Tune in to the African beat

CHARLES BASSEY-EYO CONSIDERS THE LITTLE EXPLORED ISSUES OF LIQUIDITY IN WEST AFRICA, A REGION GRAPPLING WITH THE CONUNDRUM OF GROWTH IN A CASH-POOR ENVIRONMENT.

Managing liquidity is of the utmost importance to the corporate treasurer in today's business environment, and this is particularly true in a region like West Africa where cash is increasingly scarce. The area has not been spared the plethora of structured and institutionalised reforms to the international financial services sector, yet West Africa receives little international coverage of aspects relevant to the corporate treasurer.

The three biggest economies in West Africa are Nigeria, Ghana and Ivory Coast. These three and the entire sub-region of West Africa are often referred to as one of the last remaining frontier markets in the world. In recent years they have attracted significant attention and investment (particularly foreign direct investment) in their domestic sectors.

Discussion on liquidity in West Africa often gravitates around that of the banks, which have a more structured and sophisticated function incorporating asset, liability and risk management compared to the less sophisticated treasury management activities that form part of the internal corporate structure. Historically, the corporate structures of businesses operating in the region indicate that greater emphasis is usually given to financial control, management reporting and budgeting activities – at the expense of enhanced treasury activities, which tend to be subsumed within layers of the finance function.

The region has witnessed tremendous growth in the last decade with evidence of real development during the 2007-10 global recession, particularly in Ghana and Nigeria. This has been further emphasised with the recent quest by international businesses to push beyond their economic frontiers as the developed markets of Europe and the US continue to mature and stagnate. Nigeria, with a population of 170 million (easily the biggest in Africa), has a highly skilled and fast developing financial services sector and continues to dominate the regional economy.

Pressure on the region's economies has resulted in reforms within the financial services sector, particularly banking. These changes have been triggered by the regulators in response to corporate governance and liquidity issues and to the consumer appetite for a wider array of financial products to meet changing lifestyle needs. The consumer economy is driven by a growing middle class; the former decline of the middle class has been reversed by the stronger economy and diaspora returnees.

West Africa has also seen a rise in the number of professionals practising corporate treasury as medium and large-scale companies (public, private, indigenous or multinationals) invest in building corporate treasury functions, ranking, other things being equal, with similar functions in the developed economies.

FOREIGN EXCHANGE CONTROLS ARE IN FORCE IN MOST WEST AFRICAN COUNTRIES, WHICH ALSO INFLUENCES THE EXTENT TO WHICH CROSS-CURRENCY LIQUIDITY MANAGEMENT CAN BE ACHIEVED.

A CHANGING FINANCIAL LANDSCAPE Most of the countries in West Africa lie within the Economic Community of West African States (ECOWAS). This organisation's primary objective is economic integration and its policies influence the strategy and operating decisions of businesses in the region. For example, member states are working on the harmonisation of tax laws and taxes, which should affect the working capital arrangements of businesses that operate across their borders. Foreign exchange controls are in force in most West African countries, which also influences the extent to which cross-currency liquidity management can be achieved.

West Africa's economies are cash-based and a large percentage of the official money supply lies outside the banking and financial intermediation systems. Most businesses are owner or family-managed, which has to a large extent influenced the type of financing and liquidity strategy adopted. There are also sectoral and country trends in liquidity arrangements as a result of the corporate structure of businesses. The needs of the local business and the multinational company are usually dissimilar, with factors such as access to global markets, multilateral banking relationships and individual liquidity profile accounting for the dissimilarities.

The first wave of the banking reforms in Nigeria led to a consolidation within the banking sector and heralded the regionalisation of banking. The spread of the Nigerian bank branch network across the region has fostered liquidity significantly as consistent banking arrangements are now available to clients in most member states within the ECOWAS bloc. However, foreign exchange risk has remained an issue for both bankers and treasurers (and in particular treasurers of non-resident companies), as the national currencies are not internationally convertible. Only the French-speaking countries in the bloc (francophone ECOWAS) have a common currency – the CFA franc, which is pegged to the euro – which may make FX risk less of an issue for businesses operating solely in the sub-bloc.

Nigeria is witnessing a second wave of banking reforms, spearheaded by an aggressive and risk management-focused Central Bank governor. The reforms embarked on by the Central Bank of Nigeria (CBN) must be commended despite hitches in the programme, and the process has changed the ethos of banking in Nigeria, significantly polarising players in the financial services sector. Other changes that have had an impact on the financial landscape involve the public sector, technological progress and innovation.

Several countries working with leading international institutions such as the World Bank, the International Finance Corporation and the African Development Bank have put in place public sector reforms to strengthen the capacity of these institutions. These reforms have influenced corporate liquidity trends across the region, especially where they have been properly and fully implemented. There is evidence of businesses particularly in the manufacturing and fast-moving consuming goods sectors where reduced cash conversion cycles have been achieved as a result of streamlined processes at ports and other points of entry. Most countries in the region are net importers.

Technology improvements such as the wider availability of internet broadband and modem access have opened the market for online banking and enabled better cash management and forecasting by businesses. These developments will force banks to continuously review the technology platform offerings to clients as competition tightens.

The adoption of international standards in accounting and capital adequacy (IFRS, Basel III) within the financial services sector across the region has affected corporate liquidity and will continue to do so.

IMPLICATIONS FOR LIQUIDITY MANAGEMENT Term loans generally are used in the region to fund working capital. However, with increased risk management and other reforms in the banking sector, less creditworthy businesses and counterparties have been caught up in liquidity dilemmas. Securitisation at the extreme end of the matrix has not been well received. This is due to legal issues relating to enforcement (in the event of a default) and the credit rating of special purpose vehicles, which have proved to be a costly exercise in the region, particularly for indigenous business.

Nigerian banks have started to report on an IFRS basis with a mandatory requirement in force by 2011. This development has affected the liquidity profile of businesses that hold a large proportion of their short-term borrowing with Nigerian banks. Likewise, guarantees and other short-term instruments that hitherto had been used largely by resident companies to fulfil their short-term liquidity requirements have been drastically reduced as banks sought to minimise counterparty and industry exposures.

On the other hand, techniques such as pooling and netting are still difficult to achieve effectively across borders due to legal barriers (the francophone and anglophone countries have differing corporate and legal structures), inconvertible currencies and tax barriers (until the harmonisation of tax across the region is realised). However, pan-African banks such as Ecobank (which operates in 29 of the 53 countries in the continent) are able to facilitate solutions that meet the needs of multinational clients. Nevertheless a sensible approach by any corporate is to adopt a multibank strategy within the region as no one bank can truly service all the liquidity or unique treasury needs of a business.

Also, until there is a single currency it is important that businesses maintain a plethora of foreign accounts – mainly the dollar and the euro. The CFA franc is linked to the euro, which can be used as a conduit to manage and hedge currency and liquidity risks. However, a single currency is still a long way off and the recent threat to the euro has unveiled significant issues for a single currency within an economic bloc.

Nigerian banks have become regional players and now have the widest branch network in the sub-region. Many are investing heavily in their technology platforms and offering a wide range of liquidity management solutions which will induce and empower effective cashflow reporting by corporates using them. Banks now have an opportunity to build robust platforms to cater for the liquidity requirements of their clients.

A REVOLUTION IS REQUIRED TO PROVIDE THE CORPORATE TREASURER WITH ALL THE INFORMATION NEEDED TO SUCCESSFULLY MANAGE THE LIQUIDITY OF A GOING CONCERN.

In addition, banks are actively pursuing the provision of a remittance and collection service (both within and between national borders), which has improved the liquidity of many of their customers. In fact, many banks now offer value-added services such as reconciliation of payments – in many countries it is cheaper to buy this outsourced service than it is to provide the service in-house. A multitude of manual processes with long float times was common practice before the advent of the liquidity solutions offered via bank technology platforms.

Close observation of the liquidity curve in the Nigeria money market shows a mismatch between the structure of deposits and the loans. Lending rates remain excessively high while deposit rates are negligible. Despite interventions by regulators, the trend so far is neither to reverse nor improve. It has been argued that this phenomenon is because deposits tend to be short term and are therefore inadequate to fund real growth investments, which are long term. Surprisingly, a large proportion of these banks are awash with cash but are unable to lend to a wide portfolio of customers and projects because of a more stringent risk management regime.

The recent establishment of the Asset Management Corporation of Nigeria (AMCON) in 2010 to buy, manage and sell bad loans currently held on bank books will also ease liquidity in the long term and force some lending by banks to businesses.

POSSIBLE INTERVENTIONS

Corporate liquidity management in West Africa requires a cost-effective solution where the costs of providing the service will be equal or less than the expected yield. Infrastructure remains a challenge as many branch networks are run on VSAT (satellite technology) and power generators, which adds to the cost of solutions that depend on seamless and straight-through processing of transactions. Developments such as real-time gross settlements in the last decade must be applauded but a revolution is required to provide the corporate treasurer with all the information needed to successfully manage the liquidity of a going concern.

This in itself is the opportunity that corporate treasurers, bankers and service providers must seize to provide a service that is cost-effective to a wider range of businesses, and not only to those that have significant multi-currency cashflow with multiple banking partners.

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