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The effect of the foreign capital and European subventions on the competitiveness of the Hungarian agribusiness' enterprises in the last 15 years

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Abstract. In our research we examine the foreign investments from the change of regime, privatization; EU accession, possibilities offered by subventions (2004-2006); so the experiences of the last 15 years, and we draw up the expectations from the actual *New Hungary Rural Development* and *National Diversification Programs* (2007-13).

We try to establish a complex *diagnosis* about the role, effect and results of the foreign capital and EU subsidies – by analyzing advantages, disadvantages; positive, negative effects – in order to chart the problems to be avoided and missions to be reinforced – at the company and at the sector level – like structural reorganization of sectors, or necessity of developing company structures which contribute to identify the key necessary to the improvement of the competitiveness of the Hungarian food economy.

Important strategic decisions are necessary: financial resources to investments; owners; developing structures; reinforce technological, logistical, organizational, HR, R+D and innovation background.

The sugar is a strategic product and it is considered to be a strategic sector everywhere on the world.

In our presentation we would like to present how this strategic sector had prospered and had disappeared during the last 15 years, and how the diversification takes place in Hungary.

Keywords: foreign capital, European subventions, agriculture, food industry, competitiveness, diversification

1. Introduction

A smart man - especially if he has some capital - buys during depression. This is an old truth.

This was the case at the 90-s during the privatization after the political change, when state-owned companies were bought by new investors. However they were „paid” on short notice by usually foreign investors, thus they had become the „victims” of multinational expansion.

The process of food industry privatization had finished by the end of the 90-s. By 1996 10% of the food industry firms were owned by the state, while 30% was owned by Hungarians, and 60% by foreign investors. The presence of the foreign working capital offended many people, but on the other hand kickstarted the development of the Hungarian economy in all fields of production.

The political change had its effects not only on the food industry but on all levels of the economy

At the 80-s and 90-s food factories sold their products to eastern countries: among these the Soviet Union was the most significant buyer of Hungarian food products. These products were cheap and had a great quality, so the demand for them became bigger and bigger. However, without state support, the food industry failed to follow the export expansion, and the eastern markets declined.

At the beginning of the 90-s the rate of setback was enormous. Not only had the export markets become almost extinct, local demand also dropped significantly.

1.1. The aim of our research

During our research we analyzed the companies, -especially those with French interest- of several strategic fields (sugar, canned products, vegetable oil, meat, etc).

By our analysis, we try to establish a complex *diagnosis* about the role, the effect and the results of the foreign capital and the European subventions – by analyzing advantages and disadvantages; positive and negative effects – in order to chart the problems to be avoided and missions to be reinforced – at the

company and at the sector level – like structural reorganization of sectors, or necessity of developing company structures which contribute to identify the key necessary to the improvement of the competitiveness of the Hungarian food economy – so draw up some elements of the possible *therapy*.

In the past and in the present also, important strategic decisions were and are necessary: financial resources to investments in one hand; owners' structures in the other hand. Moreover, in every sector it is important to develop structures; and reinforce technological, logistical, organizational, HR, R+D and innovation background.

Sugar is a strategic product and it is considered to be a strategic sector everywhere on the world. In our presentation we would like to present how this strategic sector has prospered and has disappeared during the last 15 years, and how the diversification has taken place in Hungary.

In our research we also touch upon the crisis periods.

Within the frames of this publication we would like to present the changes within the Hungarian *sugar industry* among the last two decades, from the 90-s, the political change (privatization) through the EU enlargement till present days, focusing on finance, owners structure and developing constructions.

1.2. The last 15 years of Hungarian sugar industry: 1993-2007

Shortly after the political change at 1993, there were 11-12 individual sugar factories in Hungary. In 1995, Ács, Ercsi, Mezöhegyes, Sarkad, Sárvár consolidated and the Magyar Cukor Plc. was formed; (Austrian owner: Agrana); in 1998 Petőháza (closed in), in 1999 Kaposcukor Plc. joined

After the shutdown of refineries with low-efficiency, and low productivity, by the time of the EU accession, 2004, five factories remained.

Agrana Magyar Cukor Plc is still currently operating, though only the factory at Kaposvár is active, and the seat of the company was also moved here.

Kabai Cukorgyár Plc (French foreign owner: Saint Louis Sucre + English: Eastern Sugar) stopped production at 2006.

The Mátravidéki Cukorgyárak Plc's factory at Hatvan was continuously active until the 10th of March, 2008. Together with the factories at Szerencs and Szolnok it was owned by French (Béghin-Say) – Italian foreign owner till 2003, when it was bought by the German corporation Nordzucker. Szolnok closed in November, 2007, Szerencs in 2008, because of the lack of sugar beet. Mátravidéki Cukorgyárak Plc's factories at Szolnok Hatvan stopped the beet sugar production, its silos and sorter's utilization rights were bought by the Eurosugar international trading corporation, which sorts imported sugar.

The area of sugar beet crop land was reduced from 25,000 hectare to 12-13,000 hectare of the shutdown of the factory at Szerencs. After closing this northern Hungary processing unit, only one sugar beet processing factory remained in Hungary at Kaposvár. Its top production is 105,000 tons of sugar; this is the remaining quota of the Magyar Cukor Plc.

During the examined period, all sugar factories – with the exception of one – stopped their production and were shutdown or switched to other activities.

After their shutdown, the financial and social environment has been significantly changed among the settlements directly or indirectly affected by the sugar factories. This required a national strategic intervention: see National Diversification Program later.

1.3. Applied research methods, sources of data and information

We have chosen the year 2000 as the basis of our research, when five large sugar industry companies were active, because we considered it being worthy of interest to perform a comparative financial analysis. This way we can examine the operative strategies of five investor groups of different nations: France, Italy, Germany, England and Austria (3 companies had French-Italian, later German; one had English-French, and one Austrian-Hungarian interests).

With the help of the financial analysis of the chosen companies we seek the answer for the following questions: how deliberate are the foreign investors when they form the capital structure of their enterprises, and what financing strategy they follow^[5]. Based on our results index figures, can we spot a

significant difference, or draw a direct conclusion between the investing behaviour of the investors of different nationality: does the foreign capital has national (French, Italian, English, Austrian) character linked to their motherland?

We used balance sheets and financial records as the data sources for this analysis, so the capital structure can be examined with full objectivity.

Principal parts of our financial analysis:

- I. Analysis of the assessments and income statements of the companies, absolute values in the continuation of time: volume and composition of the credit, average duration of refunding of the customers, structure of the capital - stockholders' equity and foreign assets, different categories of results, structure of the costs, turnover, etc.
- II. Ratios: *financial position* (liquidity, number of revolutions of stocks, cash-flow on turnover), *situation of the inheritance* (current assets, stockholders' equity, structure of the capital, provisions, offers capital), *profitability* (ROA, ROE, in proportion to returns etc), *effectiveness* (funds/assets, private capital, stockholders' equity, manpower, average buyers' stock, average suppliers' stock); rate of dividend, working capital, net circulating capital, forecast of crisis.

In calculations of the financial ratios, we followed the methods of Illés I-né^[1], and Sándor et al^[2].

Besides the financial analysis, we performed an individual data collection as well, and with the help of questionnaires we made personal interviews with the representatives of the corporations in 2000.

The questionnaire is similar; it was made by using the experience gained from the nation-independent analysis of foreign companies^[3].

2. Main findings of the financial analyses

The results of the financial analyses have indicated huge differences in several areas among the different companies.

2.1. Financial situation

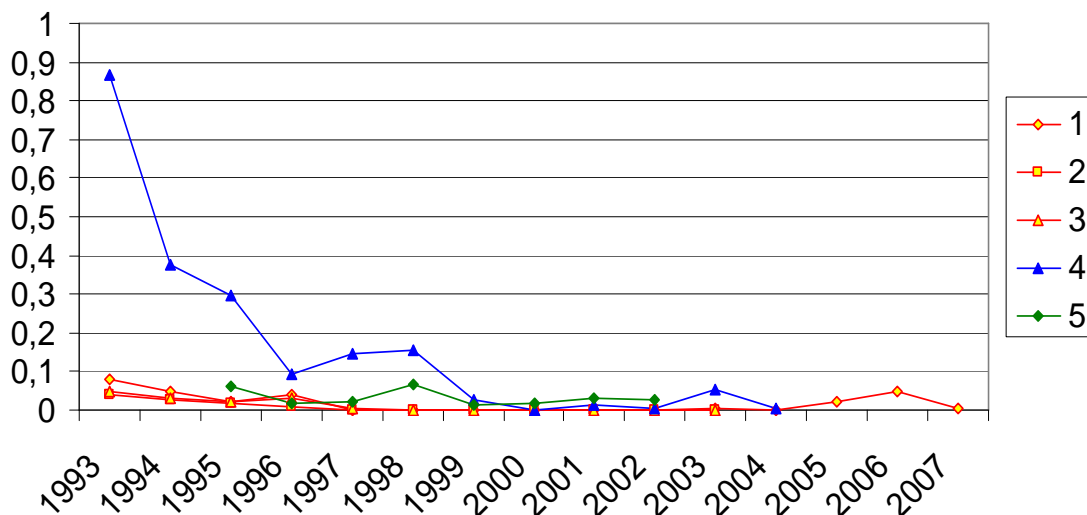


Figure 1. Variation of liquidity among the analyzed companies ** (1993-2007)
Source: Calculations of the authors

** Note: Company 1, 2, 3. is French-Italian and German after; 4. is English-French; 5. is Austrian Hungarian interest. 15 year (or until shutdown) timeline – except for company 5 which was founded in 1995

Based on the **liquidity indicator**, which was calculated by the formula *current assets / short-term debts*, we can state that the capacity of short-term payment poses problems for each company. The deterioration of the working capital ratio is explained firstly by the increase in the short-term obligations and not by the current assets.

If one examines the liquidity without stocks and the credits in the current assets with the numerator (*current assets-stocks-credits*)/ *short-term debts*, then the deterioration of the situation is even more visible, because in the current assets they are the least movable/transferable stocks and credits which are most important. (Figure 1)

The liquidity indicator can be understood as static, so if we aim to analyze and forecast solvency more accurately, we should perform a liquidity balance. To do so, we would have required information from other sources, other than the balance sheets, so we have chosen not to perform it.

2.2. Pecuniary situation

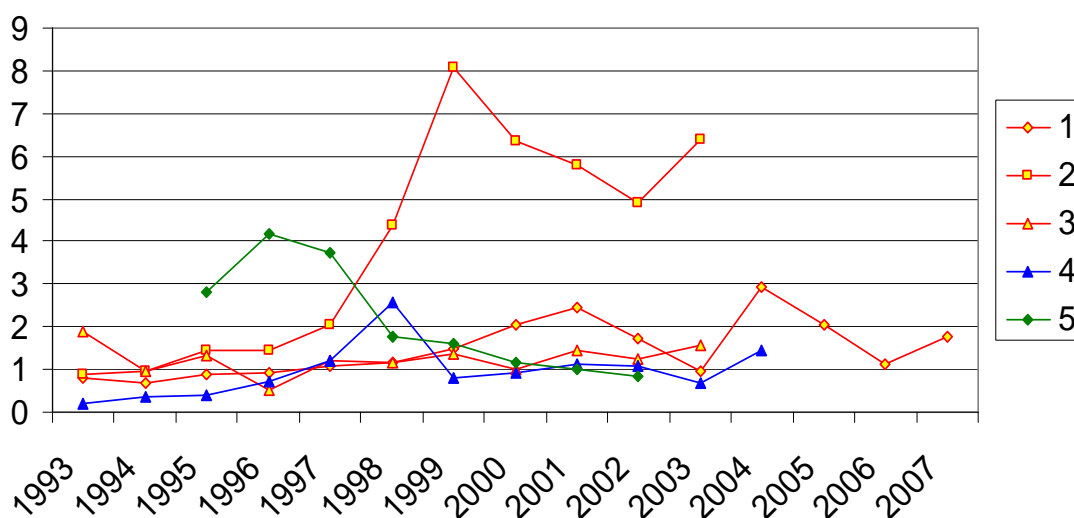


Figure 2. Variation of capital structure among the analyzed companies (1993-2007)
Source: Calculations of the authors

When analyzing the structure of the *capital* (*capital reduction indicator = borrowed capital/own capital*), we can state that the proportion of the borrowed capital does not cease increasing at most companies (Figure 2.), which posed problems, especially in case of company No 2 with French-Italian interest. This company had to rely regularly on borrowed capital to satisfy these obligations, which made its structure of capital critical for 1999 (proportion higher than 8!). After 2000 this company tried to gradually reduce the share of borrowed capital as well. The improvement of profitability was of course the main precondition for this.

We should note that contrary to the companies with French interest, at the companies with English and Austrian interest, the borrowed capital decreases. (The main reason for this is also the profitability differences.

We analyzed within the debt structure, the proportion of short term debts. This indicator was always over 90%, from 1998, 1999 and 2000 it was 100% or near 100%. This indicates that improvements were financed from own sources –thus long-term debts were not undertaken during the analyzed period- and the borrowed capital was necessary to finance the companies' operation. Company 4 was an exception, where the indicator reduced fewer than 50% in 1998, and it reached 100% again by 2003 with a rough 10% yearly increase. In 2004, when the factory was shut down, the indicator was 88%

2.3. Working capital: current assets – short-term debts

In the case of the net circulating capital (Figure 3), it is still the situation of company 2 which can be pointed out, where the values are constantly negative, which indicates an *aggressive strategy* of financing. This strategy is not expensive, but involves great risks.

In the case of the other companies, the values change from negative to positive or are always positive, this indicates, that most of the current assets, in stocks are durable credits. That indicates a *preserving strategy*, but positive net circulating capital numbers do not indicate clearly the implementation of conservative financing strategy. To form a clear picture about the strategy, we should have examined the ratio of the long-term fixed assets values within the working capital.

The question is raised: how conscious was the formation of capital structure? Net circulating capital together with the type of financing strategy can only be assessed with the other indicators of assets-profitability situation. Those companies which have a relatively better profitability indicators (at least it is positive in the longer term); capital structure did not move toward borrowed capital (especially toward short-term debts). The dominant presence of long-term sources within the capital structures determines the positive net working capital, which likely presumes the conservative financing strategy.

The choice of strategy however does not indicate that companies with different owner structure tend to have different ratio of risk taking, only the profitability differences leaves a clear mark at the financing strategy via the capital structure.

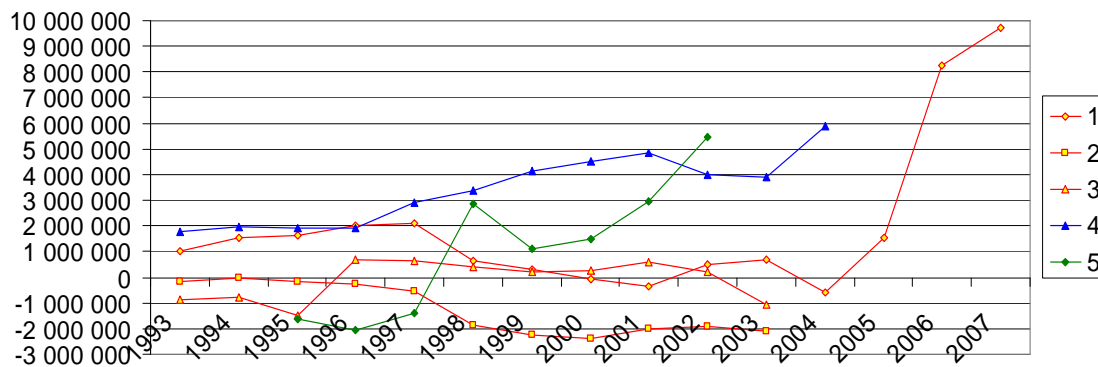


Figure 3. Net circulating capital (1993-2007)
Source: Calculations of the authors

2.4. Profitability

With regard to profitability, all the indicators are disappointing: assets' proportion (ROA), income proportion, own capital proportion (ROE), which indicate the low capacity of productivity of the sugar sector (Figure 4) (ROE): $own\ capital\ proportion = results\ before\ taxation / own\ capital$

Probably the companies with better profitability are able to perform a conservative financing strategy, but own capital of companies with loss was not increasing, rather decreasing, so they were „slipping” toward the aggressive strategy. Although in 2000, short-term (financing) resources were cheaper. Were these the same conditions as at the beginning of the 90-s? And what is the situation today?

We must note that when qualifying the cost consequences of the financial strategies, one must take extra caution in case of food industry companies. It is a general truth that the longer the source of funds is available, the more expensive it is. This draws the conclusion that for example long-term loans –as they have a higher risk factor- are usually more expensive than short-term ones. At the same time it is common at the field of food economy that for long term loans (usually for investments) the state often provides interest support. In this case the cost of the source will be the same, but the liabilities are shared between the debtor and the state. The state distorts the cost ratios of different source elements, with this intervention. However this means that performing a conservative strategy does not eventually result in higher costs for the enterprises, and the lower risk is unambiguous.

There are two types of risk linked to the aggressive financial strategy. First we can talk about the source-renewal risk, which is linked to the fact that when short term sources expire, they must be renewed. The question is: can it be done, and with what conditions. At the same time the presence of liquidity risk is highly important. If the net working capital indicator is negative, (which clearly assumes an aggressive financing strategy), the value of short-term debts are surely higher than the value of current assets. In this case the general liquidity indicator (current assets /short-term debts) is lower than the minimal request of 1. The more the capital structure switches toward the short-term sources (the ratio of own source decreases), the weaker the company's liquidity situation would be.

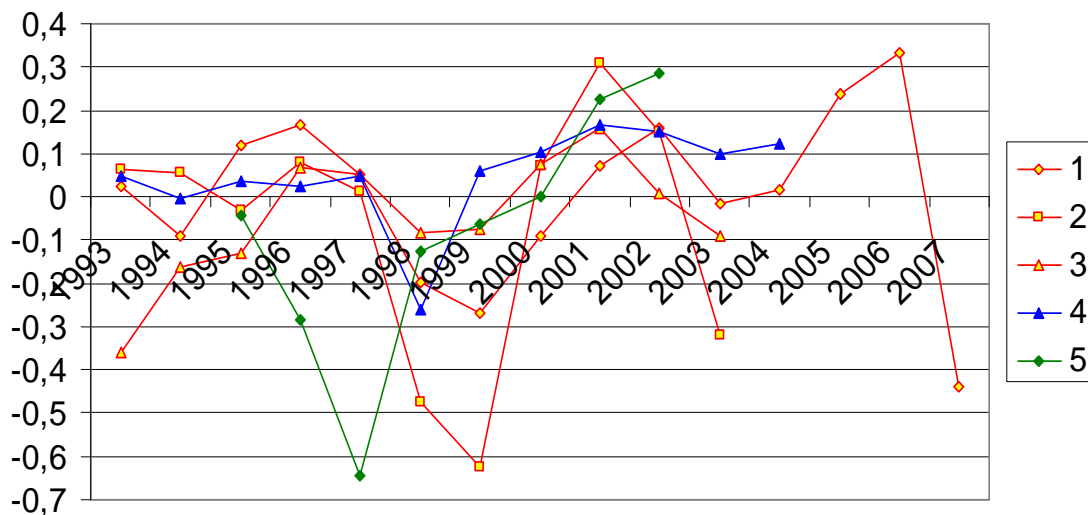


Figure 4. Variation of profitability indicators (1993-2007)
Source: Calculations of the authors

We calculated those type of profitability indicators as well, where the numerator has the category of a unit/business result.

The evaluation of these types of profitability indicators, and by means of these, the comparison of this type of profitability of the enterprises working in Hungary and in Western-Europe is difficult, because of the differences of the accounting methods of the interest-rate subsidy. In Western-Europe, in general it is characteristic that in the case of credits with interest-rate subsidy, the subsidy is received directly by the bank which allocates the credit, so the enterprise pays the "net" interest, and accounts it as expenditure of financial operations. This accounting method doesn't affect the factory/business results (profit or loss) of the enterprise. On the contrary, in Hungary, in the case of credits with interest-rate subsidy, the enterprise drawing on credits, pays to the bank the gross interest, and following that, receives the sum of the subsidy. This accounting method, doesn't reinforce the liquidity situation of the companies, moreover this carries further consequences. The gross interest is entered into the books as expenditure of financial operations of the enterprises, and the subsidy received is accounted as additional income. Consequently, the factory/business result is increasing by the amount of the subsidy received. (This method of accounting doesn't affect the amount of the results (profit or loss) before taxation. In the case of enterprises using the national accounting prescriptions in their bookkeeping, – in the case of companies receiving interest-rate subsidy – the profitability indicators calculated based on the factory/business results, can be remarkably much better like the profitability indicators of calculated based on the result before or after taxation. Furthermore, the comparison with the indicators of the Western-European companies, calculated based on the factory/business result, became more difficult. Within the stock of credit amount of the examined enterprises, current assets financing the functioning are dominating, so this distorting effect, only to a lesser degree, and only in the case of the company No. 4 can display considerable results.

2.5. Effectiveness

The index of effectiveness of funds (turnover/total funds) (Figure 5) cannot be regarded so good at any company. The minimal requirement - that the credits are recovered at least once per annum in the turnover - was not carried out at any company for a long time. The index always remained lower than 1, and the difference is minimal between the various companies. This is explained by the high volume of the invested credits and by the slow sinking of the credits. We can observe a stagnation period, except for company 1, which could only change this for a five-year period between 2000 and 2004.

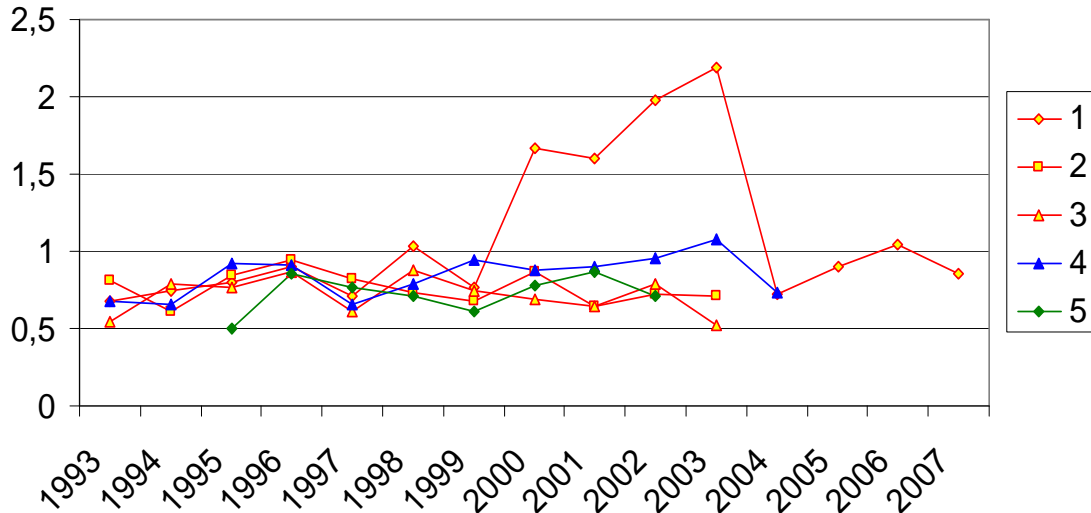


Figure 5: Variation of effectiveness among the analyzed companies (1993-2007)
Source: Calculations of the authors

Further effectiveness indicators:

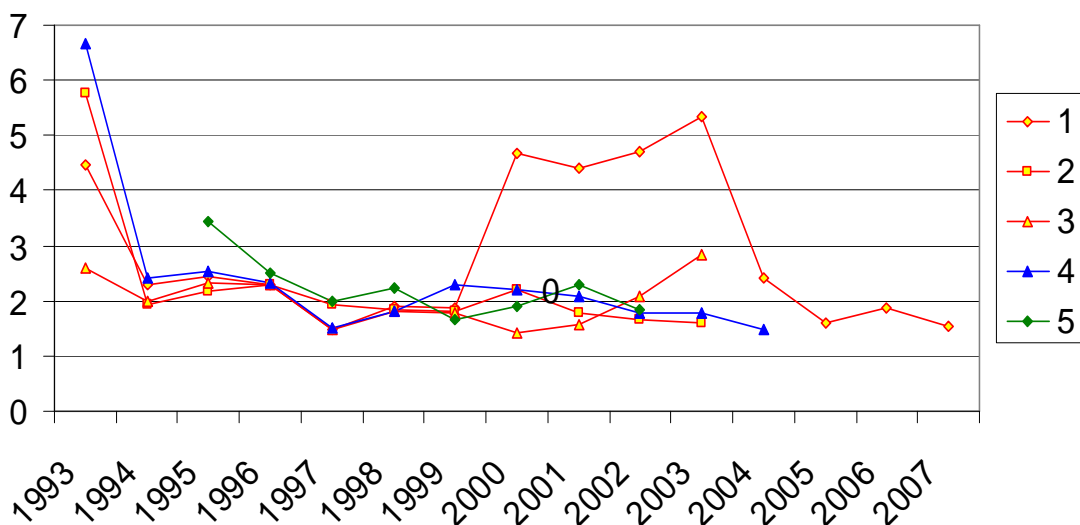


Figure 6. Variation of the revolutions of stocks (1993-2007)
Source: Calculations of the authors

For a more nuanced judgment of the mobilization of the stock of current assets, we used the indicator of *the average period of the credit customers*, but we also calculated the indicator of the *number of revolutions of stocks*: net income of the sales / average stock-value (Figure 6.).

The diminution of the number of revolutions of stocks shows the slow recovering of the fixed-term (committed) stocks within the income of the sales. This can be explained partly with sales difficulties, or by the seasonality characteristic of this sector. It would be interesting to examine what happened between 2000 and 2005, in the case of the enterprise No. 1, whereby the values had skipped up. (We know that in 2003 there was a change of owner.)

The considerable raise of *the duration of the credits customers' refunding* (Figure 7.) - the average period (in days) of the credit customers = average credit customer (the simple arithmetical average of the value of the year of the object + the preceding year)*365 / net income of the sales - indicates also financial problems, but it is not yet critical from the point of view of the liquidity.

From 2000-től, in the case of 3 enterprises we can observe significant diminution; at the closure of the company No 4. the value was about 30; and in the case of the enterprise No 1. we can observe important fluctuations.

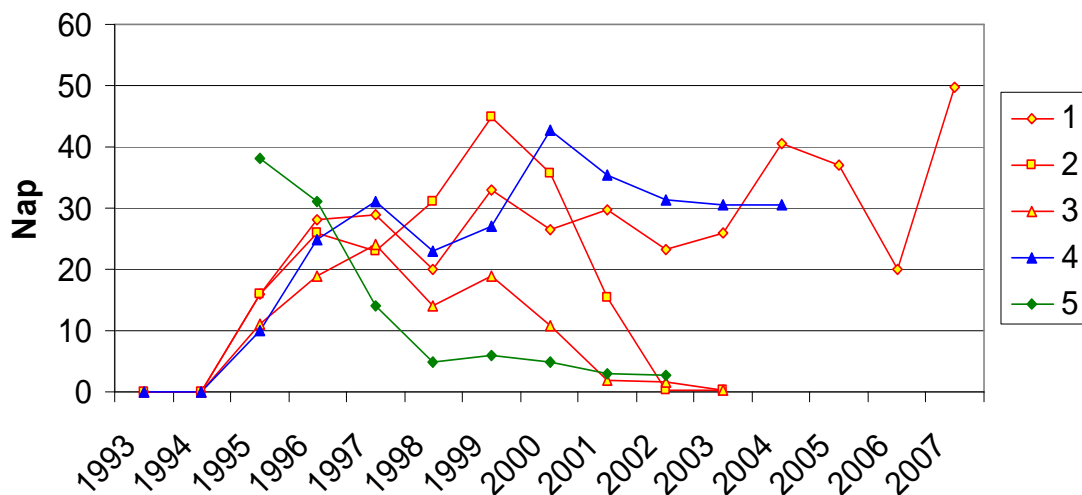


Figure 7. Variation of the credit customers (1993-2007)
Source: Calculations of the authors

When the values are approaching the level of zero, these are the periods before closure. Probably, at that time, only cash payment sales are handled. As these values are difficult to evaluate by themselves so we also calculated the average period of the credit supplier. (Average credit supplier x 365)/ value of material-like expenditures (including also the value of the purchase of goods). If we examine the difference between the values of the credit customers and the credit suppliers, we can see that, where the credit customers are higher than the credit suppliers, it has a negative effect on the liquidity, so it is in the case of these enterprises that we can expect for the formation of a weaker liquidity situation.

2.6. Indices of forecast of crisis

Indices of forecast of crisis (Figure 8) - calculated by the method of total cash-flow/of the borrowed resources - show that the company 4 and 5 with English-French-German and Austrian-Hungarian interests, did not post deterioration, but on the contrary, one can note a tendency of improvement, therefore these were companies whose operation the most is balanced.

Among the three French-Italian-German interest companies, the situation of the 3rd company was also stabilized, on the other hand the company No 2, but particularly the company No 1, show financial instability. Between 1997 and 1999, the variation of indices of forecast of risk indicates that if there had been no operational intervention in the medium term, serious problems of liquidity could appear. This indicated that the vicious circle had already started. The fall of profitability (the insufficient formation of profit-branch resource) destroys the structure of the capital, therefore the proportion of the borrowed capital and the debt increase, whose loads then will deteriorate the liquidity.

To improve the situation and to increase profitability, the solution seemed to be the voluntary rationalization of the costs.

If the value of this index is decreasing at least in 2 years consecutive (so the decrease is tendency-like), then in medium-long term – without operational intervention – financial crisis can result. If the decreasing is not tendency-like, or on the contrary, there is an increase – as we can observe it from 1999 – that indicates with a more serious probability that there is still no risk of financial crisis.

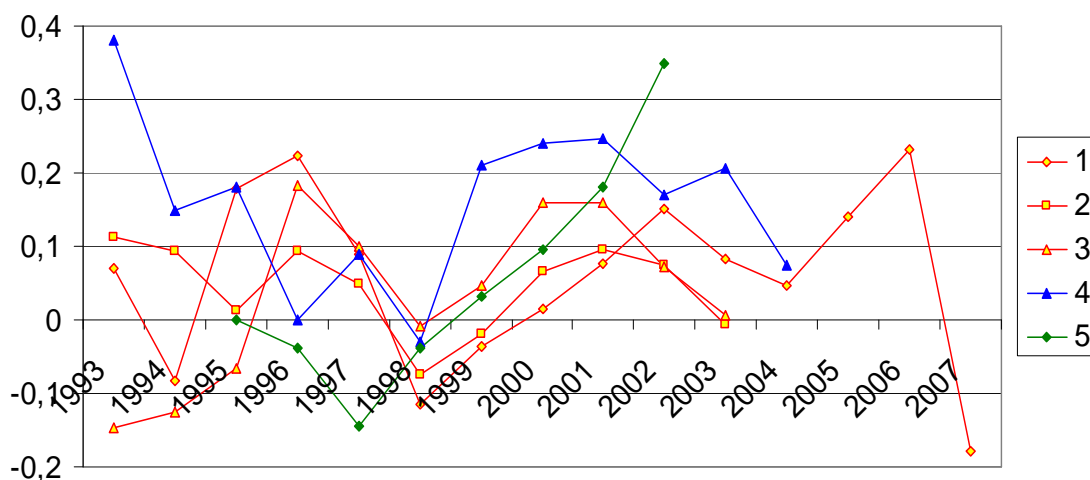


Figure 8. Crisis-forecast indices (1993-2007)
Source: Calculations of the authors

3. Conclusions

From the point of view of the foreign (multinational) companies, the sugar industry proved to be one of the most profitable investments (besides vegetable oil, tobacco, wine, spirits, and beer).

Whereas the assessment reflects only the given moment old state, their time series indicate already a kind continuity, process, therefore a strategy, which is very important, because one can show a relatively strong relation between the long-term aspect and the profitability of the companies^[4].

To conclude our financial analysis, one can note that the indices of the financial diagnoses show remarkable / notable differences between the strategies of financing of the groups of investors in different nationalities of various nationalities. Whereas the French and Italian owners prefer to follow an aggressive strategy - less expensive but riskier; the English and Austrian owners decided upon a preservation strategy - expensive but surer too. The evidence suggests not only a difference in strategies, but also that the structure of property strongly influences the financial position, pecuniary, etc also of the companies.

Sugar is a strategic product and the sugar sector is considered to be one of the most concentrated strategic sectors everywhere in the world.

Today, so in 2009, looking back on the history of the happenings of the last one and a half decade, in a nutshell, the following events played part in the process, during which the **Hungarian sugar industry** had prospered and had “disappeared”: change of regime, privatization, millennium, EU accession, sugar reform ... diversification.

In 1990, at the change of regime twelve sugar works were still in operation in Hungary; by the time of the accession to the European Union in 2004, after the closure of the low-efficiency processing plants there remained only five. According to the original plans four companies were scheduled to remain, and after the reforms there were hopes that at least three processors will continue working, producing a 300 thousand ton quota. In 2006, however, the factory of Kaba was closed down, after which 25 percent of the smallholders gave up cultivation. (As the producer decided for the closure, the smallholders were offered less money in compensation.) In 2007, three out of the four remaining factories were closed, and as a result, a further 50 percent of the smallholders ceased cultivation.

Along with the factories the majority of the Hungarian smallholders disappeared from the market as well – for the most part, they ceased cultivation due to the pressure from the European Union.

Clearly, the domestic sugar manufacturing was definitely profitable, but the reforms of the EU, the profitability of the alternative arable crops, and the thirty-six, or forty – forty-two percent drop in the price of sugar beet all urged the smallholders to cease production.

In 2008 only one domestic company, the Magyar Cukor Plc. operates a factory in Kaposvár, and only a mere 105 thousand ton quota remained for our country.

The decrease of yield and production began in 2006, with the common market organization reform of the European Union. The Union then aimed to decrease the sugar produced by six million tons in the following four years. The gross European sugar quota was 17,4 million, the Hungarian was 402 thousand tons before the reform, and the produced quantity was to be reduced to eleven and a half million^[8].

Based on the consequences of the common market organization reform of the EU on Hungary, the Agricultural Economics Research Institute compiled a study in 2007.

The common sugar market organization of the EU provided a more profitable and predictable sugar production in the first years of our Union membership for both the processors and the agricultural producers. The situation of the supply was far better than in the time prior to the accession, as the market prices of the EU far surpassed the international market price. The common sugar market organization reform began after the second year of our membership; the changes are introduced gradually, in a four marketing year span.

The restructuring process aiming to handle the structural problems of sugar industry within the Community was launched with the **320/2006/EC Council regulation**. The regulation fixes that a temporal fund is established for the restructuring of the sugar industry within the Community, which – being the member of EAGF - finances the subsidies of diversification measures as well.

As for the **provision of materials** in Hungary, the harvested area of sugar beet from the annual 66 thousand hectares in 2001 to **46 thousand hectares** in 2006. Due to the increase in the yield per hectare, however, producing the sufficient quantity of sugar beet for the quota was not a difficulty. The buying-in price of sugar beet rose till the accession, and after 2005 it decreased to a small extent. The average buying-in price of sugar beet between 1999 and 2001, given in Euro is basically the same as the minimal price for the 2009/2010 market year, which drops to 26 Euro/ton due to the reform. This means that because the significant increase in the input prices, the **domestic sugar production can only be profitable with the improvement of efficiency**.

3.1. The situation of the processing industry

After the closure of the sugar factory in Kaba, in the market year of 2006/2007 four processors were in operation in Hungary in the interests of Nordzucker and Agrana (two-two factories, respectively). The former had the theoretical process capacity of 168 480 tons, and sugar quota of 146 454 tons, while the latter had the theoretical process capacity of 203 040 tons and quota of 147 137 tons.

The producers facing capacity surplus were urged to optimise their activity by the conversion subsidies: for the 'handling' of the capacity surplus the **closure of one factory of each sugar concern** proved to be the better solution. In regards of the cost-effectiveness of sugar beet production, in the case of Nordzucker the factory of Szerencs, while in the case of Agrana the factory of Kaposvár was in a more advantageous position^[6]. For this reason, the further operation of these factories was better justified.

The closure of the factory of Kaba (Eastern Sugar Plc.)

In the district of the sugar factory of Kaba the drop of natural characteristics of sugar beet yield were clearly observable after the EU accession: the yield per hectare dropped from the annual 61,4 tons of 2004 to 46 tons by 2006, while the cost-price per tons of sugar beet rose by **40 percent**, from 5 942 Forints to 8 355 Forints.

With the closure of the factory the owners received a sum comparable to the profit of two-three years, without having to produce anything, and in addition, because of this quick decision they were freed from the 126,4 Euro/ton levy imposed on the white sugar quotas.

The inevitable drop in domestic sugar production due to the reform would have resulted in the rising of permanent expenses because of the smaller capacity utilization, that is, the company took the recession of profitability into consideration, and for the avoidance of this it made a rational, financial decision.

The closure of the factory of Petőháza (Magyar Cukor Plc.) and of the factory of Szolnok (Mátra Cukor Plc.)

After the closure of the sugar factories of Petőháza and Szolnok the Hungarian sugar quota dropped by more than 50%, with the closure of the sugar factory of Kaba. Such return of quota involves the following consequences for the drawing of subsidies:

- the payment of production bound subsidies for sugar beet becomes available from EU resources, in the value of 7 euro/ton for the maximum timespan of 5 years;

- Hungary becomes entitled to additional diversification subsidies aside from the base diversification subsidy, that is, for each ton of the sugar quota resigned in the market year of 2007/2008, the 109,50 euro diversification subsidy rises by 50%.

Because of the more than 50% fall in quota, the sector receives an additional 130 million euro subsidy: 46% for restructuring, 38% for production aid and 16% for diversification aid.

Based on the 320/2006/EC Council regulation – aiming to create a temporal system to restructure the sugar industry within the Community- the Eastern Sugar Plc resigned from its sugar quota and decided to close its sugar factory in Kaba; furthermore, the Mátra Cukor Mátravidéki Cukorgyárak also closes its sites in Szolnok and in Szerencs, and Magyar Cukor Plc. also ceases production in Petőháza. According to the contents of the regulation, the Ministry of Agriculture and Rural Development (MARD) established the National Diversification Program^[7], in which -based on situation study of the region in question and of the sugar sector- diversification measures were drawn up to handle the unexpected problems within the region.

The objective of the Program is to use the sum of 32.988.408,- euro of Community diversification subsidy available for the period between 2009-2010, for the priorities described in the National Diversification Program, as well as for the implementation of the linked measures, hereby resolving the problems generated by the closure of the factories in the regions.

The **National Diversification Program** is a diversification strategy developed for the concerned regions for the period between 2007 and 2010, which lays down the basis of the economic restructuring, following the closure of the sugar factories.

Due to the closure of the sugar factories, the economic and social situation has fundamentally changed in the direct and indirect agglomeration of the concerned sugar factories. **The liquidation of the sugar-industry of the regions, affects four groups:** the *producers* and the *engineering suppliers*, the *employees of the sugar factories*, and also the *enterprises and local authorities linked to the sugar factories*, (as the main / most important employers and taxpayers of the municipalities).

The closure of the factory of Kaba of Eastern Sugar Plc. concerns for example the producers of 52 settlements, and the cessation of the sugar transformation affects 220 employees.

Enterprises linked to the factory employ approximately the same number of people as the staff of the sugar factory itself. So the loss of market due to the closure of the sugar factory endangers the existence of 208 additional employees, over the employees of the sugar factory.

Among the enterprises regarding their main profile, we can find as follows:

- estate agency activity,
- investigation, protection of property (security),
- cleaning up,
- collecting and handling of waste,
- construction of buildings, gates, tunnels, public-service pipes,
- other industrial product commerce,
- other agent activity,
- road transport of goods,
- agency wholesale trade of agricultural products,
- service for cultivation of plants,
- fabrication of metallic structures,
- electrician works,
- metal-work.

The cessation of the sugar transformation in the factory of **Petőháza** of Magyar Cukor Plc. affects 218 agricultural - farm economic - organizations and directly 191 employees.

The cessation of the sugar transformation in the factory of **Szerencs** of Mátra Cukor Plc. affects the sugar-beet producers of **36 settlements**. The number of **workplaces winded-up:** 111 in the sugar factory and 80 in sugar factory works (in outsourcing)

As the effect of the closure, – failing alternative processing, or as the utilization for energy purposes is not competitive with other arable land cultures – the production of the sugar-beet will cease in all probability. In crop-rotation the sugar-beet can be replaced by sowing other plant; the main loss will be the existing, still not fully amortized, or not saleable specialized machine stock. These losses can only be reduced by selling some type of machines beyond the frontier, for example to the Ukraine.

The cessation of the sugar transformation in the factory of **Szolnok** of Mátra Cukor Mátravidéki Cukorgyárak Plc. affects 107 agricultural - farm economic - organizations and 105 employees.

Following the closures of sugar factories, the regions concerned confronted the following cardinal challenges:

- The processing industry must be based on new foundations in the regions;
- The structural change must be supported in the agricultural production, in order to make the previous sugar-beet producers able to adapt in short time to the quality and quantity requirements of the new factories of processing industry;
- The importance of the technological and infrastructural development of the micro-, small-, and medium enterprises must be stressed which contributes to increase their competitiveness, in order to keep their actual role in the regional employment;
- Conditions necessary for the alternative –not directly related to the agriculture nor to the processing industry - income source possibilities must be created (ex. The service sector, tourism);
- In order to make enterprises – working partly in new domain - able to face the challenges of the market, attention must be concentrated on training programs focused on the main problems of the region;
- Population retention in the region is a major problem, which will increase with the closure of factories.

3.2. Strategy

As a consequence of the closure of the sugar factories, the economic and social situation has fundamentally changed in the settlements situated in the direct and indirect agglomeration of the concerned sugar factories. With the resolute realization of a carefully examined, relevant and complex diversification strategy, the concerned economic areas will be able to preserve their viability, or develop new areas of economic development. Based on the local conditions and endogenous resources of the regions, on the national and European development policy framework and on the development needs arising in the regions, the **complex strategic objective** is outlined, which determines the direction and possibilities of development of the region until 2010: amelioration of population retention policies, and the quality of life, by the development of a diversified, competitive economic structure, able to follow the market processes and increase employment.

Based on the strategic objective, and the challenges facing the region, the **strategy of the Diversification Program** can be pointed out, which is in accordance with the New Hungary Rural Development Program, and the projects of development of the micro-regions concerned.

- A. Support to agricultural production (With the closure of the sugar factories, the motivation of the alternative agricultural activities is absolutely necessary, in order to maintain the good agricultural practice in the regions. Besides, to insure the functioning of the processing industries' factories and the basic material supply, the modification of the agricultural production structure of the regions is necessary. Accordingly, producers participating before in sugar-beet production must adapt to the changed market conditions and at the same time make efforts to the development of competitive production and selling structures, which, in the majority of cases means at the same time the modernization of the production technology)
- B. Increase in value of agricultural products
- C. Development of the production and service activities of the micro-, small-, and medium enterprises
- D. Increasing the population retaining force of the region

By knowing the strategic objective, the strategy serving to achieve the above mentioned four objectives is suitable for dynamizing the economic and social development of the regions, and for stopping the deepening of the negative effects influenced on the region by the restructuring of the sugar industry. An important characteristic of the strategy, that it lays emphasized stress on the agricultural restructuring, what helps the producers' capacities, utilized previously in the sugar industry, to become contractible and employable. Besides the strategy, it takes into consideration the characteristics of the social groups concerned, so it defines target-group-specific development domains.

And whether to know if in consequence of all these, there will be a bio ethanol factory using corn in the territory of the ex sugar factory of Kaba, or bio-power station in Szerencs using energy-plants (for ex. cereals' straw, colza- and corn-stalk), and if after the sugar, the bio-fuel would be the new strategic product / or sector – it remains to be seen.

By all means, in Kaposvár, those biogas-factory worth 1,7 thousand million Forint was inaugurated already at the end of 2007, in which they use the secondary-product of the sugar work, the slice of sugar-beet, by which they partly replace – reduce by 40 percent – the utilization of the natural gas; and based on the calculations, this investment would be recovered within five years.

"The current market-regulation reform of the European Union puts the whole Hungarian sugar sector – the sugar-beet producers' farms, and also the processing industry - in an awkward position. In order to maintain the viability of the sector, the effectiveness must increase in all domains. We started now this experience, because at the Magyar Cukor Plc we think, that the initiation of the environment-friendly technology, using secondary-product, would be one way of the future" – said 1 year ago, in November 2006, Mr. Béla Fischer director-general, at the inauguration of the experimental equipment of that.

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Abbreviations

EU: European Union

EC: European Commission

EAGF: European Agriculture and Guaranty Found

ROA: Return on Assets

ROE: Return on Equity

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