Nigeria's Economic Uncertainties:

Coping Guidelines for Business Survival

September 2022

EXECUTIVE SUMMARY

Nigeria, like many economies, is ravelled by the fallout of the Russia-Ukraine war, which worsened the enduring impacts of COVID-19 and the existing structural challenges facing the economy. In Nigeria, the inflation rate heightened to 20 percent in July 2022 from 15.6 percent in January. Likewise, exchange rate volatility intensified as the premium between the official and parallel markets widened to 63.1 percent.

Also, the interest rate environment becomes elevated with the expanding Monetary Policy Rate to 14 percent. The impacts of Nigeria's unstable macroeconomic space have been unpleasant for the overall business environment, investors' confidence and the eventual performance of firms.

What strategy does Nigerian business entity need to improve resilience in times like this? In this article, we highlighted coping strategies for Nigerian businesses in the face of growing uncertainties.

The article highlighted the four risk exposures of businesses: namely, structural, financial, external and policy exposures. Issues around the infrastructural deficit, insecurity, inflationary pressure, and brain drain constitute structural risks. Financial exposure includes risk from asset reprising, liquidity, and loan default.

The persistent Forex scarcity and volatility alongside the energy and food crisis accentuate the external exposure. Meanwhile, the heightened policy rate, fiscal weakness, and sovereign default risk constitute policy risk. The article outlined coping strategies for companies, which include localisation of supply chain, backward integration of business operations, sachetization, digitalise processes, equity financing and natural hedging, among others.

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Introduction

Nigeria, like other economies in the world, is equally ravaged by the aftermath of the Russia-Ukraine war, further worsening the protracted impact of COVID-19 on the economy and the existing structural challenges facing businesses in the country. While the economy sustained positive growth in Q1-2022 and Q2-2022 at 3.1 percent and 3.5 percent respectively, inflationary pressure heightened, rising to 20 percent in July 2022. Likewise, exchange rate volatility intensified as the premium between the official and parallel markets widened to 63.1 percent.

Also, interest rate, among other macroeconomic indicators, is expanding with Monetary Policy Rate increasing to 14 percent. In addition, the current socio-economic and political situations, particularly with insecurity, uncertainty associated with the political season and policy and regulatory bottlenecks, constitute headwinds to economic activities. As such, the oscillatory trend of the Purchasing Managers' Indices (PMI) around the 50 points benchmark of economic expansion suggests a fragile economy which is inherent in the performance of businesses and how the business environment affects them.

With no end in sight to the ravaging uncertainties in Nigeria's business environment, the outlook appears deemed. While we expect economic growth to be sustained, the general outlook for other critical drivers of business performance, such as inflationary, exchange rate, and other structural factors (such as security, infrastructure and policy consistency) remains bleak.

To wade in the stormy business environment, businesses must develop a survival framework. Hence, this article seeks to highlight coping strategies for businesses to navigate some of the risks emanating from Nigeria's business environment.

Contextually, we categorise the risks faced by businesses into four exposure channels namely, structural, financial, external and policy exposures. The rest of the article will be sectioned accordingly to highlight the risks and possible coping guideline(s).

Number 1:

Structural Risks

"Structural risks constitute headwinds to the conduciveness of operating environment and business competitiveness"

Structural risks are some of the deep-seated issues that have become characteristic of Nigeria’s operating environment that businesses have to deal with. These issues may have remained endemic apparently with no succor from the government. More so, they are constituting risks to businesses, driving up their operating costs and adversely impacting their performance. The following presents these issues alongside coping guidelines.

Infrastructural deficit

The deficiency in infrastructure in Nigeria is manifesting in deplorable transport and logistics systems, inadequate supply of electricity, and lack of water supply among others.

Take advantage of Executive Order 7

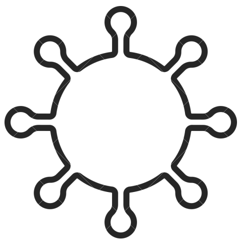
Executive Order 7 allows private businesses to invest in road infrastructure directly impacting their operations in exchange for a tax credit. At least, this will enable companies to provide public goods directly from their tax commitment to ease their network to the market.

Adopt localisation of industries

Firms operating in similar industries can come together in a geographical location to jointly invest in requisite infrastructure. These firms can also take advantage of the government's Public Private Partnership framework to finance pertinent infrastructure.

Resurgence of COVID-19

The spike in the spread of the virus within an organisation could disrupt business operations and impact the performance of organisation affected .



Reinstate COVID-19 guidelines

Companies need to re-establish guidelines such as social distancing, using of face masks, and frequent handwashing, to reduce the risk of resurgence among staff as well as clients.

Digitalise business processes

The global pandemic has shaped the way many organisations run their businesses – production, marketing strategies, client management, customer service, transactions and a host of other activities. This will help to strengthen the resilience of businesses and ensure sustainable performance.

Dreadful state of insecurity

The security situation constricts economic activities, especially in agro-businesses, manufacturing and oil & gas; likewise, the cost implications of cyber-attacks across industries.

Review Environmental Sustainability Governance (ESG) framework

As part of the ESG framework, firms should improve their Corporate Social Responsibility (CSR) to be more socially responsive and responsible to their host communities. They can donate security logistics and provide security equipment during an emergency.

Review safety guidelines

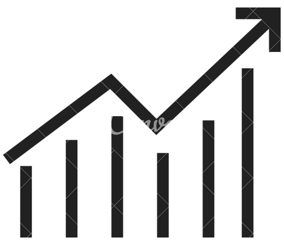
Firms need to review and maintain office (work) hours, install an identity management system to avoid impersonation and identity theft, keep up to date on the security system and adopt technology in the security management system.

Drive cybersecurity awareness

Educate staff on cyber threats and ensure they are aware of legitimate internal and external channels of contact. Likewise, firms should embark on regular system backup, use strong and unique passwords, enable multi-factor authentication, establish clearance for organisational information, and implement a stringent procedure for the safe keeping of confidential information.

Persistent inflationary pressure

Following the Russia-Ukraine war, inflation rates have become elevated. This is heightening the operating costs and turnover of businesses as purchasing power shrinks.



Localise supply chains

Import-dependent businesses need to explore local raw materials and intermediate inputs. The high price of wheat in the global market translates to a high cost of production for flour millers and producers of wheat flour derivatives such as bread and snacks.

Adopt backward integration strategy

Backward integration involves expanding business roles to provide or produce inputs into existing business operations. Companies can go as far as investing in local development and sourcing raw material and other intermediate inputs.

Adopt sachetization strategy

Sachetisation involves developing sachet products and packages (mini and nano forms) with similar quality that will fit into the purses of low-income earners. This is important to sustain demand and expand market opportunities in the face of increasing operating costs.

Leverage outsourcing services

With the rising costs of production, businesses can outsource some parts of their operations that are not core. This will also be pivotal to guaranteeing a sustainable supply chain.

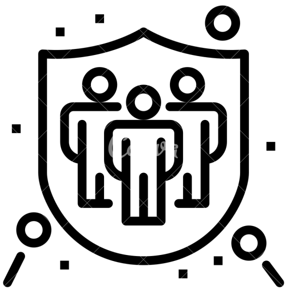
Drive sustainable and circular operations:

Sustainable/circular operations, here, refer to a production operations process that involves reusing, recycling and refurbishing production materials and products as long as possible.

Rising brain drain and staff turnover	This has become severely heightened and is now substantial enough to threaten business survival in Nigeria. it will put companies at the mercy of employees and raise wage costs.

Review company's remuneration, recognition, and reward system

Organisations must keep up with the market rate and offer competitive salaries and compensation. Also, the recognition and reward process should be flexible to recognise employees' contributions.



Invest in the personal development of employees

Firms need to show interest in the personal development of their employees and invest in their capacity building. Investment in their capacity development can also be used to guarantee commitment by tying their retention to their capacity development.

Encourage a healthy work-life balance and work environment

Feeling burnt out and a toxic working place make employees feel unsatisfied in an organisation. Hence, firms need to optimize employee utilisation and provide the necessary equipment.

Create a shared vision with employees

The success of any organisation is a product of the ingenuity employees brought on board to achieve the organisation's goal. Hence, this should be considered in dealing with employees.

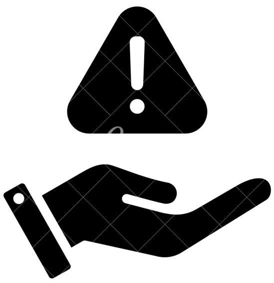
Number 2:

Financial Risks

"Financial risks are burdening companies' capital structure and causing catastrophe in financial institutions' portfolios"

The Nigerian financial market, like other countries, is experiencing sharp reprising across segments of the market. Following the global inflationary pressure, interest rates are rising across the world, with the Central Bank of Nigeria also increasing the policy rates. Accordingly, yields across the fixed income market are picking up; the equity market, however, is running bearish, while exchange rate volatility is heightened. These have significant implications for organisations' capital structure and financial institutions' portfolios. Hence the following risks are highlighted, alongside coping guidelines for businesses.

Increasing domestic interest rates	As Nigeria matches the global trend with rising rates, the costs of capital/borrowing for companies and debt obligation burden are increasing, adversely impacting their liquidity position and profitability. Financial institutions are, however, positioned to reap from the situation, but, face the risk of widening non-performing loans.
Suppressing equity market	Investors are taking advantage of rising interest rates globally, hence, the equity market is experiencing sell-offs. This will adversely impact the portfolio of investment organisations, especially financial institutions.
Liquidity crisis	With shrinking system liquidity, institutional and retail investors have no money to throw around, limiting patronage in the capital market. Accessing liquidity in the system would be at a much higher cost of borrowing, further worsening businesses' balance sheet and performance.
Suppressing equity market	With higher interest rates and liquidity challenges the NPL position could worsen; hence, putting financial institutions at risk.



Adopt equity financing

In the face of rising interest rates, debtor organisations should expand equity financing in their capital structure to raise funds through the sales of shares.

Review company's remuneration and reward system

Creditor organisations are positioned for increased returns on debt portfolios; however, they are exposed to risk in the equity market. Hence, they should diversify their holdings of equities across bellwether stocks while taking advantage of the interest rates hikes.

Provide moratorium and forbearance

Due to limited system liquidity and the risk of default from debtors, financial institutions should give customers moratorium and forbearance on their debt obligations to avoid the risk of default and potential hike in the non-performing loans.

Number 3:

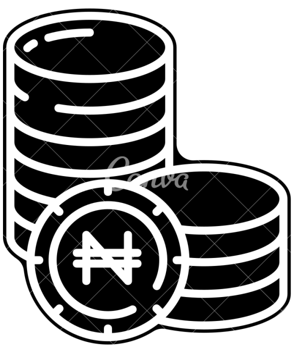
External Risks

"Business vulnerabilities amplify with growing uncertainty in the international markets"

The higher oil prices in the global market inspire trade surplus for Nigeria as crude oil export receipt drove exports in excess of imports. However, the global risk emanating from energy and food crises, appreciation in the dollar against global currencies as the greenback becomes a safe haven, increase in the cost of petroleum products and associated subsidy payment, and halt in foreign investment inflows, among many issues have elevated the business risks from the internal trade. Hence the following highlights some of the risks emanating from the uncertainties in the current global economy alongside mitigating strategies.

Intensified currency risk and foreign exchange scarcity:

The Naira continuously depreciates in the parallel market as businesses face intensified foreign exchange scarcity to import raw materials and intermediate inputs. As the CBN Forex rations remain grossly inadequate, businesses with imported inputs face lower capacity utilisation risk as inputs costs increase and inputs supply slows down. Coupled with elevated global prices level and exchange rate depreciation, operating costs increases as well as foreign debt burden increases.



Make use of forward contract

Organisations can explore forward contracts to mitigate associated risks of Forex price movements. Hence, manufacturing and service organisations can lock down a purchase price in advance.

Make use of currency options

This allows companies to buy or sell Forex at a specific future date and rate that hedged against downward movements in the Naira. Quite similar to forwards, firms are not compelled to complete the transaction, but it comes with an option premium.

Operate at a natural hedging level

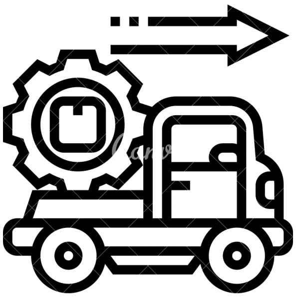
This involves companies matching their Forex costs to Forex revenues such that they net off each other to minimise Forex risk. Hence businesses need to produce for export.

Transact in local currency and limit Forex transactions

Companies need to ensure a substantial part of their cost is in Naira. As such, they should source a substantial part of their raw materials locally.

Global supply chain disruption

With energy and food being major inputs across many businesses, the elevation in their prices due to the global supply chain disruption that followed the Russia-Ukraine war hikes the operating costs of businesses.



Localise the supply chains and integrate businesses operation backwards

Localise the supply chains and integrate businesses operation backwards: Nigeria still has a comparative advantage in agriculture. Import-dependent FMCGs should source their inputs locally. They can also invest directly in the local value chain to have direct access.

Diversify energy sources

Companies should invest in other more sustainable energy sources to compensate for the deficiency of supply from the national grid and reduce the risk associated with energy price fluctuations.

Number 4:

Policy Risks

"The policy space has been constrained in a challenging time such as this, turning policy choices into risks for businesses"

The burden of policy intervention is amplified while also facing the dilemma of taming inflation and supporting the economy. Meanwhile, Nigeria's fiscal weakness intensified in 2022 as the fiscal deficit continues to upsurge. Hence, Nigeria is at a crossroads where both monetary and fiscal policies are constrained; however, they cannot remain idle. Debt service to revenue has reached 119 percent, but the government cannot stop borrowing. The monetary policy rates have been increased twice already; however, the inflation rate maintains an upward trend. With the current economic situation, it appears businesses will be at the receiving end of whatever policy direction is taken by the government. The following are some of the risks emanating from the policy space and coping strategies.

Increasing monetary tightening	With the increasing inflation rate, the CBN is expected to deepen its monetary tightening. Alongside the MPR, the CBN has increased the savings rate and reversed its moratorium on subvention loans. This means an increase in the cost of borrowing, debt service burden and system liquidity challenges for businesses.
Heightened sovereign default risk	The government has been running heavily on borrowing. With debt service to revenue reaching 119 percent in 4M-2022, the economy is at risk of a debt overhang and debt crisis. This means the cost of borrowing will skyrocket, inflationary pressure will eat deeper with loss of purchasing power, and exchange rate volatility will be elevated.
Increasing tax risk	The weak fiscal space motivates the upward review and introduction of a series of taxes to bolster government revenue. This impacts business operating costs and profitability, especially when the companies cannot shift the burden to the consumers.

Hedge against interest rate risk

As the interest rate outlook remains high, businesses need to take measures to limit their interest risk in future. This includes using interest rate futures, equity financing and capital structure adjustment.

Diversify portfolio

Creditor organisations should brace for sovereign default risk and adequately diversify their portfolio across government bonds, corporate bonds and commercial papers, equities and especially foreign denominated securities.

Reduce the cost of production

As taxes increases, businesses will be impacted by lower demand. Hence, organisations need to work to reduce their production costs. A number of guidelines have been mentioned earlier. Besides, businesses must adopt the sachetisation strategy.

ABOUT THE NESG

The NESG is an independent, non-partisan, non-sectarian organisation, committed to fostering open and continuous dialogue on Nigeria's economic development. The NESG strives to forge a mutual understanding between leaders of thought so as to explore, discover and support initiatives directed at improving NIgeria's economic policies, institutions, and management.

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