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Centre for the Study of the Economies of Africa

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MANUFACTURING SECTOR:
Operating Admist Economic Recession and Rising Foreign Exchange Rates
Survey Report (2017)

ABOUT US

ABOUT NOIPOLLS

NOIPolls is a research and opinion polling organization based in Abuja. We deliver forward-thinking research and relevant data on public opinion and consumer markets, enhancing the activities of decision makers across all the vibrant sectors of the Nigerian economy. NOIPolls mission is to provide timely and relevant information while empowering decision makers in the private and public sectors for better performance and improved governance. NOIPolls focuses on issues of governance, market trends, management of the economy, provision of social and market research services, as well as performance of government and private sector institutions. They partner with policy makers, donor agencies, civil societies, corporate organizations, governments and the media to enhance their data set of information, ultimately adding value to their output.

ABOUT CSEA

The Centre for the Study of the Economies of Africa (CSEA) is a non-profit think tank that conducts independent, high quality applied research on economic policy issues in Nigeria and the rest of Africa. CSEA was borne out of the need to bridge the gap caused by the paucity of rigorous empirical research that affects the quality of policies implemented in the African countries. The Centre serves as a forum for quality research analyses, and policy dialogue by stakeholders from the private sector, government, national assembly, and civil society. The policy-oriented research carried out by the Centre, including the articulation of policy choices, tradeoffs and implications, is put forward to the general public and decision-makers to stimulate rigorous debates on the effects of government policies on economic growth and developments in Nigeria and Africa. CSEA carries out applied research and presents policy options to enhance macroeconomic stability, fiscal transparency and accountability. CSEA's mission is to enhance development outcomes in Africa through evidence-based research, and this is achieved through the conduct of independent and high quality research.

FOREWORD

In the months prior to the global economic meltdown in 2009 the price per barrel of crude oil had soared above $100, peaking at $141.47 in July 2008. At the onset of the global economic downturn in January 2009, the price of crude oil per barrel had plummeted to $35.38. However, between 2009 and 2010, the price of crude began to recover, stabilizing at between $80 - $120 by 2011 and in the subsequent years through 2015.

Again, at the onset of the Nigerian recession, we witnessed a dip in crude oil prices from $107.95 in June 2014 to about $36.14 in December 2015. Unfortunately, since then the price of crude has not risen beyond $61. This has posed serious challenges to oil dependent economies like Nigeria, as government revenue from crude oil sales declined appreciably. This is important because government expenditure is significant to stimulating the economy.

Secondly, at the onset of the Nigerian recession the Naira lost in strength to the dollar, as the disparity in exchange rates increased. This negatively impacted on the manufacturing sector as a high proportion of businesses depend on imported materials and inputs in their production, which requires acquiring foreign currency to conduct such transactions. Over half of the businesses interviewed as part of this survey disclosed that the foreign exchange disparity has had a negative effect on their businesses. These conditions, which many thought would be dispelled in a few months, have lingered on for several months and manufacturers have had to look for opportunities to survive under these circumstances. The year 2017 witnessed many manufacturers downsizing, and yet others folding up completely. The level of pessimism expressed by manufacturers regarding the future of the sector is quite high, the highest since we have been studying the sector. This is largely based on unrelenting difficult conditions such as weak local demand, high foreign exchange rates, and poor infrastructure among others. These are some of the results highlighted in this edition of the Manufacturing Sector Survey Report, 2017. While these findings provide a snapshot in time, it is our hope that policy makers, captains of industries, and other leaders glean insights from this survey and are able to make the necessary adjustments to adapt and be better suited for their organizations and the sector as a whole to thrive despite the challenges in the environment.

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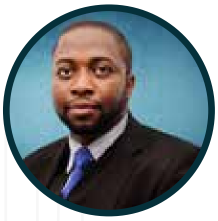

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ACRONYMS AND ABBREVIATIONS

AGSMEIS	-	Agricultural/Small and Medium Enterprises Investment Scheme
CBN	-	Central Bank of Nigeria
CSEA	-	Centre for the Study of the Economies of Africa
ERGP	-	Economic Recovery and Growth Plan
FOREX	-	Foreign Exchange
Q1	-	Quarter 1

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EXECUTIVE SUMMARY

BACKGROUND

The Nigerian economy slipped into economic recession in the second quarter of 2016, the first in more than two decades. The implication of the economic crisis for the manufacturing sector has been severe, and the slow recovery recorded in the last quarter of 2015 has been reversed with four consecutive quarters of negative growth in 2016. The manufacturing sector declined by 4.32 percentage points in 2016, compared to 2015, while its contribution to overall GDP also slowed down. Given the important role of the manufacturing sector to sustainable and inclusive economic development, understanding the challenges that continue to set the sector back is crucial for policy-makers and other stakeholders in guiding policy design and intervention strategy.

This report provides an assessment of the Nigerian manufacturing sector, highlighting the key challenges facing operators within the sector. It also examines the dynamics and major development in the manufacturing sector over the last one year. Overall, the objective of the report is to provide a snapshot of the manufacturing sector in Nigeria, which will provide a framework for policy intervention by policymakers.

METHODOLOGY

The report draws mainly on the recent mini-survey of selected manufacturing firms in Nigeria, which was conducted in February, 2017 by NOIPolls in collaboration with Centre for the Study of the Economies of Africa (CSEA). The firms were selected, taking cognizance of the heterogeneity of the Nigerian geopolitical zones and within the manufacturing sector. The survey involved administering of a structured, close-ended questionnaire on the target respondents in the selected firms. The target respondents for the survey were Manufacturers, Owners, Managers, Directors, C-level Officers and decision makers within the organizations. A total of 496 firms were interviewed from all six geo-political zones of the country.

KEY FINDINGS

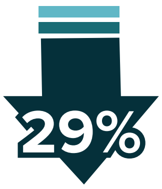
Business & economic environment

80% of the sampled firms found the business environment **unsupportive**

representing an 11 percentage points decline compared to 2016.

Among the structural bottlenecks identified to be affecting the business environment, lack of infrastructure was ranked as the most significant (5.1 out of 7, where 1 is least significant and 7 is most significant), followed by red-tapism (4.9) and corruption (4.1). The prevailing macroeconomic condition also had an adverse effect on the manufacturing sector. About 70% and 74% of sampled firms respectively considered the ongoing economic recession and inflation to have a deleterious effect on business operations.

Business & economic environment



Decline in current business situation

The proportion of firms assessing their current business situation as good or very good has declined to 29% from 43% recorded in the preceding year. This self-assessment on poor business situation ranges from 47% in the North-Central, 31% in South-South, 29% in South-West, 27% in North-East, 27% in South-East and 24% in North-West. Also, 34% of the large firms rate their situation as good or very good, compared to small firms (33%) and medium firms (28%).

Impact of foreign exchange

Overall, 75% of the companies are negatively affected by the widening exchange rate spread between parallel and official markets, including 64% in the North-Central, 66% in the North-East, 83% in the North-West, 85% in South-East, 85% in the South-West, 85% in the South-South. Comparatively, proportion of firms reporting negative effect of exchange rate spread decreased marginally by 2 percentage points from 2016, which suggests firms are slightly adjusting to exchange rate shock.

KEY FINDINGS

Import dependency and export orientation

Only 42% of the sampled firms are highly dependent on importation, a decline of 10 percentage points from 2016. This could reflect the effect of foreign exchange on capacity of firms to import raw materials and possible substitution with local materials. A further disaggregation shows that firms in the South-East region (62%) are the most import dependent, while firms in the North-East (32%) are the least import dependent. Similarly, most large firms (62%) are more import dependent than medium (46%) and small (40%) firms.

The survey results also indicate weak orientation towards external markets by firms within the Nigerian manufacturing sector. Specifically, only 33% of the firms depend highly on export markets, and this includes 31% large firms, 18% medium firms and 18% small firms.

Top operational challenges

55%	55%	47%	45%	44%
access to foreign exchange	road accessibility	Energy availability	access to credit	policy inconsistency

The survey shows that most of the key operational challenges facing the manufacturing sector have worsened. Specifically, deteriorations were reported in road accessibility (55%), access to foreign exchange (55%), petrol/diesel availability (47%), access to credit (45%), and policy inconsistency (44%). The only operational areas where significant improvements were recorded included security (43%), and lack of skills (39%).

Factors driving productivity

Over the review period, firms' profitability had been mostly driven by foreign demand (scored 4.9 out of a maximum of 6), access to new/improved machines (score = 3.9), expansion in distribution networks (score = 3.5), changes in production processes driven by innovation and technological change (score = 3.3), access to cheaper input sources (score = 3.2) and least by local demand (score = 1.8).

Capacity utilization

There was a general decline in capacity utilization in 2017, compared with 2016. The number of firms that reported high or full capacity utilization declined to 39% from the 55% reported in 2016. In addition, 61% of sampled firms reported medium to low capacity utilization compared to 45% in 2016. A further disaggregation of the results according to region indicates that the North-West had the highest number of firms with low capacity utilization (43%), while the North-Central had the lowest at 58%.

RECOMMENDATIONS

GOVERNMENT

- **Monetary-fiscal policy coordination to address forex crisis:** Given that the forex crisis lies at the heart of this recession, it becomes crucial for government to implement viable and sustainable monetary and fiscal policy to ensure stability in the exchange rate market. However, while government has implemented a number of measures at both fiscal and monetary ends, lack of coordination between them remains a major challenge and addressing it will be crucial going forward.
- **Private-public partnership for infrastructure financing:** Lack of social and economic infrastructure resurges as the most acute problem facing the manufacturing sector. This underscores the need for a holistic strategy to meet the infrastructural deficit. With the huge infrastructure deficit and limited capacity to finance it through the public finance, it is important to develop public-private partnership to unlock alternative financing options.
- **Eliminating Constraint to Doing Business:** Red-tapism emerged as one of the major challenges facing the manufacturing sector, especially small businesses. This stifles processes and growth of emerging firms, while impeding entrance to new ones. Thus, implementing measures to improve doing business and dismantle the bureaucratic bottlenecks will be crucial.
- **Strengthening the local value chain:** Nigerian manufacturing sector remains more focused on the lower end of the manufacturing value chain and lacks competitive advantage for global markets. Developing the local value chain with a focus on backward integration to develop local capacity to produce raw materials is essential.

MANUFACTURERS

- **Increasing R&D investment:** Manufacturers could benefit from the ongoing economic crisis, which has made imported goods and services dearer. Specifically, local manufacturers can develop their productive capacity on highly import-dependent sub-sectors. However, to take advantage of this, there needs to be more investment in research and development, innovation, and adoption of frontier technology in more advanced manufacturing subsectors with high value addition.
- **Improving product standardization:** The findings from the study show that while majority of the firms are import-oriented for inputs and raw material, only a minority explore external market. Improving the export-orientation of Nigerian firms is crucial. However, firms will need to develop their technical capacity towards meeting international standards and other requirements for the foreign market.

DEVELOPMENT PARTNERS

- **Leveraging on global best practices:** The development partners with their comparative advantage in technical and managerial areas could help spur the Nigerian manufacturing sector through sharing of crucial knowledge and global best practices.

- **Improving the business environment.** Development partners can help address problems around red-tapism and policy inconsistency through their interventions. Specifically, foreign aids, especially technical assistance, could be utilized in developing institutional and policy frameworks that will facilitate implementation of the needed reforms.

1 INTRODUCTION

The manufacturing sector has historically been regarded as the engine for sustainable and inclusive economic growth. While the sector still plays this role currently, the recent trend in globalization has created a broader role for the manufacturing sector in driving economic competitiveness and improving innovation. In the developing economies context, the manufacturing sector helps in transiting away from subsistence agriculture, in improving productivity and in upward mobility in the global value chain. The development dynamics in most emerging economies, especially those of India and China, indicate that growth in manufacturing sector output could help speed up industrialization process and assist in the modernization of agricultural sector. These dynamics explain the global shift in the manufacturing sector which has seen the emerging economies dominate the medium to lower spectrum of the manufacturing value chain, while the developed countries now concentrate on the high-end of the value chain.

For African countries, manufacturing sector performance continues to stagnate. Nigeria, with the highest population and one of the biggest economies on the continent, best exemplifies this dismal performance. Over the past three decades, the Nigerian manufacturing sector contribution to GDP averaged 5.4%. Over this period, the manufacturing sector reached its peak in 1990, when its share of the GDP briefly climbed to 12.4%. By historical standards, the manufacturing sector is expected to reach its peak at between 25% – 30% of the GDP. Thus, the Nigerian manufacturing sector has an enormous potential for expansion and growth. To realize this potential, it is imperative for policymakers and key stakeholders to understand the challenges constraining the growth of the manufacturing sector in Nigeria.

INTRODUCTION

This report provides an assessment of the Nigerian manufacturing sector, highlighting the business environment and key challenges facing the operators within the sector. This report is jointly produced by NOIPolls and CSEA, based on mini-survey of manufacturing firms across the Nigerian geopolitical zones. The overarching objective of the report is to provide a snapshot regarding the state of manufacturing sector in Nigeria, which will provide framework for policy intervention by policymakers. This is the second edition of the NOIPolls/CSEA "Manufacturing Sector Survey in Nigeria: Industry Snapshot".

This edition captures the dynamics and major development in the manufacturing sector over the last one year. A number of significant development has been recorded in the sector, over the brief period. On the aggregate, the past one year has seen the economy descend into severe economic recession—the worst of its kind in more than two decades. The manufacturing sector has been one of the sectors most severely affected, owing to the supply-side nature of the shock. In particular, access to foreign exchange (forex) has become severe and has constrained the productivity and access to important inputs in the sector. Moreover, the upward trajectory in inflation also has implication for consumer demand, access to finance and decision regarding investment and inventories. In essence, this report is timely in helping put a spotlight on the impact these developments have had on the manufacturing sector and the extent to which firms' external and internal operating environments have evolved over the period.

The report is organized into five sections. The first section contains the Executive Summary and Introduction, the second section briefly reviews the manufacturing sector's performance over the past year. This is followed by a discussion of the methodological approach adopted for data collection in the third section. The fourth section presents the key findings from the survey, and finally section 5 provides a concise summary and actionable policy recommendations for key stakeholders in the Nigerian manufacturing sector.

OVERVIEW OF THE MANUFACTURING SECTOR

2.1 MANUFACTURING SECTOR PERFORMANCE

The recent global economic downturn occasioned by the collapse of commodity prices sent shockwaves into the Nigerian economy that led to its worst performance in over 25 years. The economy experienced negative growth in all quarters in 2016, contracting by 1.5% compared to 2016. The manufacturing sector, which has historically been fringe, failed to show resilience to the economic headwinds. The slight contraction experienced by the sector in 2015 worsened in 2016 pushing firms to shed jobs and scale down or shut down operations. As shown in Figure 1, real GDP growth in the sector declined by 4.32 percentage points in 2016 compared to 2015. Furthermore, sectoral contribution to economy-wide real GDP decreased by 0.28 percentage point in 2016 in relation to 2015 (Figure 2). Unsurprisingly, the capacity utilization in the Nigerian manufacturing sector has declined consecutively over the past eight quarters, according to Central Bank of Nigeria (CBN, 2016)[1]. This indicates that the economy is increasingly falling short in realizing its full potential, which reinforces the fact that the manufacturing sector is not operating at its optimal level.

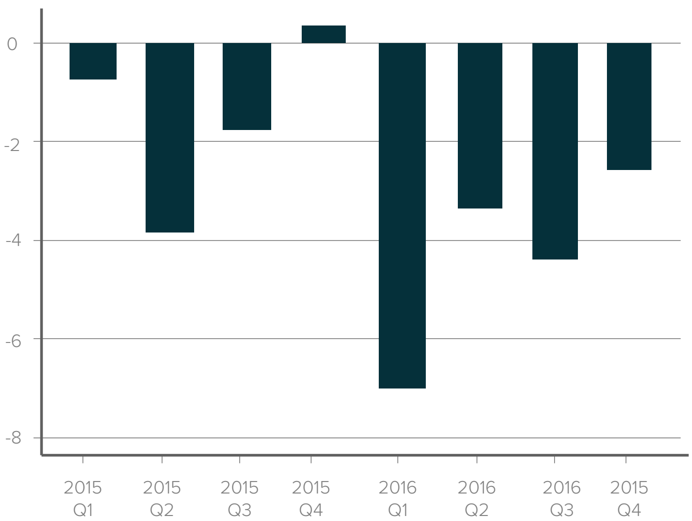


Figure 1:Manufacturing Sector Real GDP Growth Rate (%)
Source:NBS GDP Report, 2016 Q4

1 CBN Quarterly Economic Report. https://www.cbn.gov.ng/Documents/quarterlyecoreports.asp

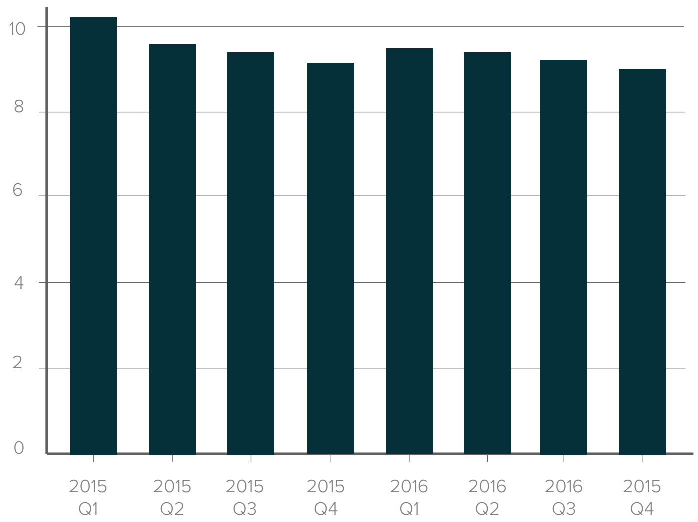


Figure 2: Manufacturing Sector contribution to GDP (%)
Source:NBS GDP Report, 2016 Q4

Moreover, a cursory look at the subsectors that constitute the manufacturing sector also showed a general decline. Over the period, all the subsectors experienced either a slow-down in growth or outright contraction with the exception of oil refining, which grew by 6.19% in 2016 mainly due to a favorable base effect (Figure 3). The food, beverages & tobacco and textile, apparel & footwear subsectors, which accounts for 66% of the manufacturing sector's output, both contracted further in 2016. Specifically, the food, beverages & tobacco subsector contracted by 6.26% while the textile, apparel & footwear subsector contracted by 1.13%.

Four subsectors—chemical & pharmaceutical products; non-metallic products; plastic & rubber products; and basic metal, iron & steel—which grew at 18.52%, 14.21%, 17.93%, and 3.14% in 2015 experienced a decline in growth, increasing modestly by 1.33%, 3.17%, 3.59%, and 0.71% in 2016 respectively. Motor vehicles & assembly was the worst performing subsector, contracting by 29.54% in 2016. This dismal performance is mostly due to the import-dependent nature of motor vehicles & assembly sub-sector. As a result, it was significantly affected by macroeconomic imbalances arising from the shortage in foreign exchange and naira depreciation. Overall, the Nigerian manufacturing sector has witnessed a substantial decline in the past year.

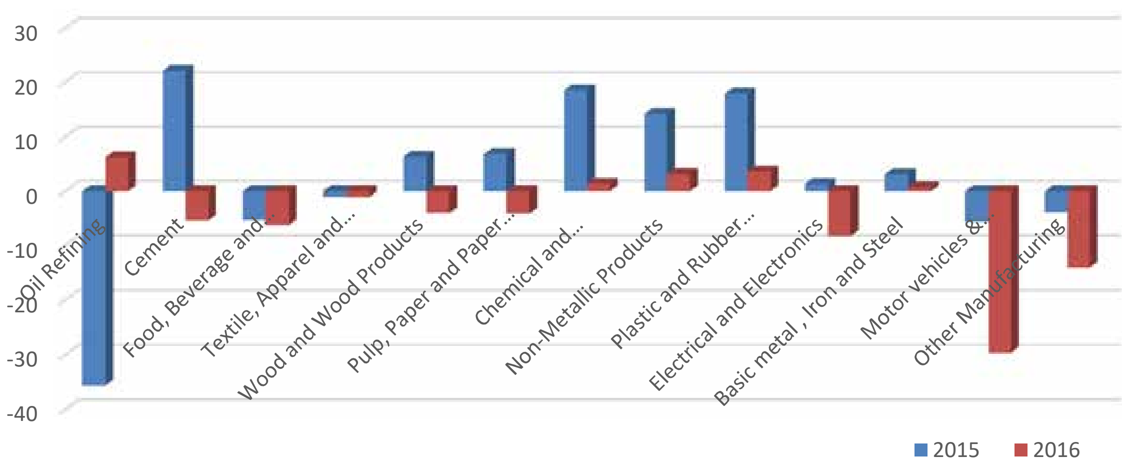
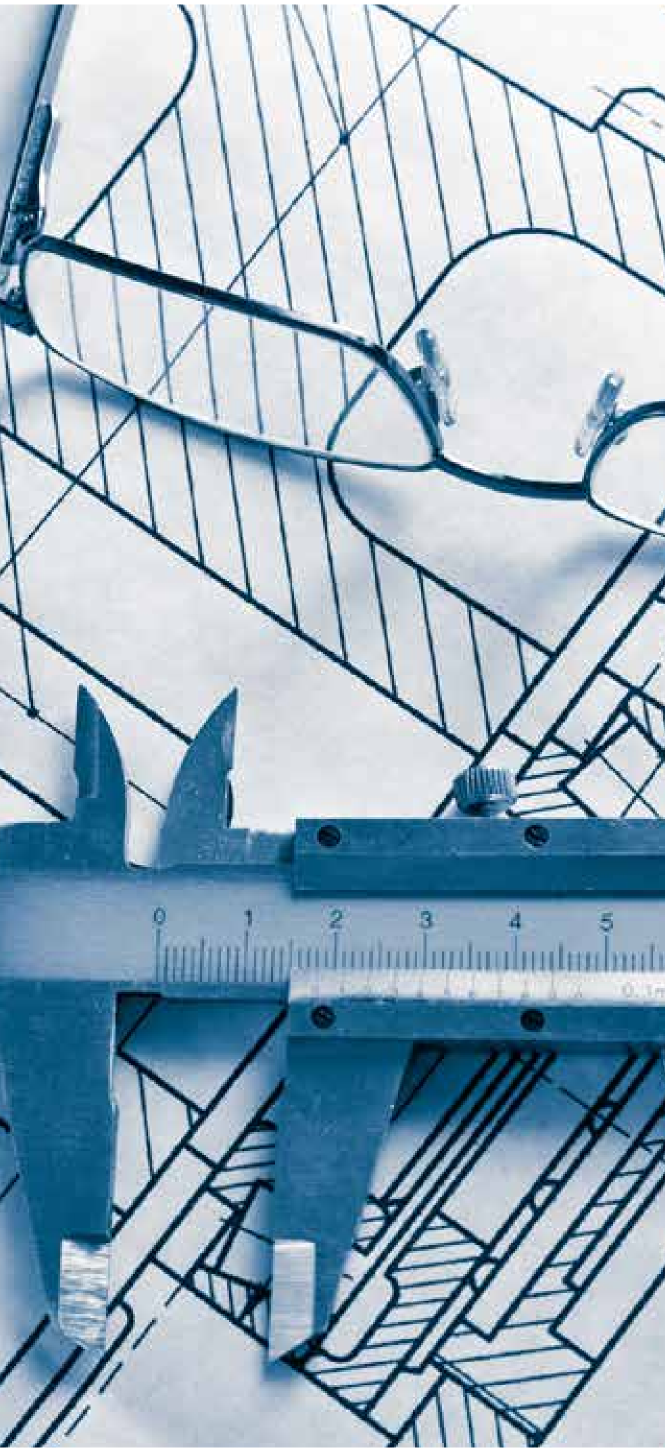


Figure 3: Growth of manufacturing subsectors 2015-2016
Source: Central Bank of Nigeria (CBN)

2.2 THE MANUFACTURING INITIATIVE: 2016Q1-2017Q1

Nigerian manufacturing sector has experienced significant decline over the past one year, majorly due to the ongoing recession. To this end, policymakers have attempted several policies to reverse the dismal and declining performance of the sector. Given the role of forex scarcity in the ensuing crisis, the monetary policy has been the focal instrument utilized by the government. In the past three quarters, the monetary policy has been largely contractionary. This is designed to quell inflationary pressures and stabilize the naira amid exchange rate volatility. The CBN also introduced a number of capital control measures and import substitution policy to ease forex scarcity within the economy. In particular, the monetary authority excluded forty-one items from accessing forex at the official foreign exchange markets, while commercial banks are required to allocate 60% of their forex to manufacturing items not delisted. In addition to this intervention, CBN also shifted its policy direction towards a floating exchange rate. This is intended to allow for market-determined exchange rate and narrow the widening gap between the official and parallel exchange rates. However, the monetary authority appears lethargic to follow through on this measure, largely due to concerns around initial overshooting of the exchange rate and possible inertia towards a downward adjustment over the long run. Overall, despite the active monetary policy put in place, manufacturing sector remains thwarted by structural and systemic bottlenecks.

On the fiscal side, the federal government involvement in the manufacturing sector comes through direct intervention mainly through regulation and indirectly by using budgetary allocations to address some of the bottlenecks in the sector's development. For example, government agenda for infrastructural development and power sector will no doubt help galvanize the manufacturing sector.



However, the dwindling government revenue due to decrease in oil prices and production has significantly impacted on the government's fiscal plan. Lack of policy direction, policy inconsistency and poor coordination between fiscal and monetary policies also constitute another aspect of challenges facing the manufacturing sector from the public space.

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On a positive note, the Economic Recovery and Growth Plan (ERGP) released in March, 2017 by the Ministry of Budget and National Planning seeks to address these challenges. For the manufacturing sector, the key aspect of the policy document of interest relates to the priority given to macroeconomic stability through fiscal stimulus, monetary stability, improved external balance of trade; and economic diversification. The main challenge remains the capacity of government to mitigate the potential risks towards implementing the plan.

Another major initiative introduced in the last one year that could positively impact the manufacturing sector is the Agricultural/Small and Medium Enterprises Investment Scheme (AGSMEIS). The scheme is targeted at agricultural businesses and small and medium enterprises, to improve the value chain and address their financing constraint. The scheme requires deposit money banks to remit five percent of their annual profit after tax to the CBN, which is then used for equity investment in permissible economic activities. Given the impediment that access to finance has on manufacturers, especially among the small-scale firms, the new initiative could help spark growth within the manufacturing sector.

3 METHODOLOGY

A survey on the selected Nigerian manufacturing firms was conducted in April 2017 by NOIPolls in collaboration with Centre for the Study of the Economies of Africa (CSEA) to provide a snapshot of the industry and elicit views of manufacturers across the country on their businesses and the environment. The survey involves administering of close-ended questionnaire on the target respondents within the selected manufacturing firms. To avoid bias in sample selection, purposive sampling was used to select 2 states in each of the 6 geo-political zones in Nigeria. A total of 12 states (two per geo-political zone) were included in the survey – Lagos and Ogun (South West), Rivers and Delta (South South), Anambra and Abia (South East), Kano and Kaduna (North West), Bauchi and Adamawa (North East) and Plateau and Abuja (North Central).

Stratified random sampling was used in selecting manufacturing companies that were included in the overall sample. Firms were randomly selected from the sampling frames of small, medium and large companies in each of the selected states from a database developed by NOIPolls. The targeted respondents for the survey were[1] Manufacturers, Owners, Managers, Directors, C-level Officers and decision makers within the organization.

3.1 LIMITATIONS

This report improves on the previous edition in terms of increase in the sample size and disaggregation of results along manufacturing subsectors. Nevertheless, the study remains limited in some respects. First, the study only assesses the challenges facing manufacturing sector, without quantifying the extent or effect size of these challenges. Second, the study is unable to assess the importance of critical factors that determine performance including but not limited to ownership structure and industrial organization. Third, the causality in effect of business environment on firms' operation and performance was drawn mainly based on the perception of manufacturers. This precludes analysis of other factors that could also influence the firm's performance. In general, these limitations underscore the need for further study that will strengthen the present report along the identified weakness areas.

3.2 THE SAMPLE

A sample of 496 companies were selected for this study. Out of which 21% were small firms (10-49 employees), 61% were medium firms (50-199 employees) and 18% were large firms (200+ employees).

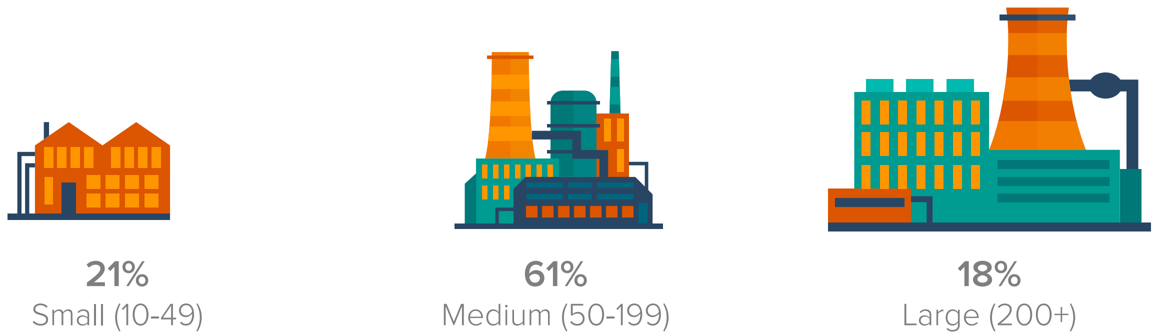

Figure 4: Size distribution of sampled companies

In terms of zonal distribution, 17% of the sampled firms are from the South-West; 10% are from North-Central, 18% are from North-East; 17% are from North-West; 19% are from South-East and 19% are from the South-South (Figure 5). Overall, the sampling distribution suggests that all the geopolitical zones are fairly represented in the final sample.

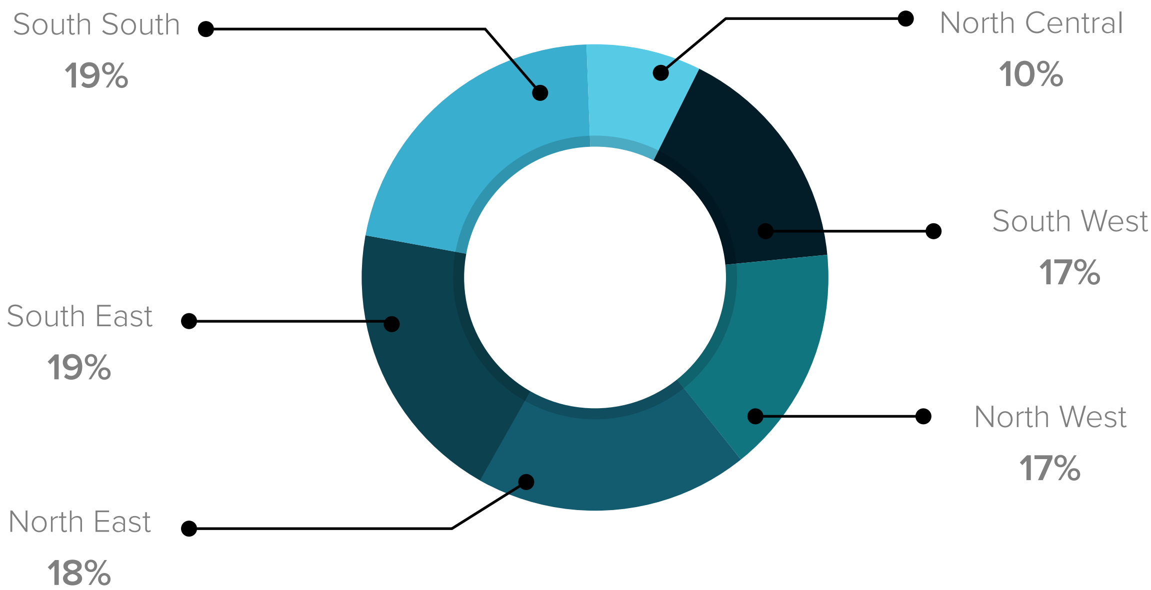

Figure 5: Zonal distribution of sampled companies

Given the heterogeneous nature of manufacturing sector, the sampling frame also categorizes firms according to their sub-sector of operation. As shown in Figure 6, 41% of the sampled firms operate in the food, tobacco and beverage sub-sector; 11% in textiles, apparel and footwear; 13% in plastic and rubber; 7% in cement, plaster and concrete; 9% in non-metallic; 11% in chemical and pharmacy; 3% in glass and glass products; 2% in clay; 2% in quarry and 1% in the ceramic sub-sector. While this distribution is skewed, it mostly matches the distribution of manufacturing firms in terms of their contribution to the economy. Essentially, the distribution reflects closely the output size of each sub-sector within the manufacturing sector.

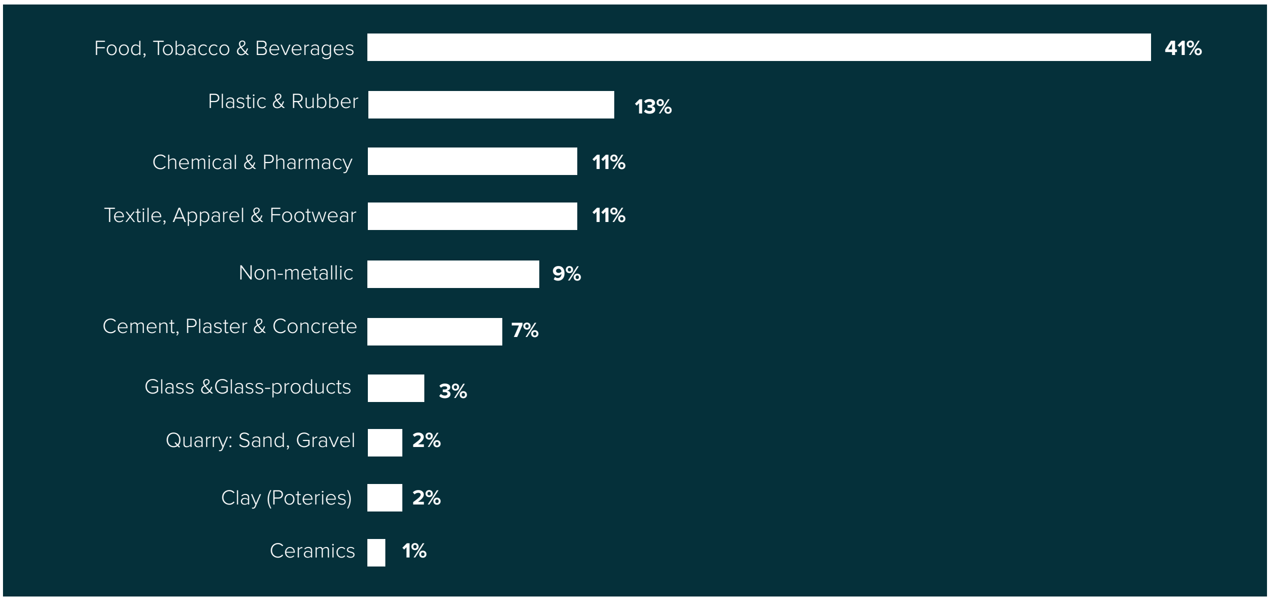

Figure 6: Sectoral distribution of sampled companies

The largest part of the sample (22%) is made up of firms with an average monthly turnover of between N1.1m and N5m. Also, 21% make a monthly average turnover of N500,000 – N1m, 18% make a monthly average turnover of N100,000 – N500,000, 14% make a monthly average turnover of N5.1 – ₦10m; 13% make a monthly average turnover of N10.1 – N50m, 7% <N100,000, and 5% make a monthly average turnover of over N50 million (Figure 7).

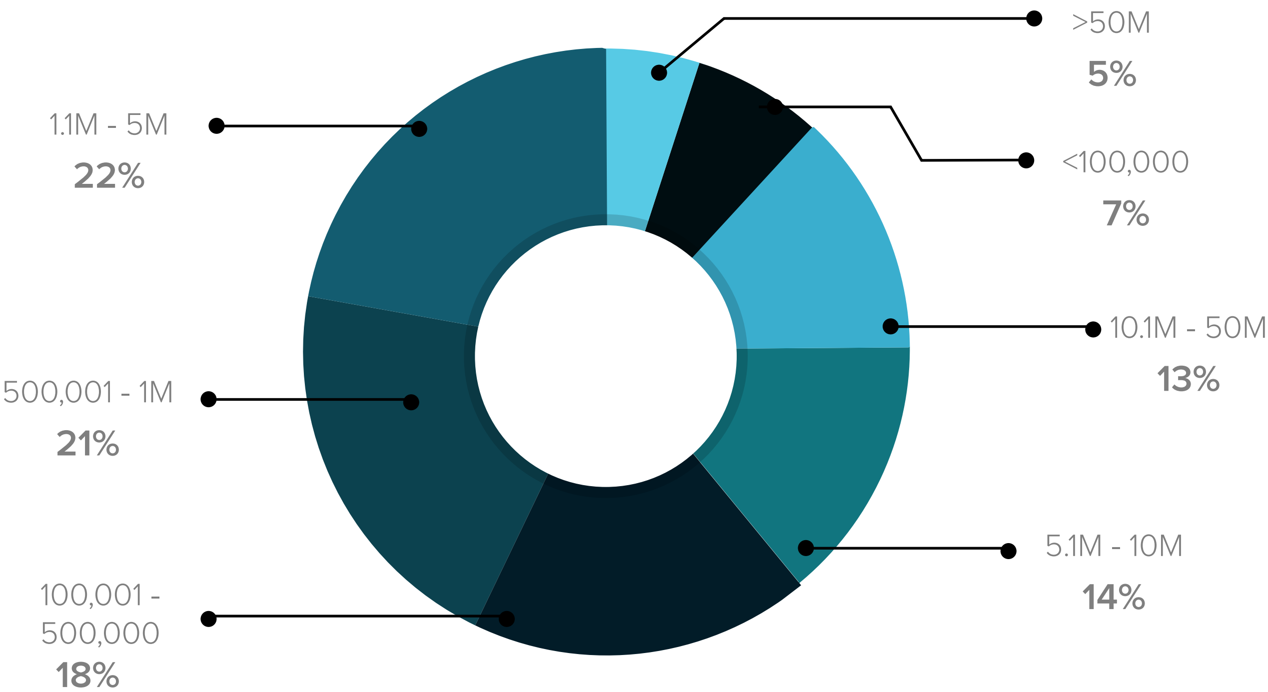

Figure 7: Average monthly turnover of sampled firms

4 KEY FINDINGS

4.1 MANUFACTURING SECTOR PERFORMANCE

The majority of the firms surveyed (i.e. 85%) produce final goods, while 31% and 13% produce intermediate and primary goods respectively. Compared to 2016, there are no significant changes in the output type. The number of firms producing final goods has increased slightly by 3 percentage points between 2016 and 2017. However, the most significant change is observed in the output type of large firms. Whereas 97% of large firms produced final goods in 2016, 77% did so in the 2017 sample. In contrast, the percentage of companies within the intermediate and primary segments of the value has increased. Specifically, firms involved in primary goods production has increased by 3 percentage points, while those within the intermediate segment increased by 16 percentage points. This might suggest a realignment in the Nigerian manufacturing value chains as a result of the forex crisis. The forex crisis should expectedly have disproportionate effect on the large firms that are export dependent for market, and import dependent for inputs. In essence, the current economic environment provides more opportunity for firms involved in local input production, and reduced the capacity of import-dependent firms to produce final goods.

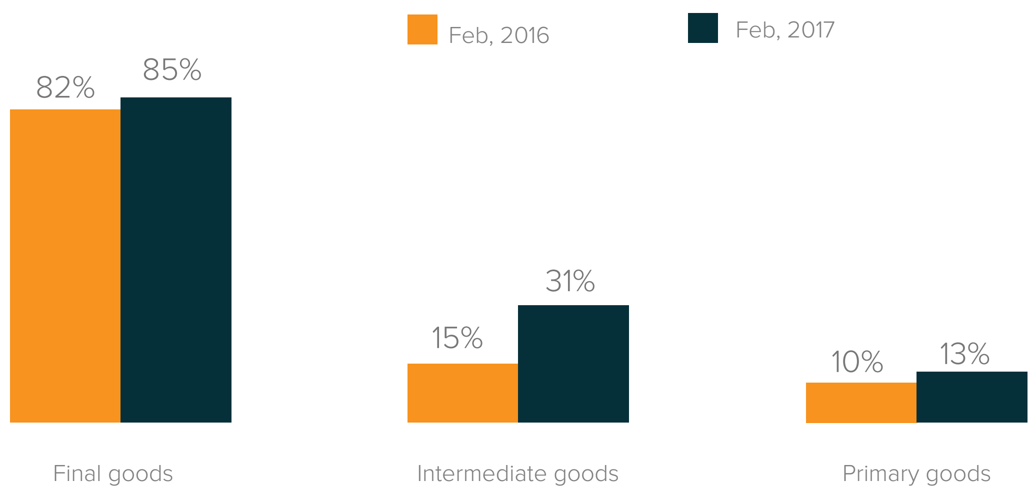

Figure 8: Output type by firm size: 2016-2017

4.2 BUSINESS & ECONOMIC ENVIRONMENT

In 2017, a smaller proportion of sampled companies consider the current business environment supportive or strongly supportive compared to 2016. Particularly, 20% of firms consider the current business environment supportive compared to 31% of firms in 2016. A higher proportion of small firms (26%) hold this notion than do medium (19%) or large (12%) firms. Across regions, companies in the North-West (47%) were more likely to consider the business environment supportive, while the South-West has the least with only 10% of the firms perceiving the business environment as supportive.

74%

Claim that the Nigerian Business environment are Unsupportive

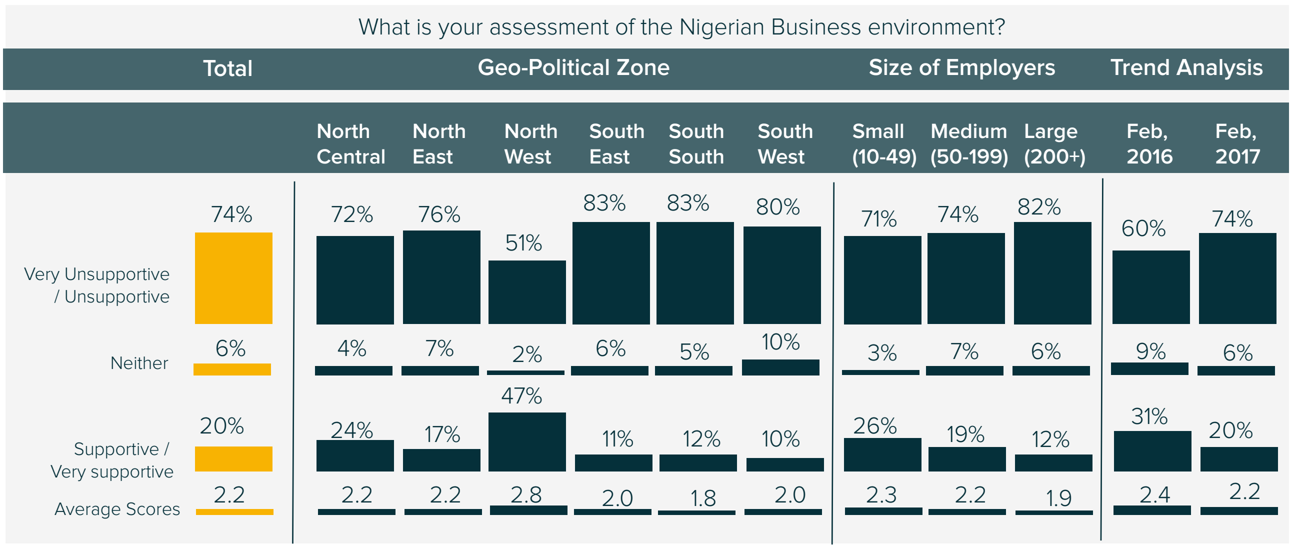

Figure 9: Business environment by geopolitical zone and firm size

Among the structural bottlenecks affecting the business environment, firms were asked to rank challenges they faced on a scale of 1 to 7, where 1 is most significant and 7 is least significant. Organizations ranked Government regulation (2.6) as the most significant factor militating against the growth of the manufacturing sector. The foreign exchange rate regulation by the Central Bank of Nigeria was also considered as part of government regulation, and given recent rising exchange rates as at the time this survey was conducted, it's no surprise why respondents to the survey considered it government regulation and the most important impediment to their business situation. This was followed by Tax policy (3.0), Policy inconsistency (3.6), Judiciary and other legal systems (3.7), Corruption (4.1), Red-tapism (4.9), and Infrastructure (5.1). Interestingly, the structural bottlenecks vary markedly across regions (Figure 10). In the North-West and North-East, red-tapism is considered as the most significant hindrance, while infrastructure is ranked highest in other regions. Overall, government regulation and tax policy is considered as the most significant impediment to the growth of the manufacturing sector by the sampled firms.

Please rank the following factors according to the level of impediment they constitute to your business situation (where 1st is for most important and 7th is for least important)

	Total	Geo-Political Zone					
		North Central	North East	North West	South East	South South	South West
Government regulation	2.6	3.1	2.3	2.4	2.6	2.4	2.7
Tax policy	3.0	3.5	2.3	2.3	3.6	2.7	3.5
Policy inconsistency	3.6	4.1	3.5	3.3	3.6	3.6	3.4
Judiciary & other legal systems	3.7	3.8	3.6	4.4	3.9	3.3	3.6
Corruption	4.1	3.8	5.0	5.1	3.9	3.2	3.9
red tapism	4.9	3.7	5.5	5.8	4.6	4.4	5.2
Infrastructure	5.1	5.1	5.2	4.5	5.1	5.3	5.4

Figure 10: Specific factors affecting business operation by geopolitical zone and firm size

Another important factor to successful business operation is the macroeconomic environment. In this regard, the economic recession and resulting inflation will no doubt impact on the manufacturing sector's performance. According to the results of the survey, 70% of the firms reported that the ongoing recession has had a significant negative effect on their operations, with firms in the North-Central and large firms much more disproportionately affected. For subsectors, the quarry subsector reported a higher impact of the recession (87%) than other subsectors. This could be due to weak private investment as well as lack of public works, as a result of the delay in budget passage and implementation. Similarly, 74% of the sampled firms reported severe effects of inflation on business profitability and operations.

To what extent has the ongoing recession affected your business operation and profitability?

	Total	Geo-Political Zone						Size of Employers		
		North Central	North East	North West	South East	South South	South West	Small (10-49)	Medium (50-199)	Large (200+)
Low / Very Low	15%	6%	8%	43%	2%	18%	8%	16%	16%	8%
Medium	15%	4%	14%	9%	16%	15%	25%	10%	15%	17%
High / Very High	70%	90%	78%	48%	82%	67%	67%	74%	69%	75%
Average Scores	4.0	4.5	4.1	3.3	4.3	3.9	4.1	4.0	4.0	4.2

Figure 11: Impact of recession and inflation on operations and profitability by subsector

What impact has the current persistent increase in price (inflation) had on your business?							
Response	Total	North Central	North East	North West	South East	South South	South West
Negative/Very Negative	74	65	67	81	85	85	61
Neither	12	17	17	13	4	10	15
Positive/Very Positive	10	15	16	3	2	5	21
Not Applicable	3	4	1	1	9	0	2
Average scores	2.0	2.2	2.3	2.0	1.7	1.6	2.4

Table 1: Impact of Inflation on your business

Although there is a general expectation of improvement in business environment in the next one year, fewer companies expressed optimism in 2017 (51%) compared to 2016 (76%). Small firms (55%), and companies in the North-West (77%) expressed the most optimism. The turn-around margin (i.e. gap between expectations next year and current experience) is highest in the North-East region (44%) and among large firms (37%), and lowest in the South-East region (23%). This may be a reflection of the onset of favourable (or unfavourable, as the case may be) policies perceived by these different categories of firms that make them express this level of optimism compared to the current situation. The high turnaround in the North-East region may be as a result of heightened expectations of economic recovery as the Boko Haram insurgency loses momentum.

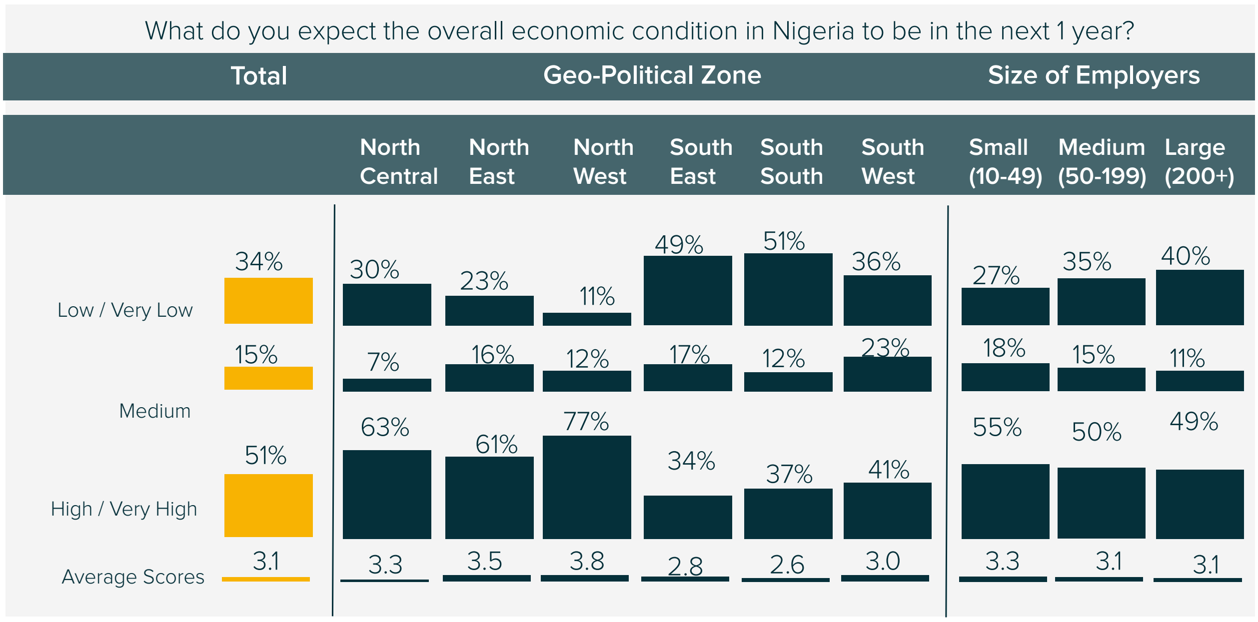

Figure 12: Expectation on business condition by geopolitical zone and firm size

4.3 COMPANY SITUATION

The proportion of firms assessing their current business situation as good or very good has declined from 43% in 2016 to a mere 29% in 2017. This self-assessment ranges from 24% in the North-West to 47% in the North-Central region. Also, more large companies rate their situation as good or very good (34%), compared to small (33%) and medium (28%) firms.

Expectation of companies' business situations in the next year declined from 88% in 2016 to 78% in 2017. Companies in the North-West region (97%) and small firms (86%) are the most optimistic about the coming year. The turnaround margin is highest in the North-West region (73%) and among small firms (53%), and lowest in the North-Central region at 33%.

What is the current business situation and your expectation of your company to be in the next 1 year?

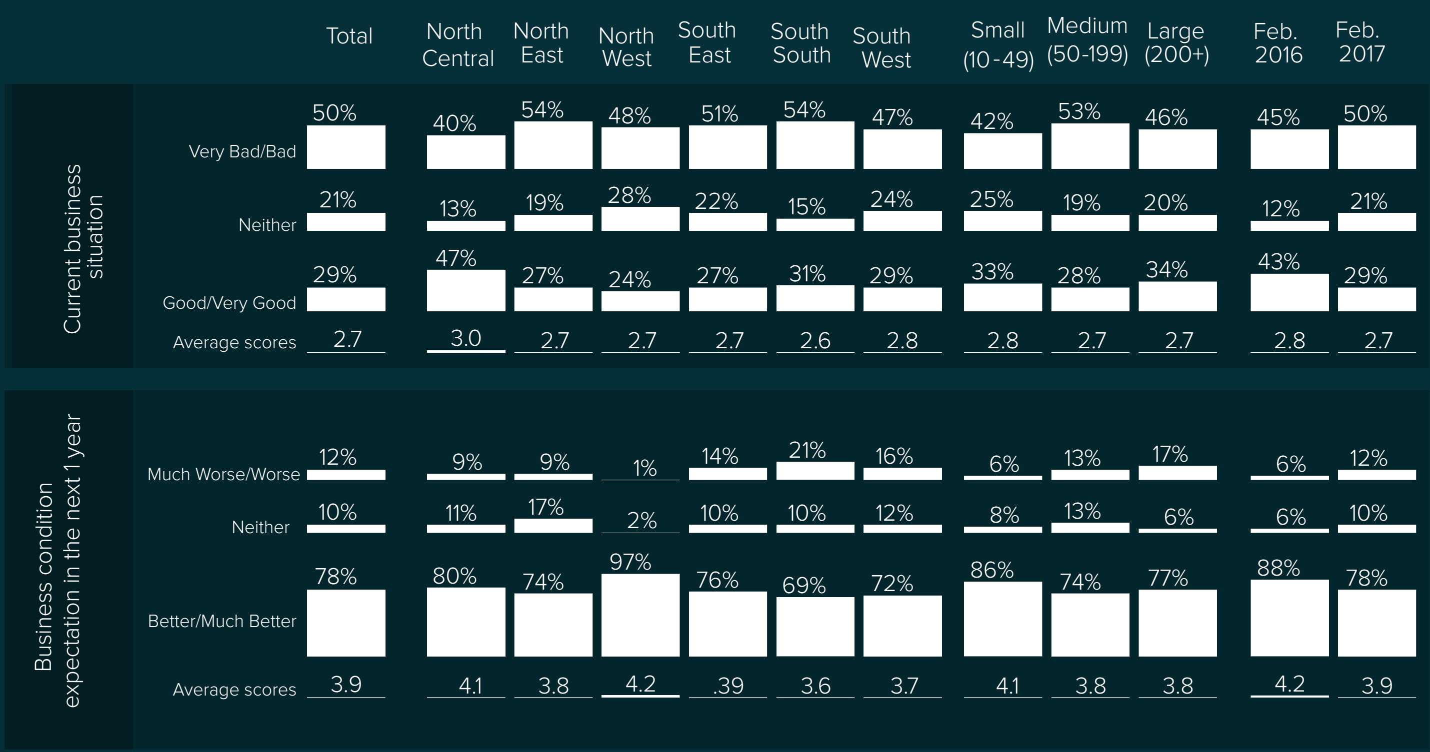

Figure 13: Company situation by geopolitical zone and firm size

There is increased pessimism about future demand among companies in the manufacturing sector. Particularly in 2017, 78% of firms expected an increase in demand for their product in the next year compared to 91% in 2016. Companies operating in the Northern region (86%) are the most optimistic about future demand compared to companies in the Southern region (72%). The variance observed in perceptions could reflect the nature of regional markets or be driven by some political and economic fundamentals across the regions. Furthermore, a significant difference is observed in expectations between own business performance and overall economic outlook over the next year (See Section 3.2). This could be a result of respondents being better aware of their immediate business situation than the aggregate economic condition.

4.4 FOREIGN EXCHANGE AND TRADE

Foreign exchange issues have been the dominant macroeconomic issues in Nigeria in the past one year. Specifically, the widening spread between the exchange in the parallel market, where most manufacturers acquire their forex, and official rate is a major source of economic instability. As shown in Table 1, 75% of the firms report that the disparity in the exchange rates has severely affected their profitability. The highest proportion of firms experiencing the negative effect of exchange rate disparity come from South-South and South-East at 85%, while South West has the lowest at 62%. Similarly, small firms reported higher negative effect (80%) than medium (72%) and large (77%) firms. Compared to 2016, there is a 2-percentage point decline in the number of firms reporting negative impact of exchange rate disparity. This suggests that firms are slightly adjusting and therefore becoming more resilient to initial external shocks.

Response	Total	Geo-Political Zone						Size of Employers			Trend analysis	
		North Central	North East	North West	South East	South South	South West	Small (10-49)	Medium (50-199)	Large (200+)	Feb, 2016	Feb, 2017
Negative/Very Negative	**75%**	64%	66%	83%	85%	85%	62%	80%	72%	77%	77%	75%
Neither	**12%**	17%	17%	13%	4%	10%	15%	10%	13%	11%	11%	12%
Positive/Very Positive	**10%**	15%	16%	3%	2%	5%	21%	6%	13%	6%	11%	10%
Not Applicable	**3%**	4%	1%	1%	9%	0%	2%	4%	2%	6%	1%	3%
Average scores	**2.0**	**2.2**	**2.3**	**2.0**	**1.7**	**1.6**	**2.4**	**1.9**	**2.1**	**1.8**	**2.1**	**2.0**

Table 2: Impact of the exchange rate disparity on your business by geopolitical zone and firm size

Imported materials and inputs are of utmost importance to production for sampled firms in the South-East region as 62% of them indicated it is highly important and only 6% indicated it is of low importance to business operations. The reverse is the case for the North-West region as a majority (44%) of firms ascribed low importance to imported inputs and 32% of firms indicated its high importance. This mirrors the results of the previous survey indicating no change in input sourcing across the regions. Most firms' indicate medium to low importance of export markets to their business; the highest region (North-Central) had just 37% of firms indicate high importance of export markets to their business. The South-South zone had 59% of its firms indicating low importance of export markets.

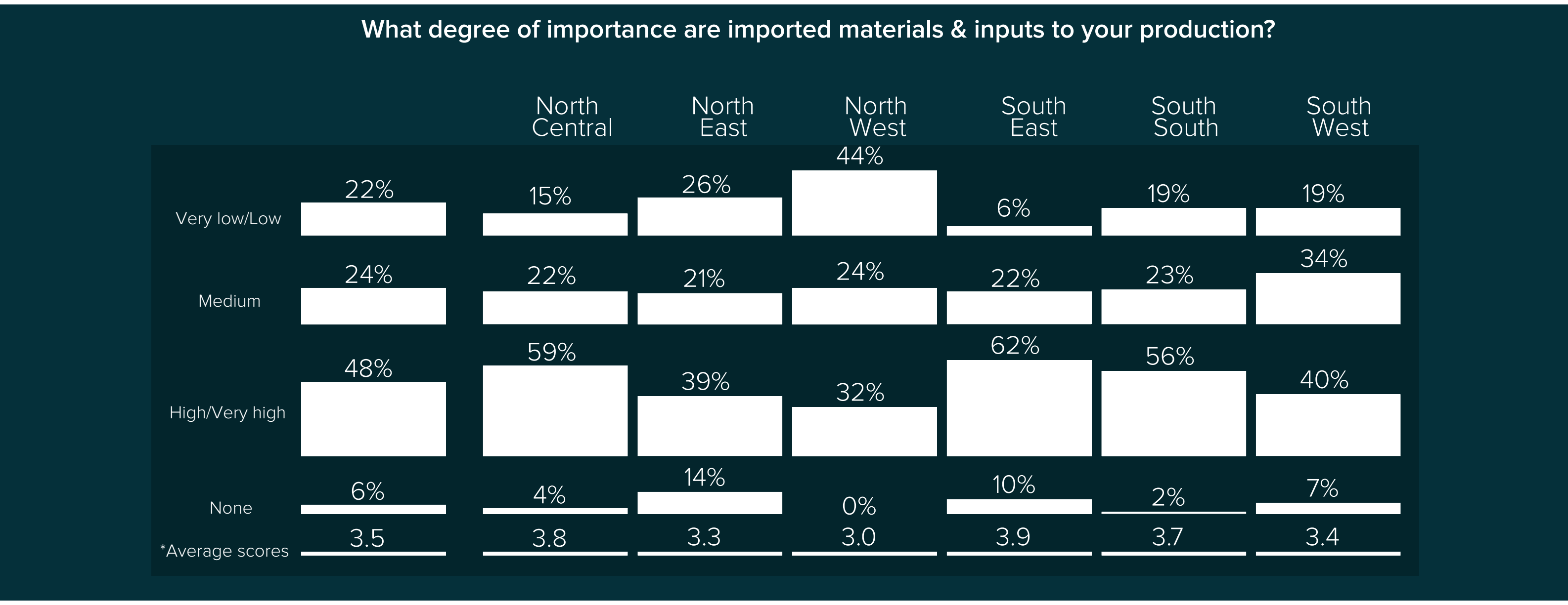

Figure 14: Importance of imported materials and inputs to production activities

A further investigation of extent trade internalization within the Nigeria manufacturing sector indicates that large firms are the most import-oriented. Specifically, 62% of the large firms in the sample considered imported material and inputs as significant to their production, compared to 46% and 40% for medium and small firms. In terms of export orientation, majority of large firms ranked export as more important to their turnover at 31%, compared to 18% respectively for both medium and small-scale firms. However, 70% percent of the firms considered exports as either less or not important to business turnover. This is 10 percentage points higher than the percentage of firms indicating the same in 2016 (Figure 15). This could reflect the effect of foreign exchange crisis affecting the level of export-orientation of firms.

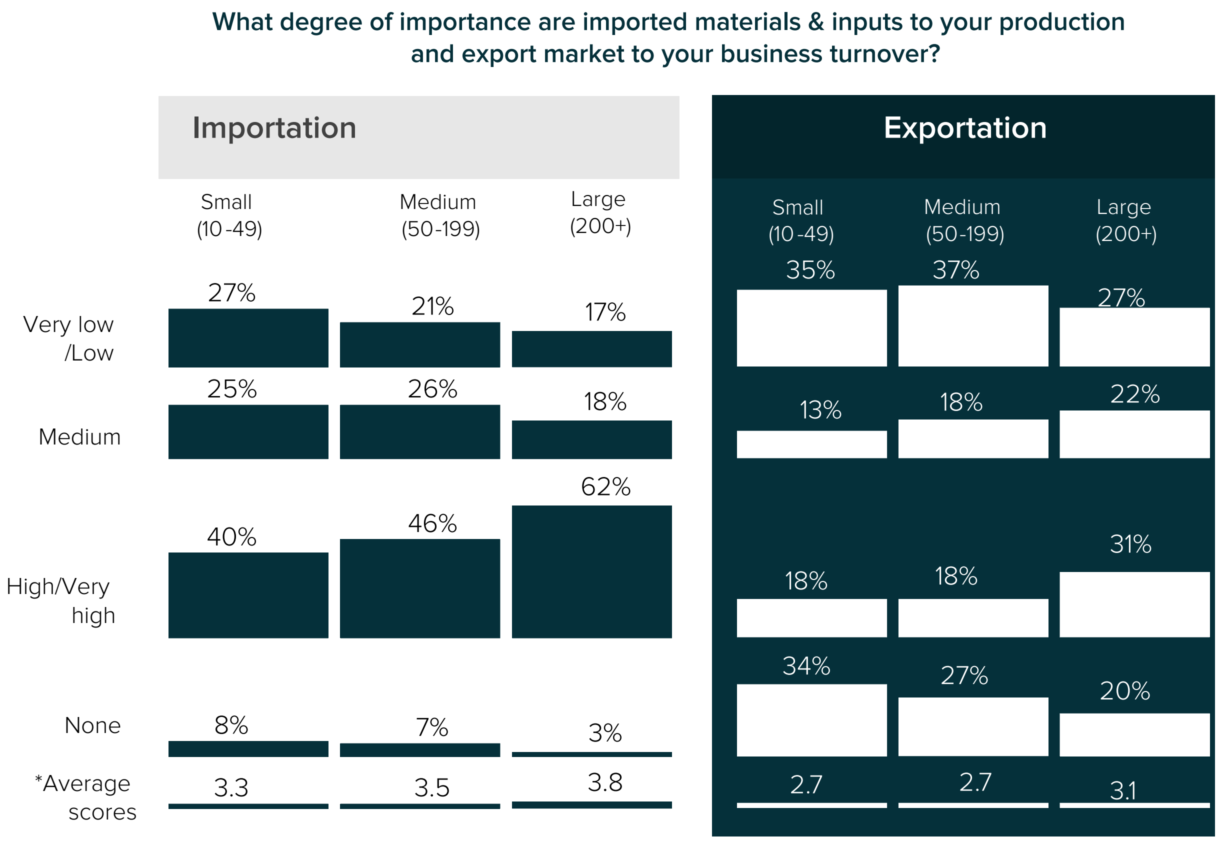

Figure 15: Importance of imported inputs and export markets

This observation is reinforced by the disaggregation of the result by sub-sectors (Figure 16), which shows export markets is most important to firms in the chemical & pharmacy sub-sector (38%) and least important to firms in the glass and glass products sub-sector (57%).

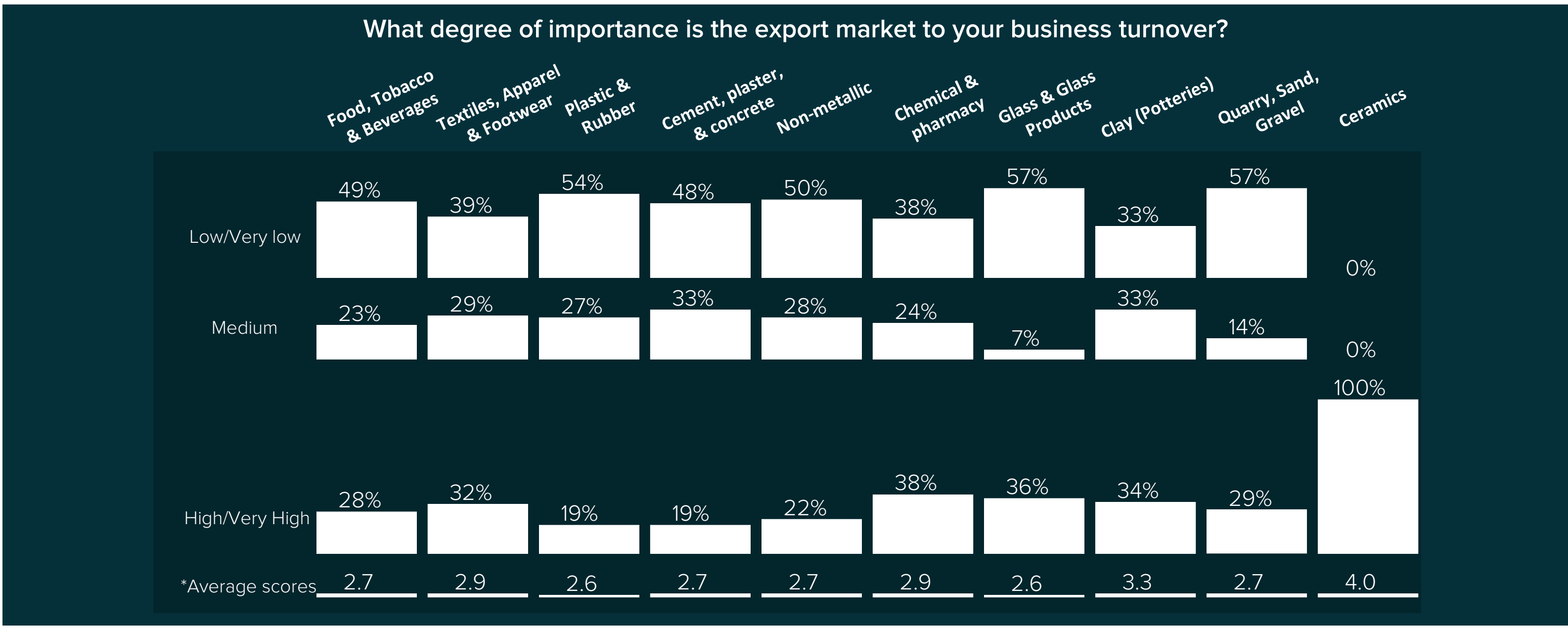

Figure 16: Importance of export markets to business turnover

4.5 FACTORS DRIVING PRODUCTIVITY

Similar to 2016, local demand remains the primary driver of manufacturing firms' profitability over the past year followed by cheaper input sources. However, companies' ability to optimize operations by innovating or imitating has displaced the extent of their distribution networks as the third most important factor helping firms to remain profitable in 2017. New technology remains in fifth place, as foreign demand continues to be insignificant for many firms' profitability. These dynamics are similar across all geopolitical zones and firm sizes.

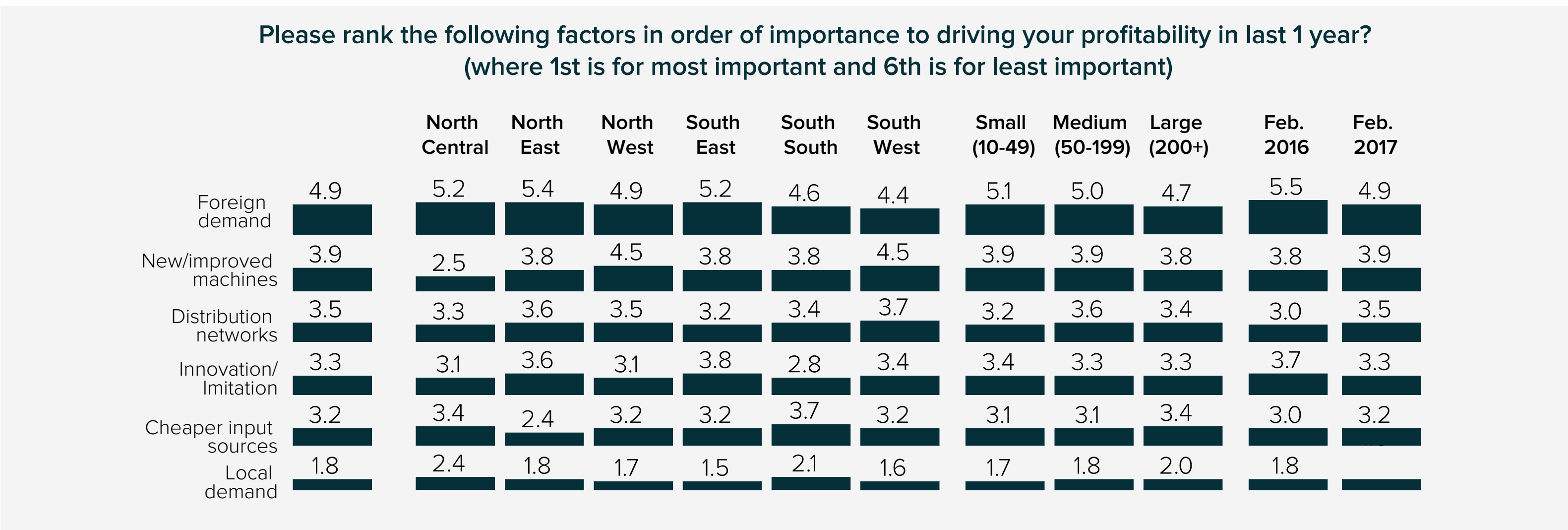

Figure 17: Drivers of business profitability, 2016-2017

4.6 CAPACITY UTILIZATION

There was a general decline in capacity utilization within the observed period. The number of firms that reported high or full capacity utilization declined from 55% recorded in 2016 to 39% in the current period. Additionally, 61% of sampled firms reported medium to low capacity utilization compared to 45% in 2016. A further disaggregation of the results according to region indicates that the North-West had the highest number of firms with low capacity utilization (43%), while the North-Central had the lowest at 58% (Table 2). Similarly, 50% of the large firms surveyed recorded high capacity utilization, compared to 37% high level of capacity utilization attained by medium and small firms. Weak demand followed by inadequate power supply were cited as the major reasons for the underutilization of their capacity. The prevalence of weak demand reflects the impact of the economic recession on private and public-sector demand. Mostly affected by this trend are firms in the North-East where 81% of the sampled firms identified weak demand as their major reason for capacity underutilization. This could be due to the recession coupled with insecurity challenges in the region, leading to the migration of businesses to more peaceful zones.

96%

of sampled firms operate **below full capacity**

What is your estimate of capacity utilization in your company?										
Response	**Total**	**Geo-Political Zone**						**Size of Employers**		
		North Central	**North East**	**North West**	**South East**	**South South**	**South West**	**Small (10-49)**	**Medium (50-199)**	**Large (200+)**
Very low (<30%)	5%	4%	3%	1%	5%	13%	2%	7%	5%	5%
Low (30%-45%)	23%	4%	23%	42%	12%	29%	20%	29%	24%	9%
Medium (45%-60%)	33%	19%	43%	21%	32%	42%	38%	27%	34%	36%
High (60%-75%)	24%	29%	22%	21%	31%	13%	31%	21%	24%	29%
Very High (75% - 90%)	11%	29%	8%	10%	15%	3%	8%	9%	11%	15%
Full (90%-100%)	4%	15%	1%	5%	5%	0%	1%	7%	2%	6%

Table 3: Breakdown of capacity utilization

Factors responsible for underutilization of capacity										
Weak demand	69%	46%	81%	60%	73%	70%	71%	73%	68%	67%
Availability of power supply	58%	50%	48%	39%	64%	75%	70%	58%	61%	51%
Petrol/Diesel Availability	38%	50%	48%	55%	23%	37%	23%	50%	34%	39%
Lack of supplies	37%	22%	48%	32%	24%	36%	54%	40%	38%	30%
Insufficient inventory	27%	28%	22%	30%	26%	16%	40%	20%	28%	30%
Access to Foreign Currency	26%	30%	10%	24%	48%	24%	20%	24%	22%	41%
Plant shutdown due to maintenance	19%	17%	8%	32%	23%	18%	14%	18%	18%	22%
Insufficient labour	17%	9%	16%	26%	11%	29%	6%	17%	17%	13%

Table 4: Factors responsible for underutilization

4.7 OPERATIONAL CHALLENGES

The firms in the Nigerian manufacturing sector face a myriad of challenges that influence operations. From the skills mismatch problem that increases difficulty in filling vacancies to inadequate infrastructure, policy inconsistency, insecurity and limited access to credit, among others. The recession experienced within the period equally exacerbated these challenges. Compared to the 2016, a lot of these challenges worsened. However, a number of firms sought innovative ways to minimize the effects of these problems.

On access to credit, 45% of sampled firms indicated that the situation had worsened within the last year, compared to the 41% that indicated the same in the last report. It can therefore be concluded that the credit challenge is increasingly becoming a glitch in the sector. The same can be said for a lack of infrastructure as 39% of respondents attested to the worsening condition in the availability of infrastructure. Also, 41% of the respondents indicated that the condition of roads had worsened, with the majority (59%) coming from the South-West. The results are not very different in the area of power supply where 55% of all respondents indicated a deteriorating situation. On policy inconsistency, 44% of the sampled firms indicated that the situation has worsened, although this represents an improvement when compared to the 50% score recorded in 2016. Furthermore, level of insecurity, access to currency and availability of diesel were all observed to have significantly worsened than in the previous year. This reflects the shattering and devastating effect that the ongoing recession has had on the manufacturing sector in Nigeria.

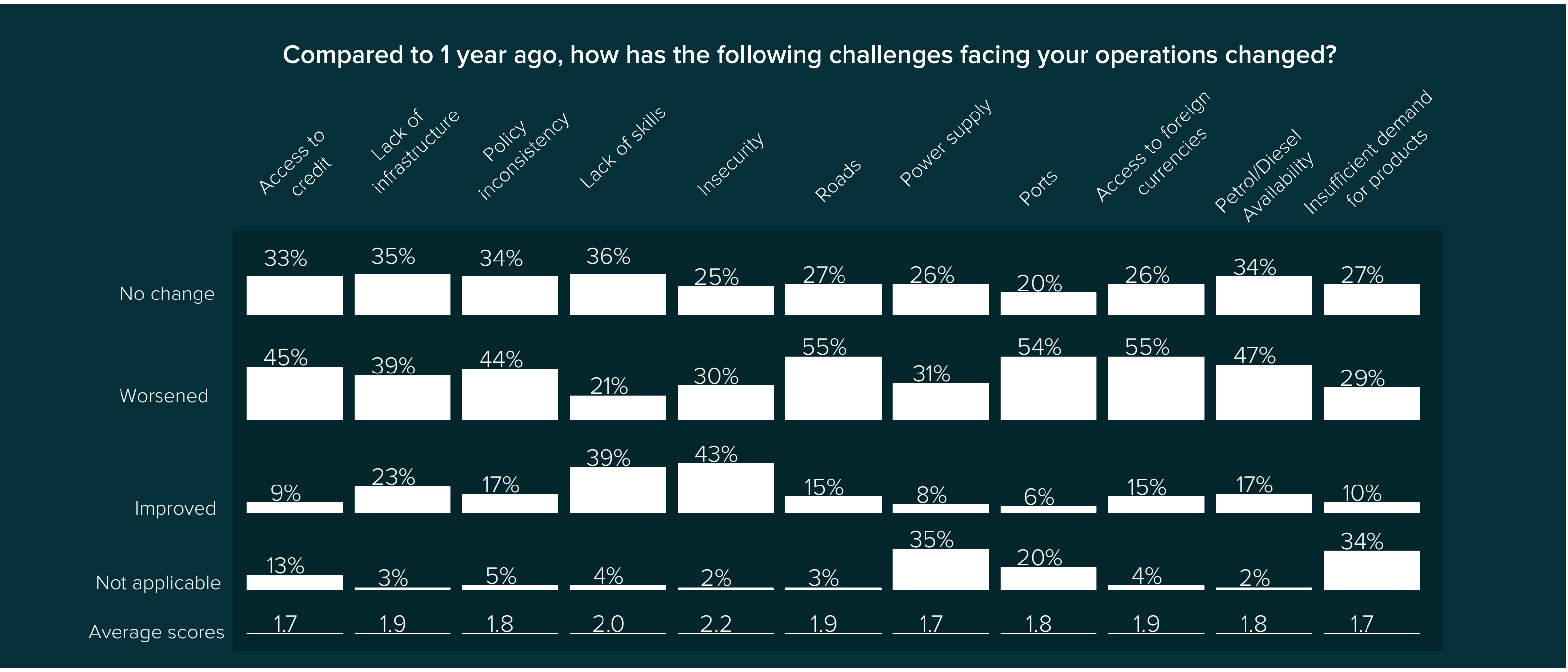

Figure 18: Changes in operational challenges over the last one year

However, it is very interesting to observe that firms are responding to the challenges through exploring own innovation and adaptation strategy. Based on the responses to the survey, 69% of the firms are using their own innovation/adaptation, 31% are using alternative private sources, and 30 percent are using the public sector improvement in addressing the challenges. Expectedly, large and medium firms adopt predominantly their own innovation. Compared to 2016, the proportion of firms using own innovation surged up by 20 percentage points (Figure 19).

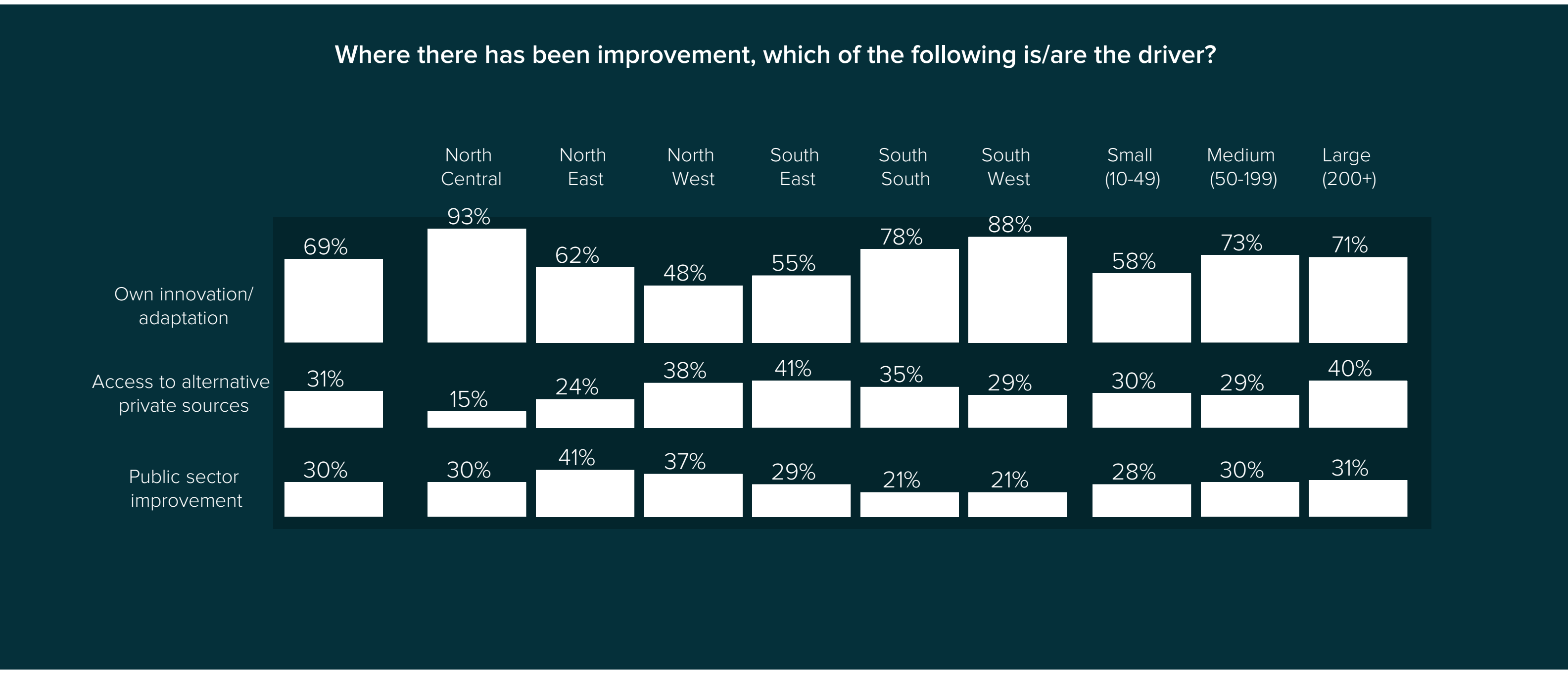

Figure 19: Adaptation strategy of firms to the challenges facing the sector

5

SUMMARY

This report has examined key developments in the Nigerian economy, and the extent to which they have impacted on the manufacturing sector performance. Over the past years, the Nigerian manufacturing sector has experienced dismal performance, due to a number of structural and systemic challenges. However, the recent economic crisis has further worsened the challenges creating a more challenging environment for manufacturers to operate. A major finding from the survey of manufacturing firms shows that key performance metrics and profitability have worsened due to widening forex spread, economic recession and inflation. The overall business environment is also becoming increasingly unsupportive for business growth and development. With regards to business environment, the study found government regulation and tax as the major challenges facing the manufacturing sector.

Other key findings from the survey include:

- The Nigerian manufacturing sector relies heavily on foreign inputs and raw materials. This suggests lack of integration with other sectors, especially agriculture and mining sectors. This partly explains the huge negative shock to the economy in response to forex scarcity, which increased the cost of imported inputs and [1]raw materials. Thus, the industrialization strategy will need to strike a balance between the import-substitution and export-promotion strategies.
- The manufacturing sector is presently dominated by sub-sectors with low technology requirement and little value addition. This in part is as a result of low human and technical capacities as well as lack of viable policies to improve economic competitiveness. However, for the manufacturing sector to realize its full potential, there is need for gradual shift from low-spectrum to medium-spectrum within the manufacturing value chain. In essence, it is important that capacity and technical challenges constraining the sector's development are swiftly addressed.
- An increasing proportion of firms are developing and utilizing their own innovative/adaptation strategy to mitigate against the deteriorating business environment. Despite numerous government efforts, there is no significance increase in the percentage of firms using public-sector improvement. This suggests that addressing manufacturing sector challenges will require more coordination between public and private sectors, in designing the appropriate intervention.

5.1 RECOMMENDATIONS

On the part of government, the following actions are recommended:

- **Monetary-fiscal policy coordination to address forex crisis:** The key challenges facing the manufacturing sector has been exacerbated by the ongoing recession. Given that forex crisis lies at the heart of this recession, it becomes crucial for government to implement viable and sustainable monetary and fiscal[1] policy to ensure stability in the exchange rate market. However, while government has implemented a number of measures at both fiscal and monetary ends, lack of coordination between them remains a major challenge. Also, the various strategic window created for manufacturers to access forex at the official rate seems not to have yielded positive impact. Policymakers will need to work more directly with manufacturers, especially through the Manufacturing Association of Nigeria (MAN), in monitoring incidences of abuse of the policy by financial intermediaries.
- **Private-public partnership for infrastructure financing:** Lack of social and economic infrastructure resonates again as the most acute problem facing the manufacturing sector. This underscores the need for a holistic strategy to meet the infrastructural deficit. At present, the Nigerian infrastructural deficit is estimated at around USD300-billion. Indisputably, government alone lacks capacity to meet this financing need. It is therefore important that partnership with the private sector is built to unlocked alternative financing options.
- **Eliminating Constraints to Doing Business:** Red-tapism emerged as one of the major challenges facing the manufacturing sector, especially by small-scale businesses. This stifles growth of the emerging firms, while impeding entrance to new ones. Thus, implementing measures to improve doing business and dismantle the bureaucratic bottlenecks will be crucial. Increasing technological adoption will be a major step forward in this regard.
- **Strengthening the local value chains:** Nigerian manufacturing sector remains more focused on the lower end of manufacturing value chain and lacks competitive advantage for the global markets. Developing the local value chains with a focus on backward integration to develop local capacity to produce raw materials is therefore essential. This is important to ensure that the economy becomes more resilient to systemic risks associated with changes in the global economic performance and foreign exchange.

For the Manufacturers, the following are deemed necessary

- **Increasing R&D investment:** Manufacturers could benefit from the ongoing economic crisis, which has made imported goods and services more expensive. Specifically, local manufacturers can develop their productive capacity in highly import-dependent sub-sectors. However, to take advantage of this, there is need[1] for more investment in research and development, innovation, and adoption of frontier technology in more advanced manufacturing subsectors with high value addition.
- **Improving product standardization:** The findings from the study shows that while majority of the firms are import-oriented for inputs and raw material, only a minority explore external markets. Improving the export-orientation of Nigerian firms is therefore another crucial area. However, firms will need to develop their technical capacity towards meeting international standards and other requirement for the international market.

For Development Partners, their interventions will be crucial in the following areas:

- **Leveraging on global best practices:** The development partners with their comparative advantage in technical and managerial areas could help spur the Nigerian manufacturing sector through sharing of crucial knowledge and global best practices. Development partners can also support small and medium scale enterprises by launching funding opportunities directed at them. Similarly, development partners can use their influence to facilitate the integration of Nigeria's manufacturing sector into global value chains to diversify operations, enable technology sharing, enhance value addition capability, and open up new markets.
- **Improving the business environment:** Bureaucratic bottlenecks and policy inconsistency are some issues that create a harsh business environment for manufacturing firms. Development partners can target their foreign aids, especially technical assistance, to develop institutional and policy framework to assist government in implementing needed reforms.

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