Nigeria's Economic Uncertainties: Coping Guidelines for Business Survival

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Abstract

Nigeria, like many economies, is ravelled by the fallout of the Russia-Ukraine war, which worsened the enduring impact of the COVID-19 pandemic and the existing structural challenges facing the economy. The macroeconomic instability experienced in Nigeria over time cannot be dissociated from the country's massive dependence on crude oil, which remains the largest source of fiscal revenues and export earnings. The unstable macroeconomic space – in terms of high inflation, exchange rate volatility, constricted fiscal space, weak external reserves, and balance of payments problems – and deepening instability on the social and political landscapes – have proved the extent of Nigeria's vulnerability to shocks. A more recent ranking showed that Nigeria was among the bottom half of African countries classified as less resilient to shocks by the African Development Bank (AfDB) in 2021[1]. The burden of vulnerability is borne by the people at the bottom of the income pyramid, which could aggravate the insecurity problem. Consequently, Nigeria's unstable macroeconomic space has worsened the business environment, subdued investors' confidence and weighed on the financial performance of businesses in Nigeria. In this paper, the NESG highlighted four variants of business-related risks alongside the coping guidelines Nigerian businesses could adopt.

Introduction

Nigeria consolidated post-pandemic recovery with economic growth of 3.1 percent and 3.5 percent in the first and second quarters of 2022, respectively. The average growth stood at 3.3 percent in the first half of 2022 (H1'2022), higher than the average growth of 2.8 percent in the first half of 2021 (H1'2021). This stellar growth was driven by the improved performance of the non-oil sector, which grew by an average of 6.1 percent in H1'2022, relative to an average growth of 3.8 percent in H1'2022. On the contrary, the oil sector contracted further by 11.8 percent and 18.9 percent in 2022Q2 and H1'2022, respectively. Inflation remained elevated, rising from 15.6 percent in January 2022 to 20.8 percent in September 2022. With the inflation rate remaining high and real income eroded, the World Bank projects that an additional 7 million Nigerians will fall into extreme poverty in 2022. In reaction to the upward inflation trend, the CBN's Monetary Policy Committee (MPC), at its last meeting in September 2022, raised the monetary policy rate and cash reserve ratio to 15.5 percent and 32.5 percent, respectively. On the fiscal policy side, great concerns continue to trail the growing public debt stock, which grew to an all-time high of N42.8 trillion (US$103.3 billion)[2] as at June 30, 2022.

Moreover, the growth in exports outpaced that of imports, further expanding the trade surplus to N2 trillion in 2022Q2 from N327.3 billion and N1.2 trillion in 2021Q2 and 2022Q1, respectively. The trade surplus was sustained on the backdrop of higher global crude oil prices. Similarly, the overall foreign investment inflows stood at US$3.1 billion in H1'2022, representing a 10.7 percent increase compared to US$2.8 billion recorded in H1'2021. Nonetheless, key factors including declining investors' confidence as illiquidity in the foreign exchange (FX) market persists, real returns on investment remain negative and structural rigidity constrains domestic crude oil production continue to supress substantial inflows of foreign investment in Nigeria. Despite the rising global oil prices, Nigeria's external reserves have stayed below US$40 billion so far in 2022. However, due to robust FX demand and illiquidity in the official market, the parallel market premium has widened by over 60 percent in 2022. In addition, the Naira has slumped by 5.1 percent and 44.2 percent against the US dollar at the official and parallel FX markets, respectively, so far in 2022. Similarly, the standard deviation of the exchange rate – a crude

[1] AfDB (2021). African Economic Outlook for 2021. Retrieved from: https://www.afdb.org/en/
[2] CBN Official Exchange Rate of US$1 to N414.72 as at June 30, 2022, was used for currency conversion

measure of the domestic currency's steadiness – is about 16 percent higher between 2019 and 2022, relative to the preceding four years (2015-2018). This indicates that the exchange rate has become increasingly volatile in recent times.

With no end to ravaging uncertainties in Nigeria's business environment, the outlook appears deemed. Contextually, in this paper, the NESG categorised businesses' risks into four channels of exposure: structural, financial, external and policy exposures. The rest of the paper explains the risk types and possible coping guidelines in great detail.

Risks and Coping Strategies

Structural Risks: These constitute headwinds to the conduciveness of the operating environment and business competitiveness. Structural risks include business risks, driving up operating costs and adversely impacting business performance. What follows are the dimensions of the structural risks and the associated coping guidelines suggested for businesses.

Forms of Structural Risks	Coping Strategies
Infrastructural deficit	**Take Advantage of Executive Order 7**: This allows private businesses to invest in road infrastructure directly impacting their operations in exchange for a tax credit.
	Adopt localisation of industries: Firms operating in similar industries can jointly collaborate to invest in requisite infrastructure in a geographical location.
Resurgence of COVID-19	**Reinstate COVID-19 guidelines**: Continued enforcement of social distancing, wearing nose masks and frequent cleansing hands with sanitiser, among others.
	Digitalise business processes: This has shaped the different aspects of business operations: production, marketing, client management, and customer service, among others.
The dreadful state of insecurity	**Review Environmental Sustainability Governance (ESG)**: Firms should improve their Corporate Social Responsibility (CSR) to be more socially responsive and responsible to their host communities.
	Drive cybersecurity awareness: Educate staff on cyber threats and ensure they are aware of legitimate internal and external channels of contact.
Persistent inflationary pressure	**Localise supply chains**: Import-dependent businesses need to explore local resources.
	Adopt backward integration strategy: Backward integration involves expanding businesses' roles to provide or produce inputs into existing business operations.
	Adopt Sachetisation strategy: Sachetisation involves developing sachet products and packages (mini and nano firms) with similar quality that will fit into the purses of low-income earners.
	Leverage outsourcing services: With the rising production costs, businesses can outsource some parts of their operations that are not core.
	Drive sustainable and circular operations: Sustainable/circular operations, here, refer to a production process that involves reusing, recycling and refurbishing unused products
Rising brain drain and staff turnover	**Review the company's remuneration, recognition, and reward system**: Organisations should keep up with competitive salaries and compensation and reward labour efforts adequately.
	Invest in the personal development of employees: This could guarantee commitment to work as retention is tied to employees' capacity development.
	Encourage a healthy work-life balance environment: Workers should be able to lead a balanced life, which is critical to workers' satisfaction and retention.
	Create a shared vision brought on board to achieve the organisation's goal. product of the ingenuity employees bought on board to achieve the organisation's goal.

Financial Risks: Financial risks burden companies' capital structure and cause catastrophes in financial institutions' portfolios. The Nigerian financial market, like other countries, is experiencing sharp asset repricing across segments of the market. Following the global inflationary pressure, interest rates are rising worldwide, with the Central Bank of Nigeria 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 capital structure and financial institutions' loan portfolios resulting from increased non-performing loans.

Forms of Financial Risks	Coping Strategies
Increasing domestic interest rates and liquidity crisis	**Adopt equity financing**: With rising interest rates, debtor organisations should expand equity financing in their capital structure to raise funds through the sales of shares.
	Provide moratorium and forbearance: Due to limited system liquidity and the risk of default from debtors, financial institutions should give customers a moratorium and forbearance on their debt obligations to avoid the risk of default and potential hike in non-performing loans.

External Risks: Business vulnerabilities amplify with growing uncertainty in the international markets. The higher oil prices in the global market inspired a trade surplus for Nigeria as growth in merchandise exports outpaced that of merchandise 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 import bills on petroleum products and high subsidy payments, and halt in foreign investment inflows have elevated the exposure of businesses to risks associated with international trade and foreign capital flows.

Forms of External Risks	Coping Strategies
Intensified currency risk and foreign exchange scarcity	**Make use of currency options:** This allows companies to buy and sell Foreign Exchange (Forex) at a specific future date and rate hedged against downward movements in the Naira
	Operate at a natural hedging level: This involves companies matching their Forex costs to Forex revenues to net off each other to minimise Forex risk.
	Transact in local currency and limit Forex transactions: Companies need to ensure a substantial part of their cost is in Naira and should depend mainly on local raw materials.
Global supply chain disruption	**Localise the supply chains and integrate businesses operation backwards**: Import-dependent FMCGs should source their inputs locally and invest directly in the local value-chain development to now access the input source.
	Diversify energy sources: Companies should invest in more sustainable energy sources to compensate for a deficiency in electricity supply from the national grid.

Policy Risks: The policy space has been constrained in a challenging time, with policies appearing as a threat rather than an enabler to business growth. As with most global central banks, Nigeria's monetary authority battles with the trade-off between reining in inflationary pressures and stimulating economic growth. However, the fiscal authority has maintained an expansionary fiscal policy, with fiscal deficits overshooting the 3 percent of GDP target set by the Fiscal Responsibility Act 2007. Hence, Nigeria is at a crossroads where both monetary and fiscal policies are constrained; however, they cannot remain idle. The debt service-to-revenue ratio has reached 119 percent, but the Nigerian government cannot curb borrowing due to a weak revenue base. This poses significant challenges for businesses in the country

Forms of Policy Risks	Coping Strategies
Monetary policy tightening	**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.
Sovereign default risk	**Diversify asset 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.
Risks associated with a tax rate increase	**Reduce the cost of production**: As taxes increase, businesses will be impacted by lower demand. Hence, organisations need to work to reduce their production costs. Several guidelines have been mentioned earlier. Besides, businesses must adopt the sachetisation strategy.