Research Note

The Financial Viability of the Fiji Sugar Corporation: An Assessment from the Corporation's Annual Financial Reports

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Abstract

This paper analyses the performance of the Fiji Sugar Corporation on the basis of its annual financial reports for the period 1997-2002. The analysis shows the following: that despite FSC undertaking an internal restructuring, there is no evidence of any material improvement in operating efficiency; there is no evidence of FSC having taken any initiative to foster grower-miller collaboration; and that despite FSC's calls for a renegotiation of the Master Award there is no evidence to suggest that the revision of the Master Award sought would of itself solve FSC long term financial problems. The analysis indicates that with the removal of Fiji's access to the preferential sugar markets equity holders' interest in the corporation would be rapidly destroyed, given the industry's current cost structure. The study also raises concern at the delays in the FSC taking out its annual reports.

Introduction

Notwithstanding Fiji sugar industry's decline, it still generates some 7% of Fiji's gross domestic product and 20% of the country's export earnings (Reserve Bank of Fiji 2003). The welfare of the in-

[1] I wish to acknowledge the constructive comments provided by three anonymous reviewers, to an earlier draft of the paper. Their observations have served to enhance the analysis offered. I am solely responsible for the remaining shortcomings.

dustry is indisputably of crucial importance not only to these directly involved in it, but to the economy as a whole. Concern over the future viability of the industry is clearly warranted. Identifying appropriate policies to address the industry's problems requires a comprehensive review and analysis. This research note contributes to an assessment of the industry's problems by way of review of the Fiji Sugar Corporation's (FSC) annual reports for the financial years ending 31st March 1997-2002.

The Fiji Sugar Corporation Limited was incorporated in Fiji by an Act of Parliament in 1972 taking over the operations of the Colonial Sugar Refining Co Ltd on 1st of April 1973. The Government of Fiji now holds 68% of the issued share capital. The Corporation is Fiji's largest private sector employer.

FSC owns and operates four sugar mills in Fiji of which three are on Viti Levu and one on Vanua Levu. It manufactures raw sugar, and molasses. In addition, the Corporation owns and maintains some 730 kilometres of railway network on which sugarcane is transported to its mills. The corporation's role in the industry extends to facilitating the growing and harvesting of sugar cane. On behalf of the industry, it manages the Sugar Cane Research Centre, and is responsible for the storage, marketing, delivery, and sale of raw sugar and molasses to customers in Fiji, the Pacific and the rest of the world (FSC, 2002). Prior to the 1996-7 season the FSC had been a profitable entity other than when the cane crop had been severely damaged by cyclones in 1982 (Fiji Development Bank, 1983). However in five of the six years under review the FSC has incurred losses. Table 1 gives the trends in reported profits.

These losses have been incurred despite Fiji's ongoing access to the European Community (EC) market at preferential rates in the order of 300% of the world market price.[2]

[2] I am grateful to Mr Deo Saran from the Fiji Sugar Corporation for providing me with this information.

Table 1: Reported Net Profits (Losses) for the years ending 31st March

	$ million
1997*	(1.2)
1998*	(3)
1999	2
2000	(2.2)
2001	(20.8)
2002**	(16.4)

(Source: FSC annual financial reports, years ending 31st March 1997 – 2002).

Notes: * The corporation's reported financial performance was affected to some extent by the sale of its subsidiary, South Pacific Distillery (SPD) in 1997. SPD contributed $0.4 million to group income for the financial year ending 31st March 1997. The sale of the subsidiary generated a gain for FSC of $2.1 million for the financial year ending 31st March 1998. Abstracting these incomes to determine FSC's financial performance from its core operations requires an adjustment in reported losses as follows:-

Financial year end 31st March 1997 $1.6 m

Financial year end 31st March 1998 $5.7 m.

** The losses for the financial year ended 31st March 2002 include the write off of $4.6 million tax benefits, which, given the corporation's financial position, it no longer expected to realise. The operating loss for the year was a little under $12 million.

In the next section, this paper considers whether the FSC can return to profitability by improving its own operating efficiencies. The following section considers the argument that the master award, which determines the allocation of revenues between the miller and the grower should be restructured in favour of FSC and the impact that such a restructure will have on the corporation's financial viability. The paper then reviews the quality of dialogue between the FSC and the growers to consider the potential to secure an industry wide solution to the problem. After this, the paper provides an estimate of how the loss of access to the EC market on a preferential basis will impact on the FSC's financial viability. It then considers the observation made by FSC's auditors on the corporation's status as a going concern and the inferences that might be drawn from the delay in producing the annual report for the year ending 31st March 2003. Finally the paper calls for and provides pointers for further research, which can provide further insights into the nature of FSC's problems and those of the industry as a whole.

Operational efficiencies

When a business enterprise incurs one or more periods of financial losses it behoves it to consider two alternatives, - restructuring operations or closure. In the case of FSC of course an immediate closure would create substantial economic and social dislocation, owing to the importance of the industry as a source of employment and the contribution it makes to the country's foreign exchange earnings; consequently it cannot be considered an option.

An extensive restructuring of operations will also require adjustment in the industry as a whole. FSC has repeatedly called for an industry wide restructure in its annual reports (FSC, 2000, 2001, 2002). FSC as the miller operates in a symbiotic relationship with the growers. The growers are predominantly Indo Fijian tenant farmers whose leases are expiring. Many expired leases have not been renewed and many farmers with leases approaching expiry date have low expectations that their leases will be renewed. In such an uncertain environment growers have little reason to take a long term view of the industry and are consequently reluctant to make any short term sacrifices any restructure might entail to generate long term benefits they will not share in. It is, however, appropriate to consider if FSC's financial problems are due to failure in its own internal operations or factors that require an industry wide restructure. To this end a review of its production statistics is instructive. Table 2 provides details of production statistics.

Indicators of operating efficiencies provided by the FSC show no discernable downward trend other than in regard to the levels of sugar production, where moving averages demonstrate a secular decline in output and the extent of plant utilisation, - actual crushing time as a percentage of available time.

The decline in production over time is explained by the reduction in land under sugar cultivation with the non-renewal of ALTA leases. The contraction in any event will not have impacted on FSC's profitability as the sugar actually produced goes first to satisfy the markets, which earn a premium income. The FSC simply has less sugar to sell on the world market, where it struggles to break even.

The corporation is on record that it wishes to see a reduction in sugar production. Reducing the proportion of sales to the world market is one reason. Confining rail transportation of cane to fields close to the mills is a second; FSC bears the entire cost of rail transportation. A third reason relates to the workings of the Master Award on the allocation of revenues between the miller and the growers, with the allocation increasing in favour of the farmers where more than 325,000 tonnes of sugar are produced in one year.

Table 2: Production Statistics, 1992-2002

Season	2001	2000	1999	1998	1997	1996	1995	1994	1993	1992
Cane Crushed (000t)	2805	3786	3958	2098	3280	4380	4110	4060	3704	3533
Sugar Produced (000t)	293	341	377	256	347	454	454	517	442	426
Molasses Produced (000t)	106	164	159	96	139	186	181	155	136	129
Tonnes Cane/Tonnes Sugar	9.57	11.10	10.50	8.20	9.45	9.65	9.05	7.86	8.38	8.29
Molasses % Cane	3.8	4.3	4.0	4.6	4.2	4.2	4.4	3.8	3.7	3.7
POCS %	11.50	9.96	10.00	13.19	11.90	11.15	11.8	13.29	12.60	12.56
Cane Purity %	83.2	80.5	80.4	83.5	83.1	82.4	82.8	85.0	84.3	83.9
Fibre in Cane %	11.96	11.79	11.40	12.77	12.62	12.18	12.24	12.83	12.64	12.31
Averaged Crushing Rate – All mills (tcph)	1083	11.15	1025	968	984	1044	1071	1057	1039	1042
Actual Crushing Times as % of Available Time	71.0	69.97	74.4	76.8	70.7	83.0	80.6	89.0	80.7	88.7

(Source: Fiji Sugar Corporation annual financial report for the year ending 31st March 2002)

The noticeable decline in plant utilisation is a different matter. While it is not possible to quantify the costs of downtime from the data available, excessive downtime points to costs being incurred, which may well have been avoidable. The problem of downtime is a complex one and just how much FSC can do to address it is not clear. FSC's reports over the years in question point to the need to halt the crush for various reasons. In 1997 it was necessary to do so in order to undertake maintenance and repairs. Had more rigorous maintenance been conducted outside of the crushing season FSC may have been able to reduce, or even eliminate interruptions to the crush. Downtime can of course also arise out of failures in the supply process. The reports point to cases of interrupted supply owing to adverse weather conditions (FSC, 1997, 2000, 2001). Failures in delivery systems have also contributed to interruptions in crushing. FSC is responsible for the maintenance and operation of the rail delivery system, but not deliveries that are made by road (FSC, 2000). Here, FSC may be able to exercise a partial control.

Industrial disputes have also contributed to interruptions in operations. In 1998 and 2000 there were industrial disputes at the mills. FSC may have been able to handle these internal problems better than it did. In 1999 delays and interruptions were due to a growers boycott of the harvest. FSC may have been able to expedite a resolution to this problem, but this is by no means clear.

The corporate reports provide limited opportunities to analyse operational efficiency by focussing on inputs, as companies are under no obligation to disclose operating costs. However FSC's annual reports do offer clues to the effectiveness of an internal restructure, which was initiated in 1997 and was completed in 1999. The 1999 report stated that payroll constituted 55% of the corporation's operating costs and was clearly too high. Clearly reducing the workforce offers the best opportunities for operational cost savings. As a result of the restructure FSC instituted a voluntary redundancy scheme in 1999, which has seen the workforce falling from some 3,200 in the 1997-1998 season to about 2,400 for the 2001-2002 season. Given the contraction in operations as a whole redundancies were called for. However the annual reports provide tentative evidence as to the effectiveness of the internal restructure in improving operational efficiencies. Table 3 compares the FSC workforce numbers with the amount of cane crushed for the years' under consideration.

Table 3: Workforce and Crushing per Worker

Season	Workforce during crushing	Cane crushed (000tonnes)	Cane crushed/ Workforce (tonnes)
1996-1997	3200	4380	1386
1997-1998	3200	3280	1025
1998-1999	3100	2098	677
1999-2000	3000	3958	1319
2000-2001	2900	3786	1299
2001-2002	2400	2805	1160

(Source: FSC Corporate annual reports for the years ending March 1997-2002).

The poor measures for productivity for the seasons 1998-1999 and 2001-2002 can be explained by the poor harvests for the year, inevitably leaving FSC with spare capacity.

Leaving these results aside FSC through its internal restructure, does not appear to have done more than maintain operational efficiency with respect to labour, at best, at the 1996-1997 level. The substantial cut in the labour force in 2001-2002 cannot be relied upon to reverse the trend in future years. Based on the moving averages for sugar output, FSC might have expected to process 3,083 thousand tonnes of cane. Had it done so FSC would only have achieved a crush/employee ratio of 1,284:1.

The efficiency of FSC's operations will of course be influenced heavily by the quality of its plant. The corporation's financial reports over the period show non current assets at cost in excess of $370m and written down values of $200m. For a mature operation these figures look acceptable. One would expect an established operation with little scope for expansion to have, on average, used up half the working life of its non current assets. However such assets must still be progressively replaced. Investments in non current assets for the years in question are given in Table 4.

Table 4: Investments in Non Current Assets

Financial Year	Investments ($ million)
1997	18.7
1998	11
1999	5
2000	8.5
2001	8
2002	8.4

(Source: FSC annual financial reports for the year's ending 31st March 1997 – 2002.)

The relatively large sum invested for the year ended 31st March 2002 represented the end of a substantial upgrade of the Labasa mill. The corporation has indicated that larger investments are needed than the 2-3% renewal of non current assets undertaken. The report for 2000 points to the need to invest $12.5 million to upgrade the rail system, quite apart from the need to improve milling equipment. The reports for 2001 and 2002 both state that investments made were the absolute minimum necessary to maintain operations.

FSC's indisposition to make substantial investments in new equipment is understandable given the fact that the industry is contracting, and the uncertainties associated with sugar farming. The lack of well equipped mills that can be run continuously may therefore arise out of the uncertainties surrounding the industry as a whole.

In reviewing this section the reader will note that FSC is dependent in many respects on the collaboration of other parties in the industry, as well as the ways in which it conducts its own affairs, in improving its operational efficiency.

Equity in the Industry

It is necessary to ask the question whether or not FSC is financially non-viable owing to possible inequities in the Denning award, which determines the breakdown of sugar revenues between growers and the miller. This was set in 1972. The formula now, as contained in the Master Award, is shown in Table 5.

Table 5: Sugar Proceeds Distribution

Total sugar produced	Growers revenue share	FSC's revenue share
First 325000 tonnes	70%	30%
325000-350000 tonnes	72.5%	32.5%
Tonnes in excess of 350000	75%	25%

The corporation argues that this arrangement is inequitable, pointing out that revenue ought to be allocated 35% to the miller and 65% to the grower. Reallocating revenues on this basis would lead to an adjustment to revenues and profits as shown in Table 6.

Table 6: FSC Profits with 35% Revenue Share

	Actual proceeds and profits		With 35% Revenue Share	
Year ending 31st March	Proceeds to FSC $m	Profits after tax $m	Proceeds to FSC ($M)	Profits after tax ($m)
1997	79.1	(2.0)	92.28	7.37
1998	69.3	(11.1)	80.85	4.51
1999	73.5	3.0	85.95	9.96
2000	83.1	(5.3)	96.95	5.84
2001	70.7	(20.9)	82.48	(13.54)
2002	71.8	(13.6)	83.77	(8.26)

(Source: FSC Annual Financial Reports for the years ending 31st March 1997-2002).

While an adjustment of the kind sought by FSC would inevitably improve matters it would by no means fully address the financial problems of the two most recent years. The issue of the allocation of the sugar revenues is in any event a contentious one. Notwithstanding the fact that arrangements in other countries' industries are more favourable to the miller than Fiji's master award, it does not necessarily follow that it is a 'correct' arrangement.

It should also be noted that the government, by imposing a 10% export tax on sugar, has already demonstrated that this issue can be addressed. Without adjusting for the element of domestic consumption in the total sugar revenues, and other minor sources of income, the 10% tax imposed on the turnover for the year ending 31st March 2002 would yield $24.38m of which $17.07m is the growers share of the tax. If the $7.31 million collected from FSC is refunded and part of the tax raised from the growers is directed to the miller FSC's share of the proceeds from sales can be adjusted to figures around the 35% of total proceeds mark, the total which the corporation would seem to regard as equitable. Indeed, the tax at the current rate would permit a greater redistribution in FSC's favour.

Dialogue in the industry

As the prosperity of the FSC is bound up with that of the farmers, a review of the annual reports of the corporation over the years of financial stress might be expected to provide some insights into discussions between the parties in the industry. The report of 1999 refers to the need for greater co-operation with other parties in the industry and the need to introduce a quality cane payments system. This was trialed at the Lautoka mill, with an intention to formalise this reward system in 2000. The need to reward growers on the basis of sugar, rather than cane, delivered is self-evident. However there is no reference to the corporation's dialogue with growers on this matter. Furthermore, the quality cane payment system has yet to be introduced.

The report in 2000 called for a renegotiation of the master award but provided no insight on discussions held with the farmers' representatives on this issue. The reports of 2000 and 2001 both refer to the corporation's efforts in growers' education regarding the quality of cane and the need to avoid burning cane, but give no indication of the farmers' response. The reader of these reports is left with the impression that perhaps the corporation talks at the farmers but not with them. The lack of dialogue is also reflected in the 2002 report. In this report the FSC refers to its proposals for restructure of the industry as a whole but not to discussion on the proposals.

In fairness to the FSC it may not be evident who the corporation should be in dialogue with. Many cane growers are quitting the industry, some owing to the non-renewal of farming leases, others because they no longer view cane growing as economically viable. It is not the current generation of farmers that the FSC needs to engage in dialogue with, but the generation that will replace them. The FSC's reports acknowledge that its operational efficiency is largely bound up with that of the growers. Dialogue with the farmers would seem to be essential and ongoing. The lack of any report on such discussions is disconcerting and will rightly cause the reader of the reports to ask if such discussions have in fact taken place.

Operating without Preferential Markets

The financial position will inevitably be bleaker when preferential access to the EC market is withdrawn. It is difficult to determine the precise magnitude of the lost revenues as this will be dependent on fluctuations in the world market price of sugar and currency exchange rates. The impact of a loss in preferential markets has been under consideration for some time. Grynberg and White (1998) evaluated eight different scenarios based on the FSC's financial reports for the year ended 31st March 1996, considering possibilities of a devaluation in the Fiji dollar, movements in the world price of sugar and possible downsizing of the industry. The outcomes ranged from the FSC carrying a loss of $18.13 million to a loss of $38.54 million.

In 2003 sugar sales are made to the EC at $FJD 1012 per metric tonne as compared to a world market price of $FJD270. For the year ended 31st March 2002 Fiji exported a total of 247,373 metric tones of sugar, 172,693 of which were sold to the United Kingdom and a further 19,000 tonnes to Portugal. Sales of these tonnages at current world market prices as opposed to the EC price would have reduced total revenues by $142.24 million. Gross revenues to growers would fall by $99.57 million and to the FSC by $42.67 million. FSC's losses after tax would increase by $29 million to a figure in the order of $68 million after allowing for the necessary write down in FSC's inventory of sugar, over half the book value of FSC's equity of $131 million as it stood on 31st March 2002. FSC's prospects and those of the sugar industry as a whole are in an even more parlous state in 2003 than was the case in 1996.

Auditors View of FSC's Financial Reports

The FSC has consistently received a clear report from its auditors on its published financial reports up to the report for 31st March 2001. While the report for the year ended 31st March 2002 was not qualified, the auditors, PricewaterhouseCoopers included a statement of 'Matter of Emphasis', a term which is one stage short of a formal qualification, in the audit report. The matter of emphasis called the reader's attention to the fact that FSC's financial reports had been drawn up on the going concern basis, something that could only be sustained on the basis that the Fiji government had agreed to underwrite FSC's operations. The company itself states, in its explanatory notes to the financial statements:

> The accounts have been prepared on a going concern basis, which the directors believe is fair and reasonable given the following:
>
> a) the directors are taking active steps to restructure the company and the industry via its Industry Restructure Proposal to achieve future viability and are currently awaiting Government approval of the same;
>
> b) an undertaking by the Government to provide periodic finan-

cial guarantee and related support. The Government has renewed its guarantee to 31 March 2003.

Neither the corporate nor the industry restructure has materialised. This paper has sought to demonstrate that the prospects of executing a restructure of the industry as a whole are remote in the extreme. The FSC, therefore, exists very much at the government's pleasure.

Timeliness of corporate financial reporting is regarded as an essential quality by both the international accounting community and Fiji's own professional accounting body for financial reports to be useful to the reader (International Accounting Standards Committee, 1989). FSC as a company listed on the South Pacific Stock Exchange is bound by the Exchange rules to publish its annual financial report within four months of the end of their financial year; the four months expire on 31st July. FSC's record over the six years in question is patchy, failing to meet the deadline in three of the six years, once by as much as six weeks.[3] FSC has failed to meet the deadline for the production of the report for the year ending 31st March 2003 by over four months.

Delays of this kind are almost invariably due to a company wishing to defer the disclosure of bad news such that its relevance is diminished due to the untimely nature of the report, disagreements between the reporting entity and the auditor, or both. The late availability of FSC's financial report for the year ended 31st March 2003, in itself signals that it faces problems beyond those discussed in this note.

Conclusion

The analysis offered in this research note is inevitably partial. The content of corporate annual reports are determined in part by regulation and in part by the reporting entity itself, which will typically employ the report as a public relations tool. Further insights into the future financial viability of the FSC, and by extension the sugar

[3] The dates at which an entity's reports are available are reflected by the dates of the auditor's report. For the years under study these were, 1997, 18th September; 1998, 26th August; 1999 2nd July; 2000 14th July; 2001 30th August; and 2002, 25th July.

industry as a whole, can be gained by researching FSC's cost accounting data, the relationship FSC has with the growers, and the means by which the farmers themselves can contribute to FSC's operational efficiency through the production and delivery of high quality cane. The importance of the sugar industry to Fiji, justifies the wide-ranging research and analysis called for in the introduction.

It is, however, possible to draw certain clear conclusions from the archival exercise undertaken. First, despite FSC having undertaken an internal restructuring exercise, there is no evidence to suggest that there has been any material improvement in operating efficiency. Second, despite calls for greater collaboration between the miller and the growers on common concerns, there is no evidence of FSC having taken any initiative to foster such collaboration. Third, despite calls for a renegotiation of the Master Award, which sets the distribution of sugar revenues between the miller and the grower, there is no evidence to suggest that the revision of the Master Award sought would of itself solve FSC's long term financial problems. From a public relations perspective it could reasonably be expected that if the FSC had information to disclose on any of these three counts it would do so. Finally, the analysis clearly indicates that with the removal of Fiji's access to the EC market for sugar on the current highly preferential terms, the equity holders' interest in the corporation would be rapidly destroyed, given the industry's current cost structure.

Certain policy implications logically follow. The greatest potential to reduce operating costs would be realised by the parties in the industry operating in tandem rather than in isolation. An environment needs to be created that will facilitate and foster such collaboration. It is, however, by no means certain that Fiji's sugar industry will be financially viable if it no longer enjoys preferential access to certain markets, even if it is able to successfully restructure. A realistic evaluation of the industry's long term viability is needed. The most appropriate policy to pursue may well be one that enables the orderly winding down of the industry and its ultimate closure.

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