateralizing on the open market would require a steep (75 %) discount on the valuation of receivables. This strategy is however, not recommended.
- o Agrowest should establish an internal information system (more monthly or weekly reports).
- o Agrowest should develop better cash flow forecasts. At the beginning of each year, take the previous year's total production overhead increase this by a projected inflation factor and allocate production overhead across each product based on volume processed. The same allocation procedure should be used with respect to sales and marketing functions.
- o Because debt financing (and, subsequently, interest payments) are used to finance inventory, Agrowest should use interest payments in its direct product cost calculations. The interest costs should be allocated by sales contribution.

⁴ Million Hungarian Forints

Human Resources

- o Personnel changes may be needed to introduce a more innovative and ambitious management group. Senior management may consider introducing a more aggressive marketing and sales staff.

Production

- o Over the short term Agrowest should begin to organize a Research and Development Department. The company should:
 1. Select their five most profitable crops. These crops should be selected on the basis of their robust contribution margins.
 2. Obtain exclusive marketing and production rights to a variety of brand seeds. Make sure that these seeds are on the Hungarian national list.
 3. Produce, promote and market Agrowest proprietary variety seeds.
- o Over a longer period of time, Agrowest should:
 1. Hire a plant breeder(s).
 2. Breed and develop varieties of 10 crops that can be produced in and around the positive Agrowest growing environment. The varieties will be proprietary seed and command higher prices and subsequently may reflect higher margins. Agrowest needs to develop a product that it singularly owns and with which the produce can identify.
 3. Agrowest should then market these proprietary seeds under their own brand label.
- o Agrowest should search for alternative locations to clean its seed. It should consider shutting down and moving one cleaning line at a time from its current tower building and moving the line(s) as alternative sights are found. The company's current building imposes substantial operating costs on each seed cleaned. Seed is handled too many times and is not moved to the ground floor on a timely fashion. Moving the equipment on-site facilities will reduce transportation charges. In addition, setting up the equipment vertically will substantially lower operating costs because it will reduce the number of times that seed is handled.

- o Agrowest should move its seed lab to the currently underutilized headquarters building.
- o After moving its production lines to alternative sites, Agrowest will potentially have 2 to 3 seed cleaning sites in three counties. Cleaning costs would be substantially reduced by moving the cleaning lines closer to the source of the raw product. It is estimated that costs can be reduced by 25% to 30% by moving the lines to alternative locations due to:
 - reduced transportation costs;
 - increased labor productivity and efficiency; and,
 - as a result of not paying 5 MHUF per year rent on its current obsolete facility.

On the basis of the company summary and analysis, Agrowest should concentrate on the following principle areas:

- o Marketing and sales;
- o Liquidity management;
- o Development of internal management reports and management information systems; and,
- o Development of a well focused procedure for privatization and a privatization plan.

APPENDIX

Ownership of Agrowest

Owners	Book Value (In Thousands HUF)	% Shares
Vetomag Vallalat	40,000 HUF	63%
Joseph Marten	600	1.0
Antal Nemeth	600	1.0
Papa State Farm	4,500	7.1
Bakony Ag. Coop	2,000	3.1
Jobaratsag Ag. Coop	4,500	7.1
Egyetertes Ag. Coop	1,000	1.6
Pannonia Ag. Coop	1,000	1.6
Sarvar State Farm	1,000	1.6
Egyetertes Ag. Coop	1,000	1.6
Other	1,000	1.6
Osterreichische Raiffeisen Warenzentrale	6,188	9.7

APPENDIX 1

Table 1. Quantity & Value of Seed Sales in 1990

Groups of seed Quantity(t) Ratio(%) Value(1000 HUF) Ratio(%)

A. Cereals

Winter Barley	3,486.62	17.70	31,373.00	17.68
Wheat	11,857.37	60.20	108,794.00	61.31
Spring Barley	2,963.21	15.04	26,388.80	14.87
Oat	1,192.24	6.05	8,968.00	5.05
Group Total	19,696.82	100.00	177,437.20	100.00
The group's ratio to total (1990) value ----->				15.48

B. Corn (total) 2,942.35 100.00 290,010.20 100.00
 The group's ratio to total (1990) value -----> 25.29

C. Feed crops

Grass Mix	17.50	0.59	2,050.90	0.94
Red Clover Tetra.	202.64	6.88	29,061.50	13.39
Crimson Clover	341.10	11.58	21,904.10	10.10
Red Fescue	382.80	13.00	24,072.10	11.09
Sport Grass Mix	115.62	3.92	15,086.00	6.95
Hard Fescue	100.41	3.41	6,131.40	2.82
Italian Ryegrass	608.66	20.66	22,411.50	10.32
Turf Mix	118.20	4.01	16,869.10	7.77
Red Clover Dipl.	55.20	1.87	5,397.60	2.49
Group Total	2,945.47	100.00	217,053.70	100.00
The group's ratio to total (1990) value ----->				18.93

D. Industrial Crops

Feed Rape	207.76	1.06	8,097.60	2.56
Winter Rape	7,267.69	37.02	122,437.70	38.74
Pea Yellow	3,328.89	16.96	49,138.00	15.55
Sunflower	1,614.63	8.22	25,137.10	7.95
Pea Green	6,066.16	30.90	90,798.90	28.73
Group Total	19,632.16	100.00	316,077.40	100.00
The group's ratio to total (1990) value ----->				27.57

E. Horticultural seeds

Legume Grass	0.90	3.56	171.80	6.70
Caraway	24.40	96.44	2,391.20	93.30
Group total	25.30	100.00	2,563.20	100.00
The group's ratio to total (1990) value ----->				0.22

APPENDIX 2

Table 2. Quantity & Value of Seed Sales in 1991
 Groups of Seed Quantity(t) Ratio(%) Value(1000 HUF) Ratio(%)

A. Cereals

Winter Barley	1,141.65	10.88	11,152.70	9.80
Wheat	4,290.76	40.90	42,539.10	37.40
Spring Barley	3,030.99	28.90	37,316.70	32.80
Oat	1,599.06	15.24	18,646.30	16.40
Group Total	10,489.15	100.00	113,769.40	100.00
The group's ratio to total (1991) value ----->				9.52

B. Corn (hybrid)	2,226.59	91.60	413,290.80	99.70
Group Total	2,431.71	100.00	414,521.50	100.00
The group's ratio to the total (1991) value ----->				34.70

C. Feed Crops

Grass Mix	20.90	0.71	1,926.10	0.88
Red Clover Tetr.	314.74	10.69	46,384.90	21.23
Crimson Clover	480.61	16.32	39,155.00	17.92
Red Fescue	464.36	15.77	27,732.90	12.70
Sport Mix	95.86	3.25	12,037.70	5.51
Hard Fescue	163.07	5.54	11,771.70	5.39
Italian Rygrass	234.10	7.95	11,153.80	5.10
Turf Mix	59.86	2.03	8,102.70	3.70
Red Clover Dipl.	54.82	1.90	5,717.90	2.62
Group Total	2,945.00	100.00	218,526.00	100.00
The group's ratio to total (1991) value ----->				18.29

D. Industrial Crops

Feed Rape	363.54	1.98	12,263.80	4.38
Winter Rape	10,292.81	56.03	147,726.00	52.82
Pea Yellow	2,551.12	13.89	38,114.40	13.63
Sunflower	1,810.96	9.86	31,042.90	11.10
Pea Green	1,925.97	10.48	29,708.50	10.62
Group Total	18,368.98	100.00	279,674.00	100.00
The group's ratio to total (1991) value ----->				23.41

E. Horticultural Seeds

Legume Grass	20.69	31.21	3,119.50	38.12
Caraway	40.00	60.34	3,827.00	46.76
Group Total	66.29	100.00	8,184.20	100.00
The group's ratio to total (1991) value ----->				0.68

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APPENDIX 3

Table 3. Quantity & Value of Seed Sales in 1992.

Groups of Seed	Quantity(t)	Ratio(%)	Value(1000 HUF)	Ratio(%)
A. Cereals				
Winter Barley	813.46	9.23	10,199.40	9.97
Wheat	3,163.01	35.90	39,395.10	38.50
Spring Barley	3,667.66	41.63	41,314.20	40.38
Oat	968.48	11.00	8,989.10	8.79
Group Total	8,808.91	100.00	102,308.90	100.00
The group's ratio to the total (1992) value ----->				10.97
B. Corn (hybrid)				
	1,250.93	100.00	123,930.40	100.00
The group's ratio to the total (1992) value ----->				13.29
C. Feed Crops				
Grass Mix	373.67	8.57	47,527.10	14.96
Crimson Clover	646.19	14.82	43,324.10	13.64
Red Fescue	871.86	20.00	61,844.30	19.47
Hard Fescue	264.53	6.07	16,615.40	5.23
Italian Ryegrass	605.28	13.89	29,077.00	9.15
Red Clover	432.93	9.93	65,136.50	20.50
Group Total	4,359.00	100.00	317,620.70	100.00
The group's ratio to the total (1992) value ----->				34.07
D. Industrial Crops				
Feed Rape	823.21	5.08	30,791.30	11.50
Winter Rape	7,316.59	45.16	109,602.50	40.93
Sunflower	1,553.19	9.59	21,535.00	8.04
Pea Yellow	5,095.34	31.45	77,737.60	29.03
Group Total	16,202.54	100.00	267,789.10	100.00
The group's ratio to the total (1992) value ----->				28.72
E. Horticultural Seeds				
Legume Grass	37.74	31.93	4,932.10	37.88
Caraway	65.71	55.60	5,372.10	41.26
Group Total	118.19	100.00	13,019.80	100.00
The group's ratio to the total (1992) value ----->				1.40

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APPENDIX 4

- .1. PRIVATE CUSTOMERS: 89
2. CONSUMER COOPERATIVES & STORES: 78
3. KFTS & COMPANIES: 100
4. COOPERATIVE & STATE FARMS: 403
5. FOREIGN COMPANIES: 3

APPENDIX 5

CATEGORY I.

- AGROINTERT KFT (Private)
- DUFAR BT (Subsidiary of Agrowest)
- KONSTANS AGRO KFT (Private)
- LUNA N.SZ. KFT (Private)
- MAGNET KFT (Private)
- TARTALEKGAZDALKODASI RT (Government reserve organization)
- VETOMAG KERESKEDOHAZ RT (VKH)
- VETOMAGTERMELTETO & ERT (Trading Co.)

CATEGORY II.

- CENTRUM ARUHAZAK KFT (Department Store)
- HETES NEPE MGTSZ REDICS (Cooperative)
- MAG-INTER VET NEM.&KER. (Private)
- UJHELYI AGOSTON, BUDAPEST (Private)
- VETOMAG KULKER IRODA (VT)
- OSSZEFOGAS MGTSZ, SUMEG (Cooperative)

APPENDIX 6

1. Private customers : - Bakon Imre Lovászi
- Komondi Istvánné Szombathely

2. Consumer cooperatives & Stores :

- Örségi ÁFÉSZ Pankasz
- Zirc és Vidéke ÁFÉSZ
- Zalaiparker Zalaegerszeg
- Vasvár és Vidéke ÁFÉSZ Vasvár
- Sárvár és Vidéke ÁFÉSZ Sárvár
- Szentgotthárd és Vidéke ÁFÉSZ
- Pápa és Vidéke ÁFÉSZ Pápa
- Páka és Körzete ÁFÉSZ Páka
- Pacsa és Vidéke ÁFÉSZ Pacsa
- Nagykanizsa és Vidéke ÁFÉSZ
- Mura ÁFÉSZ Letenye
- Kőszeg és Vidéke ÁFÉSZ Kőszeg
- Körmend és Vidéke ÁFÉSZ
- Kerkavölgye ÁFÉSZ Lenti
- Georgikon ÁFÉSZ Keszthely
- Centrum Áruházak Budapest

3. Kfts & Companies : - Ambrus Export-Import Kft. Budapest

- Balaca Növénytermesztési Kft. Nemesvámos
- BKR System Kft. Keszthely
- Bábólna RT. úraiújfalui Gazdasága
- Centrum Áruházak Kft. Szombathely
- Compack Ker. Csomagoló Vállalat Budapest
- EEUROMARKK Kft. Bábólna/telkib
- High-Tech Marketing Kereskedelmi Kft.
- IKR Bábólna Bábólna
- KSZE Agrárfejlesztési & Kereskedelmi Kft.
- Kaposmag Vetőmagtermelő Kft. Dombóvár
- Laktovit Tejtermelő Kft. Nemesvámos
- Marcal-Mix Kft. Jánosháza Jánosháza
- MN Erdő-és Vadgazdálkodás Bp. Uzsai üz.

- Monori Vetőmagtermelő Kft. Monor
- Pannonker Napfény Kft. Veszprém
- Unitas-Coop Ker. RT. Tapolca Tapolca
- Zéta Kereskedelmi Kft. Nagykanizsa

4. Cooperative & State farms : - Zalavölgye Pogányvár MGTSZ

- Zalaegerszegi Állami Gazdaság
- új Barázda MGTSZ Zalaszentgrót
- Szilasmenti MGTSZ Kerepestarcsa
- Szabadság T'SZ Ugod
- Somlóvár MGTSZ Noszlop
- Rákóczi MGTSZ Vép
- Pannónia MGTSZ Szombathely
- Nagyrécsei MGTSZ Nagyrécse
- Március 15. MGTSZ Gelse
- Marcalmenti MGTSZ Gógánfa
- MTA Kísérleti Gazd. Martonvásár
- Kisalföldi Áll. Gazd. Nagysz.j.
- Jóbarátság MGTSZ Kerta
- Hajdúszoboszlói Áll. Gazd.
- Fenyvesalja MGTSZ Rátót
- Egyetértés MGTSZ Nemesszalók
- Béke MGTSZ Gércse
- Búzakalász MGTSZ Püski
- Becshelyi MGTSZ Becshely
- Bakonyalja MGTSZ Bakonykoppány
- Badacsony MGTSZ Nemesgulács
- Alkotmány MGTSZ Nagykanizsa

5. Foreign Companies : - Bio-Interprodukt GMBH Budapest

- Natale und Ferdinando Neri Italy
- Sementi Dotto Italy

APPENDIX 7

LIST OF CLEANING EQUIPMENT

#	Machine	Mode/#	Origin	Age
5	Aspirator	UB 1250	Sweder	9 yrs
1	Rubber machine	HA 600	Denmark	9 yrs
1	Rubber machine	HA 800	Denmark	9 yrs
1	Rubber machine	K 310/A	East Germany	3 yrs
2	Separator	GA 81	Austria	9 yrs
3	Magnetic machine	G -IV	West Germany	9 yrs
1	Sewing machine	Union spec.	West Germany	9yrs
4	Velvet machine		USA	appr.25yrs
1	Precleaner	K 523	East Germany	2 yrs
1	Screen machine	K 546	East Germany	14 yrs
3	Indent cylinder	K 231	East Germany	11 yrs
1	Rubber belt			
4	Bucket elevator			9 yrs
1	Seed blender			9 yrs