Advisory outlook

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Thriving in a troubled economy

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The changing dynamics in Nigeria's economic climate Uncertainty has engulfed the Nigerian economy, and as the government grapples with how best to bring stability to the system, businesses continue to struggle with the challenges being thrown their way on a seemingly daily basis.

The decline in oil prices from the highs of $105 p/b down to $40-$50 p/b, the depreciation of the naira by over 50% in the parallel market - a measure of true market sentiment, and the recent announcement of the scrapping of fuel subsidies leading to significant increases of petrol at the pump, have impacted government revenues, the foreign reserves, and the business environment significantly.

These changes have and will continue to put immense pressure on the economy as a whole. Unfortunately many businesses are not prepared for these conditions, and are finding it difficult to respond appropriately.

What does this mean for businesses?
One measure introduced by the government to reduce the nation's reliance on imports and hence curtail the demand for foreign exchange, is the addition of several more products to the ineligible imports list. The list includes certain food products and medicines, some industrial products such as glass bottles and fabric textiles, and consumer items like furniture and footwear. Foreign exchange is no longer made available for the importation of these goods. Local substitutes therefore have to be employed for sales or production to continue. Very often unfortunately, the substitute is of lesser quality which then leads to dissatisfied customers and eventually loss of sales.

Where a business relies on legitimate imports for its raw material, obtaining foreign exchange can be an onerous process and often involves a wait of sometimes up to three months.

What's more, the business faces downward pressure on its profits as the higher price of imports due to the depreciating currency, increases costs, which is passed on to consumers, who often then seek cheaper alternatives where suitable substitutes exist.

As uncertainty persists, and inflation starts to bite due to the depreciating currency, rising petrol prices and yet stagnant wages, consumer demand weakens and many purchases, particularly at the high-end, are curtailed or postponed. This affects businesses who have to reduce prices to entice consumers, or face dwindling sales.

Adverse currency movements also impacts businesses, in that those with foreign denominated debt have to generate more naira revenue to service these borrowings. In addition, local securities pledged to foreign banks as collateral, have to be revalued and often, this means further pledge requirements. Likewise, those who pay a portion of their staff, (e.g. expatriate staff) in foreign currency will have to convert more naira to fulfill the same salary obligations.

Many Nigerian banks have seen their non-performing loans increase as a result of over-exposure to the Oil and Gas sector. Lending has therefore being cut back as part of rebalancing exercises. Access to credit for many businesses has diminished as a result, which affects their ability to continue daily operations.

Planning, budgeting and pricing becomes extremely arduous under these conditions and unfortunately, many businesses are unable to weather the storm to emerge stronger post the turbulence.

So what can businesses do to survive the turbulence and emerge stronger?
All too often, businesses focus on driving top line growth, i.e. sales and revenues. However, in the current environment, focusing on cost reduction and the bottom line would be more prudent.

The process of turning around a struggling operation can begin by a few pertinent questions being asked.

1. What are your debt levels? Are you able to sustainably service them?
Have you considered refinancing or restructuring your debt? This can be effective in alleviating the cost of repayments. Refinancing allows the borrower to replace an existing loan with a new one, gaining more favourable terms in the process. For example, after an analysis of the impact of currency devaluation, you may arrive at the conclusion that a foreign loan could be refinanced for local funding or vice versa.

Debt restructuring involves modifying the terms of an existing loan and would typically be an effective tool should you already be distressed. In such instances, the lender may be willing to amend terms of the existing credit agreement such as extending the term of the loan, thereby reducing monthly repayments, waiving of fees, or a debt moratorium. After refinancing or restructuring, you should emerge with improved or restored liquidity and can therefore continue operations.

It is critical however, that you are very clear about your earnings and cash flow capacity. It is equally important that you have a realistic view of your business's sustainable debt levels. Restructuring your debt based on unrealistic analysis and projections will only increase the pressure on your company, reduce your credit worthiness, and can eventually end up with court action by your lenders.
Debt restructuring can be a complex process and if you are considering this, it would be beneficial to seek assistance from financial advisor(s).

Once the process of debt refinancing or restructuring has been completed, it is essential that you stay on top of all liabilities. **In an environment where the currency is depreciating, it is easy to fall back into debt. You must ensure that there are robust systems and procedures in place to track and evaluate excessive debt, eliminate inefficiencies, and unlock cash.** Accurate and timely reporting on debt is a prerequisite for the success of any debt management process. Reporting should be comprehensive enough to assist in drawing up a debt management strategy.

2. What are the future working capital needs of the business? Are there reliable sources of cash to pull the company through its recovery?
The critical areas to monitor are account receivables, account payables, inventory and cash management. Perhaps it is time to revisit your debtor management strategy and ensure constant and open communication with both customers and employees. Consider altering credit terms extended, ensure prompt and accurate billing, introduce incentives for early payments, and track customer performance. On the payables front, developing a detailed payment plan, that is updated regularly and which provides visibility on the timing of cash outflows, is essential. Importantly, have candid discussions with your creditors and if possible, renegotiate payment terms in order to avoid default.

Manufacturing and distribution companies need to consider rationalising stock keeping units, identify and eliminate slow moving and low margin items, and sell off obsolete stock.

Once you have got a handle on your working capital, budget and plan better. With thorough budgeting and planning, you can better understand and manage your foreign exchange risks. By setting a budget that details the expected level of trading, the number of foreign exchange payments and likely timings of these transactions, along with realistic assumptions of future rates, you can minimise the impact of any exposure to currency fluctuations. It is important that budgets are carefully thought through, and adherence closely monitored. Historical variances in previous budgets should be analysed to identify potential improvement strategies. Depending on the size of your business, producing rolling daily, weekly and monthly performance reports which provides information on income and expenditure levels, profits and expected cash flows, will be crucial.

A robust budget will enable you to adequately plan and monitor income and expenditure levels.

3. Have all costs been cut to the minimum efficient level? Can expenses be reduced without the product quality falling?
The systems and processes that drive your business operations must be meticulously reviewed to identify and eliminate inefficiencies. Often, it is discovered that costs can be cut from general and administrative functions without compromising the quality of goods and services provided. Any investments in making your business more efficient will make it more competitive and resilient in the short, medium and long term.

4. Import substitution and strategic sourcing. Have you researched alternative sources of supplies?
Many companies source raw material from foreign suppliers without fully investigating and researching local alternatives. Opportunities to cut costs and eliminate exchange rate risks can be uncovered if local sources are explored. If you are already using local suppliers, ask yourself these questions: Can I buy at a lower price? Can suppliers offer a better price based on volumes? Are there alternative specifications? Can suppliers help drive efficiencies? Can I change the supply relationship? Can I change behaviours to reduce costs? Import substitution and strategic supply management are critical to operational effectiveness.

5. Have you communicated with key suppliers, vendors, creditors and debtors to ensure they will support your company in its restructuring efforts?
If a company in your supply chain falls into financial difficulties this could potentially adversely affect your business. It is essential that all businesses within the chain are kept informed of any internal or external changing circumstance. Communication channels must be kept open to encourage candid discussions, as both creditors and debtors could be facing similar financial struggles. The current economic and financial challenges are not likely to abate in the short term and debt can quickly spiral out of control. A good candid relationship will make the process of setting up and implementing any debt management plan more effective.

The smart will survive
Conducting business in Nigeria is tough and very competitive at the best of times. With the economic difficulties currently being experienced, it is unlikely to get any easier. The penalty for acting slowly is unforgiving and hits very quickly as many businesses would have experienced. It is critical that business managers take decisive and proactive steps early to stay ahead of the curve. Adapting some of the measures outlined above, will stand your business in good stead to overcome some of these challenges, and emerge from it stronger and better positioned for the future.

For more information on ways to thrive in a troubled economy you can contact the following:

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