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9B15M047

LARSON INC. IN NIGERIA

Professor Paul W. Beamish revised this case (originally prepared by Professor I.A. Litvak) solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

David Larson, vice-president of international operations for Larson Inc., was mulling over the decisions he was required to make regarding the company's Nigerian operation. He was disturbed by the negative tone of the report sent to him on January 04, 2015, by the chief executive officer (CEO) of the Nigerian affiliate, George Ridley (see Exhibit 1). Larson believed the future prospects for Nigeria were excellent and was concerned about what action he should take.

COMPANY BACKGROUND

Larson Inc. was a New York-based multinational corporation in the wire and cable business. Wholly-owned subsidiaries were located in Canada and the United Kingdom, while Mexico, Venezuela, Australia, and Nigeria were the sites of joint ventures. Other countries around the world were serviced through exports from the parent or one of its subsidiaries.

The parent company was established in 1925 by David Larson's grandfather. Ownership and management of the company remained in the hands of the Larson family and was highly centralized. The annual sales volume for the corporation worldwide approximated $936 million in 2014. Revenue was primarily generated from the sale of power, communication, construction and control cables.

Technical service was an important part of Larson Inc.'s product package; therefore, the company maintained a large force of engineers to consult with customers and occasionally supervise installation. As a consequence, licensing was really not a viable method of serving foreign markets.

BACKGROUND ON NIGERIA

Nigeria is located in the west-central part of the African continent. With 178.5 million people in 2014, it was the most populous country in Africa and the seventh most populous nation in the world. Population growth was estimated at 2.8 per cent annually. About 44 per cent of the population was under 15 years of age. A majority of the labor force in Nigeria worked in agriculture but there was a trend of more people moving to urban centres.

The gross domestic product in 2014 was about $510 billion, making it the largest economy in Africa. While per capita GDP was about $3000, on a purchasing power parity basis it was substantially higher at

$ 5676. GDP had grown from 2005 to 2014 at about six per cent annually. This increase was fueled in part by growth in services and the export sales of Nigeria's oil reserves.

During the 2005 to 2014 period, Nigeria's average annual inflation rate had been 10.3 per cent. This high level had contributed to the change in the value of the naira from about 132 to the U.S. dollar in 2005 to about 165 to the U.S. dollar in 2014.

THE NIGERIAN OPERATION

Larson Inc. established a joint venture in Nigeria in 2005 with a local partner who held 25 per cent of the joint venture's equity. Sales revenue for the Nigerian firm totalled $45 million in 2014. Of this revenue, $39.4 million was realized in Nigeria, while $5.6 million was from exports. About 40 per cent of the firm's Nigerian sales ($16 million) were made to various enterprises and departments of the government of Nigeria. The company was making a reasonable profit of 10 per cent of revenue, but with a little bit of luck and increased efficiency, it was believed it could make a profit of 20 per cent.

The Nigerian operation had become less attractive for Larson Inc. in recent months. Although it was widely believed that Nigeria would continue to be one of the key economic players in Africa in the years to come and that the demand for Larson's products would remain very strong there, doing business in Nigeria was becoming more costly. Furthermore, Larson Inc. had become increasingly unhappy with its local partner in Nigeria, a lawyer who was solely concerned with quick "paybacks" at the expense of reinvestment and long-term growth prospects.

David Larson recognized that having the right partner in a joint venture was of paramount importance. The company expected the partner or partners to be actively engaged in the business, "not business people interested in investing money alone." The partner was also expected to hold a substantial equity in the venture. In the early years of the joint venture, additional funding was often required and it was necessary for the foreign partner to be in a strong financial position.

The disillusionment of George Ridley, the Nigerian firm's chief executive officer (CEO), had been increasing since his early days in that position. He was an expatriate from the United Kingdom who, due to his background as a military officer, placed a high value upon order and control. The chaotic situation in Nigeria proved very trying for him. His problems were further complicated by his inability to attract good, local employees in Nigeria, while his best expatriate staff requested transfers to New York or Larson Inc.'s other foreign operations soon after their arrival in Nigeria. On a number of occasions, Ridley was prompted to suggest to head office that it reconsider its Nigerian commitment.

THE DECISION

David Larson reflected on the situation. He remained convinced that Larson Inc. should maintain its operations in Nigeria. Larson also wondered what should be done about Ridley. On the one hand, Ridley had been with the company for many years and knew the business intimately; on the other hand, Larson felt that Ridley's attitude was contributing to the poor morale in the Nigerian firm and wondered if Ridley had lost his sense of adaptability. Larson knew Ridley had to be replaced, but he was unsure about the timing and the method to use, since Ridley was only two years away from retirement.

Larson had to come to some conclusions fairly quickly. He had been requested to prepare an action plan for the Nigerian operation for consideration by the board of directors of Larson Inc. in a month's time. He thought he should start by identifying the key questions, whom he should contact, and how he should handle Ridley in the meantime.

EXHIBIT 1: THE RIDLEY REPORT

In response to the request from head office for a detailed overview of the Nigerian situation and its implications for Larson Inc., Ridley prepared the following report in December, 2014. It attempts to itemize the factors in the Nigerian environment that have contributed to the problems experienced by Larson's joint venture in Nigeria.

Repatriation of Capital

1. While the Nigerian Investment Promotions Commission (NIPC) has removed time constraints and ceilings on repatriation, the divesting firm still has to submit evidence of valuation. In most cases the valuation is unrealistically low. This has represented substantial real-capital asset losses to the overseas companies concerned.

Remittance

2. A problem regarding remittances has arisen as a result of the 2003 Nigerian Insurance Act, section 67, under which cargoes due for import to Nigeria have to be insured with a Nigerian-registered insurance company. For cargoes imported without confirmed letters of credit, claims related to cargo loss and damage are paid in Nigeria; however, foreign exchange for remittance to pay the overseas suppliers is not being granted on the grounds that the goods have not arrived.

Problems Affecting Liquidity and Cash Flow

3. A number of problems have arisen during the last two years that are having a serious effect upon liquidity and cash flow, with the result that the local expenses can be met only by increasing bank borrowing, which is not only an additional cost but also becoming more difficult to obtain.

   a) Serious delays exist in obtaining payment from federal and state government departments for supplies and services provided, even in instances where payment terms are clearly written into the contract concerned. This is particularly true for state governments where payment of many accounts is 12 months or more in arrears. Even after payment, further delays and exchange-rate losses are experienced in obtaining foreign currency for the part that is remittable abroad. This deterioration in cash flow from government clients had, in turn, permeated through to the private clients.
   b) There is a requirement that a 100 per cent deposit be made on application for foreign currency to cover letters of credit.
   c) In order to clear the cargo as soon as possible and to avoid possible loss at the wharf, importers normally pay their customs duty before a ship arrives.

EXHIBIT 1 (CONTINUED)

d) Most company profits are taxed at a flat rate of 30 per cent. Firms operating in Nigeria must contend with a number of arbitrary levies and taxes, imposed mainly by state governments eager to augment their extremely thin revenue bases. The federal government attempted to put a halt to such practices by specifying which taxes all three (federal, state and local) tiers of government can collect, but it has not been entirely successful in enforcing compliance. Tax authorities are constantly trying to "trip up" companies in the course of inspections or audits, through their "interpretation" of the tax legislation. Consequently, net earnings after tax are insufficient to cover increased working capital requirements.

Incomes and Prices Policy Guidelines

4. Many of the guidelines issued by the Productivity, Prices and Incomes Board are of direct discouragement, as they make operations in Nigeria increasingly less attractive in comparison with other areas in the world. Although these guidelines were removed, increases for wage, salary, fees for professional services and auditing are still subject to final government approval.

Offshore Technical and Management Services

5. Restrictions on the reimbursement of expenses to the parent company for offshore management and technical services are a cause of great concern, since such services are costly to provide.

Professional Fees

6. The whole position regarding fees for professional services provided from overseas is most unsatisfactory. Not only are the federal government scales substantially lower than those in most other countries, but also the basis of the project cost applied in Nigeria is out of keeping with normally accepted international practice. The arbitrary restriction on the percentage of fees that may be remitted is a further disincentive to attracting professional services. Moreover, payment of professional fees in themselves produces cash flow problems exacerbated by long delays in payments and remittance approvals.

EXHIBIT 1 (CONTINUED)

Royalties and Trademarks

7. The National Office of Technology Acquisition and Promotion (NOTAP) restricts the payment of royalties for the use of trademarks for a period of 10 years, which is out of keeping with the generally accepted international practice. This can be extended only under special cases. Limits for licensing and technical service fees are between one per cent to five per cent of net sales. Management fees are chargeable at two per cent to five per cent of a company's profit before tax (or one per cent to two per cent of net sales when no profits are anticipated during the early years). The maximum foreign share of consulting fees is five per cent. Such applications, however, are only granted for advanced technology projects for which indigenous technology is not available. Further, service agreements for such projects have to include a schedule of training for Nigerian personnel for eventual takeover and Nigerian professionals are required to be involved in the project from inception.

Quotas, Work Permits, and Entry Visas

8. It must be recognized that expatriate expertise is a very important element for this business, but expatriate staff is very costly. Unfortunately, at the present time there are a number of difficulties and frustrations, such as the arbitrary cuts in expatriate quotas, the delays in approving quota renewal, and in some cases, the refusal of entry visas and work permits for individuals required for work in Nigeria. Expatriate quotas are usually granted for two to three years subject to renewal.

Expatriate Staff

9. In general, the conditions of employment and life in Nigeria are regarded as unattractive when compared with conditions in many other countries competing for the same expertise. These differences are due to: the general deterioration of law and order; the rising security threats from the Boko Haram insurgency; the restrictions on salary increase and home remittance; the difficulties in buying air tickets; the poor standard of health care; the unsatisfactory state of public utilities such as electricity and water; the harassment from the police, airport authorities and other government officials; the general frustrations related to visas and work permits mentioned above. The situation has now reached a stage where not only is recruitment of suitably qualified, skilled experts becoming increasingly difficult, but we are also faced with resignations and refusals to renew contracts even by individuals who have worked and lived here for some years. Furthermore, the uncertainty over the length of time for which employment in Nigeria will be available (due to doubts whether the necessary expatriate quotas will continue to be available to the employer) is most unsettling to existing staff. This and the restriction of contracts to as little as two years are important factors in deterring the more highly qualified applicants from considering posts in Nigeria. These factors are resulting in a decline in the quality of expatriate staff it is possible to recruit.

EXHIBIT 1 (CONTINUED)

Local Staff

10. Nigeria has one of the strongest national unions in Africa — the Nigeria Labour Congress (NLC). It is almost impossible to discipline a worker without attracting confrontation with the union. On certain occasions, some union members can be very militant. The union is also continuously attacking the employment of expatriates and trying to replace them with Nigerian staff.

11. Inadequate local technical training leads to low quality workers who tend to be lazy and not quality conscious.

12. The desirability of maintaining a tribal balance in the work force limits the options in recruiting the best workers.

13. Nigerian companies suffer heavily from pilferage, which normally accounts for two per cent of sales.

Public Utilities

14. The constant interruption in public utility services not only affects the morale of all employees but also has a very serious impact upon the operation of the business itself. Unless reasonable and continuing supplies of electricity, water, and petroleum products can be assured, and the highway adequately maintained, the costs related to setting up and operating escalate.

Continuity of Operating Conditions

15. The general and growing feeling of uncertainty about the continuity of operating conditions is a matter of considerable concern. It would seem that this uncertainty is engendered by a whole range of matters related to: short notice changes (sometimes even retrospective) in legislation and regulations; imprecise definition of legislation and regulations, which leads to long periods of negotiation and uncertainty; delays between public announcement of measures and promulgation of how they are to be implemented; and sometimes inconsistent interpretation of legislation and regulations by Nigerian officials.

Government Officials

16. Foreign partners have to rely on their Nigerian counterpart to handle the government officials. But it is impossible to measure its performance nor to control its expense in these activities. In addition, carefully cultivated relationships with officials could disappear, as they are transferred frequently.

Bribery

17. Surrounding many of the problems previously listed is the pervasive practice of bribery, known locally as the *dash*. Without such a payment it is very difficult to complete business or government transactions with native Nigerians.

Terrorism

18. Since 2009, Boko Haram's activities have caused a significant threat to our operation and to the security of our employees, especially expatriates. The militancy and strength of the terrorist group have been on a steady rise and foreign companies and nationals have traditionally been its main targets.