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RISK MANAGEMENT IN DEVELOPING COUNTRIES: A CASE STUDY OF THE BEVERAGE INDUSTRY IN NIGERIA

by

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INTRODUCTION

The beverage industry in Nigeria is capital intensive with investment running into billions of naira. It produces both non alcoholic and alcoholic drinks. It is one of the major contributors to the Nigerian economy through taxation and employment. Under the operating Companies Act of 1968, manufacturing companies pay about fifty percent of their profit to the government as tax. In 1997, Cadbury Nigeria Plc., the manufacturers of bournvita and other confectionery drinks for example, paid the sum of N131,254,000.00 (one hundred and thirty one million, two hundred and fifty four naira) while Nigeria Breweries Plc, the manufacturers of gulder beer paid the sum of two hundred million naira as tax to the Federal government.

This industry employs between one to two million people in Nigeria. As seen from Table 1 below, the total number of people employed in five of the beverage industry is about one million, one hundred and eighteen thousand and ninety people.

Table 1. Staff strength of five Beverage Companies in Nigeria.

	NON ALCOHOLIC BEVERAGE COMPANIES	ALCOHOLIC BEVERAGE COMPANIES
EXECUTIVE STAFF	30	500
MANAGEMENT	1345	3000
NON MANAGEMENT	614915	500000
TOTAL	615290	503500

Source - Manufacturers Association of Nigeria.

The main activities of the beverage industry include procurement of raw materials especially cocoa and sorghum, production of the bev-rage from the raw materials e.g, beer from sorghum and packaging of the beverage either in bottles or cans. Following this, the company transports the beverage to the market through its distributors and also collects its revenues from the distributors.

RISKS FACED BY THE BEVERAGE INDUSTRY:

At each level of its operations, the beverage industry is faced with multiple risks, both pure (common) and speculative (unique) risks. Some of these are discussed below.

Procurement Risks:

Most manufacturers cannot produce the major raw material in large enough quantities and the supply from the local farmers of sorghum or cocoa is limited, consequent on the oil boom which diminished farming activities. Most of the raw materials and production machinery are from other countries especially from Europe and Asia. This requires a large amount of foreign exchange which is not readily available through the banking system in the country. Obtaining foreign exchange through bank bidding at the African market takes months since each participating bank has outbid each other and only a few eventually get to buy the foreign exchange at government rate. When this fails or proves inadequate, manufacturers end up buying foreign exchange at the black market where the exchange rate is higher than the government rate which ranges between ninety and one hundred naira, to the US dollar.

Production Risk :

Most industrial boilers make use of gas, but the quantities of gas supplied by the Nigeria gas company is short of that needed by the beverage industries in Nigeria. Nearly one hundred metric tones of gas is flared away every day as a result of operational problem. In some cases, beverage companies make use of electric boilers as an alternative to meet up demand. However, electric power failure is not uncommon in Nigerian industries and the generators which provide electric power during power failures are limited in their capacity.

The greatest of the production risks involves difficulty in obtaining spare parts required for equipment maintenance or replacements. Many of the manufacturing companies have joined multi-national groups in order to ease their access to equipment and spare parts. However, honouring their financial obligations to their foreign affiliates remains a problem as a result of the difficulties in obtaining foreign exchange.

Packaging Risks:

Glass bottling is the most common packaging used for beverages in Nigeria. There are only a few glass companies such Ughelli Glass Company making bottle supply inadequate for commercial need. Inadequate supply of bottles often delays production of the beverage industry and to ease this, bottles are surcharged to encourage their return for re-use by the beverage manufacturers. The glass company at Ugheli buys broken bottles from the public, and recycles these to make more bottles.

Other problems with bottle packaging include sterilization of the bottles due to the fact that the cleaning agents also imported and this adds to the cost of production. The glass companies also rely heavily on foreign exchange to import its raw materials to manufacture the bottles and are subjected to the same foreign exchange problems discussed earlier.

Plastic bottles which would have served as alternative to glass bottles are not utilized by beverage companies in Nigeria because there is presently no means to recycle plastic or adequately sterilize plastic bottles for reuse without damage to its structure. In addition, the resin base for plastic manufacture is also imported since the producing plant is yet to be completed making it more costly to use plastic rather than glass bottle.

Marketing Risk:

The major marketing risk is failure of reimbursement for credit sales by distributors on whom the company relies for distribution. This affects the turnover of the beverage product. The total turnover of Cadbury Nigeria Plc for the two past years is tabulated below showing a thirty-three percent decrease that was attributed to distributors' failure to reimburse the company.

1997	1996	Difference
6,435,317	8,276,134	33%

Source - Cadbury Annual Report 1997

This translated to a decrease of about one million, eight hundred and fifty thousand naira in profit.

Transportation Risks:

Packaged beverage is transported mainly by road either in company or distributor owned vehicles The distance between Lagos to Kano is about eight hundred kilometers and takes about nine hours to transport a load of beverages. A full trailer load averagely carries about one thousand crates, each with twenty - four bottles or cartoons of beverage. it is not unusual for the vehicles to break down or be involved in road traffic accidents. The insurance companies pay for vehicle repair under comprehensive insurance but liability insurance often does not pay even for the vehicle repair of the other party as in most developed countries. This is often a great loss especially to distributors who tend to take on liability rather than comprehensive insurance and the loss is eventually turned over to the beverage companies. In the case of a total write off, the insurance companies will settle on the insured amount less the applicable excess which almost nets little or nothing.

Most manufacturing companies insure the broken bottles and lost beverage, under the 'Goods in Transit Policy' which offers insurance coverage finished goods or raw materials whilst in transit. Any loss that occurs during the period is expected to be paid by the insurance company provided the insurance company at the inception of the policy received an estimate of goods to be transported in a year and the premium charged adequately.

As the beverage company transports its finished products, the actual number and types of beverages transported is expected to be supplied to the insurance company within a time frame. these should also match the estimates earlier given. The insurance company gets to avoid paying these claims due to the fact that these figures are not always returned as required or they do not match the estimates. Delays in production or sales are also not accommodated in evaluating these figures.

RISK MANAGEMENT PROCESS:

Companies involved in the beverage industry have in policy an internal risk management process based on the four basic step: Risk Identification, Risk Analysis, Risk Control and Risk Financing. However, these are not always adhered to.

Some of the risks faced by the beverage industries in Nigeria were identified above. The major limitations of the process are in risk analysis and risk control. Risk financing may be internal (by the company) or external (through insurance companies). Internal risk financing is limited by how much the beverage company can retain money in the event of a loss without affecting the operations or cash flow especially with the constraints of foreign exchange. Insurance is probably the solution to risk financing and one which may be of greater interest to the actuarial world.

Insurance is purchased by companies in the beverage industry to provide compensation to the insured in the event of any peril in exchange for a premium. About forty sixty million naira, equivalent to 5.8 million US dollars are paid as premium by beverage companies. However, the insurance process in Nigeria has its own problems and limitations in meeting the needs of the beverage companies. Some of these are associated with the numerous risks faced by the companies and these make it impracticable to cover all the losses associated.

"Not all risks are insurable". This is a clause included in many of the insurance policies and often used as a blanket escape where the insurable risk are not specified. It serves as a deterrent to insurance purchase and is responsible in part for the distrust between the beverage companies, their distributors and the insurance system. For example, the public liability policy of an insurance companies has some extension such as the product liability, which gives indemnity to the manufacturer. In most cases the excess under the policy is very high and the amount claimed often falls below the policy excess. In a court action against Guinness Nigeria Plc. for food poisoning after consuming some bottles of big stout. The amount claimed by the plaintiff was about five million naira. The limit of liability of the insurance company per any one event is one million naira. If judgement is in favour of the plaintiff for the full amount, Guinness Nigeria Plc will have to pay for the balance of four million naira to comply with the judgement.

Where the insurance company provides compensation to the insured, the deductible is high and this puts a lot of pressure on the internal risk financing. Some insurance companies set up captive insurance companies to underwrite its insurance business with reduced premium and a promise to honour its obligation in the event of a claim. The lower premium encourages greater enrolment and ensures that the company has access to more funds, and that the money is circulated within the conglomeration. Captive insurance companies also serve as a means to minimize risk exposure because it will tend to attract low risk companies or individuals who only wish to pay minimum premium. Examples of captives insurance companies in Nigeria is UNIC Nigeria Plc in which United African Company (UAC) own the largest holding. All the insurance policies of UAC are written by UNIC.

The insurance companies send a surveyor to inspect the premises of the manufacturing company at the inception of the policy and subsequently every two years depending on the insurance company. The surveyors inspect the physical locations of the generating plant and boilers. The operational flow charts are evaluated to identify and highlight areas prone to risk while the loss data and financial records of the company are evaluated. Organizational Charts are reviewed to take stock of the risk which exist with personnel and put in place necessary safety standard to minimize occupational risk. The exposure inventory form must also be made available.

The insurance surveyor takes all the risk noted from the inspection, analyzes these against records of past events that required company to replace or repair equipments. From these, a picture of how frequently a loss may occur evolves and this is used in determining the premium. In addition, A system of risk control or measures that need to be taken to prevent or minimize loss are then set up within the company. These are targeted at risk avoidance and risk control. Periodic risk assessment are conducted and seminars are organized to reiterate these risk control measures.

The inflexibility of the beverage companies to embrace the recommendations by their insurance surveyors often complicates the process and frequently leads to friction between the insurance companies and the beverage companies. This may be due in part to ditrust between the beverage and insurance companies. In the event of a loss whereby any of these guideline are not observed, compensation are usually not paid and further fuels the friction.

RECCOMMENDATIONS:

In summary the beverage companies in Nigeria recognizing that internal risk financing a thing of the past especially with foreign exchange constraints should try to limit their losses by embracing the following recommendations

1. Adhering to the recommendations of the insurance surveyors aimed at loss prevention and risk control.
2. Regular upgrade and maintain its equipments in order to minimize identified risks and possibly lower insurance premiums.
3. Diversification of investments of the beverage companies should be encouraged. Large scale farming for raw materials for example may reduce its heavy reliance on imports and limit complications with foreign exchange as well as cost. This may lead to better growth in sale and turnover.

The insurance companies should try to generate better dialogue with the beverage companies in order to make their recommendations more acceptable without lowering the safety standards. The use of captive insurance should continue and be encouraged to grow in order to increase of number of low risk insurable.

CONCLUSION:

The beverage industry in Nigeria is exposed to greater and unusual risks when compared with contemporaries in developed countries as a result of its needing to rely on imports for its raw materials and equipment. This process is complicated by the limited access to foreign exchange rate. The distrust between the beverage and insurance companies has made the process of external risk financing not as effective as it could be for the beverage industry. It is important that this must be eased since internal financing is impracticable without strangulating the operations of the beverage industry. It is important that the elements of risk control and avoidance be practiced as much as possible to minimize the risks faced by the industry.

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