Conducting Business in a challenging climate

The changing dynamics in Nigeria's economic climate

Operating in an environment where the currency is depreciating and interest rates are rising is challenging. The devaluation of the naira in November 2014, coupled with declining global crude oil prices has resulted in declining market growth expectations for 2015. Nigeria's Gross Domestic Product growth rate which averaged 6.14% between 2005 and 2014 is now forecast to decline to 5.5% in 2015.

Unfortunately many businesses are not prepared for these eventualities, and now find themselves struggling to operate profitably. Several are still trying to understand and come to terms with the impact of these conditions on their operations.

What does this mean for your business?

The most obvious impact of currency devaluation is an increase in the cost of importing raw materials and finished goods. This is even more critical as Nigeria is an import dependent country. Many raw materials and consumer goods cannot easily be sourced locally and therefore need to be imported, resulting in higher prices which are passed on to consumers. Customers then seek cheaper alternatives where substitutes are readily available. Overall, the inflationary pressures affect consumer purchasing power; and where wages remain stagnant, spending is reduced, resulting in slower economic growth.

Another effect of the adverse currency movements on Nigerian businesses is that those with foreign denominated debt will have to generate more naira revenue to service these borrowings. Furthermore, 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.

Additionally, businesses with naira denominated debt will have to pay higher interest rates following the rate rise. If higher naira earnings are not forthcoming to offset the increased cost of debt, any profits realised are quickly eroded. The risk of a default then looms.

So what can Nigerian businesses do to recover from the turbulence?

All too often, businesses focus on driving top line growth, i.e. sales and revenues. However, in this environment, focusing on cost reduction and the bottom line would be more prudent.
You can begin the process of turning around a struggling operation by asking a few pertinent questions.

1. ***Have you cut all costs to the minimum efficient level? Can you reduce expenses without reducing the quality of your product?***

   The systems and processes that drive your business operations must be meticulously reviewed to identify and eliminate

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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.

2. ***What are your future working capital needs? 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 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. ***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 and in increase in interest rates, 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.

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 and interest rates are rising, 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.

4. ***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.

5. ***Have you researched local 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 could be uncovered if you explore and research these avenues. Carry out some market research focused on local industries. This could be beneficial for your business in the long run.

The questions asked above are by no means exhaustive. There are no doubts many more concerns businesses will have in this climate, and several recovery options that can be explored. We are happy to take this conversation further and answer any questions you may have. Why not send us an email, or visit the PwC Nigeria website.

The smart will survive

Conducting business in Nigeria is tough and very competitive at the best of times. With the economic difficulties that lie ahead, 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, plus the many more we will discuss following your questions, will stand your business in good stead to overcome some of these challenges, and emerge from it stronger and better positioned for the future.

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