A NEW PERSPECTIVE ON SMALL FIRMS IN NIGERIA

Summary of Key Findings from the Small Firm Diaries

The Small Firm Diaries followed the financial lives of 161 small businesses in Nigeria between August 2021 and August 2022. This study is part of a global research initiative active in 7 countries—Colombia, Nigeria, Uganda, Ethiopia, Kenya, Indonesia, Fiji—which seeks to understand the role of low-income small firms in poverty reduction, and the barriers that limit their contribution to local economies. Small firms in this study are defined as those with 1-20 non-household employees.

Better serving this population represents a significant opportunity to advance financial inclusion (including digital), and pro-poor economic growth.

small firm DIARIES

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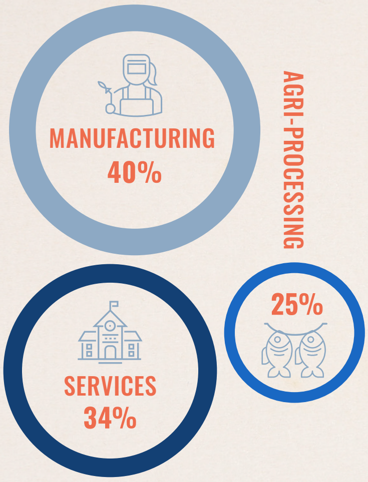
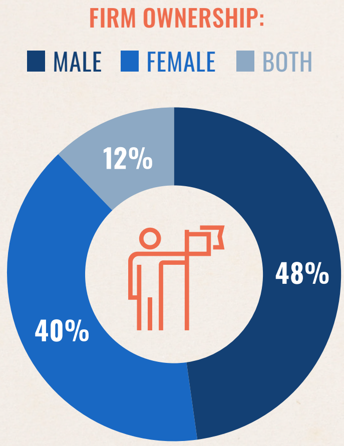
smallfirmdiaries.org

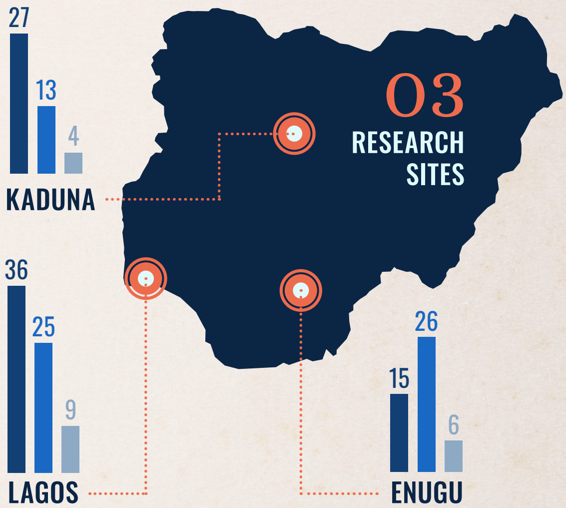
8,372 HOURS OF INTERVIEWS

161 SMALL FIRMS

15 FIELD RESEARCHERS







1 THE SMALL FIRMS ARE UNIQUE IN WAYS THAT ARE IMPORTANT FOR POLICY AND FINANCIAL SERVICES

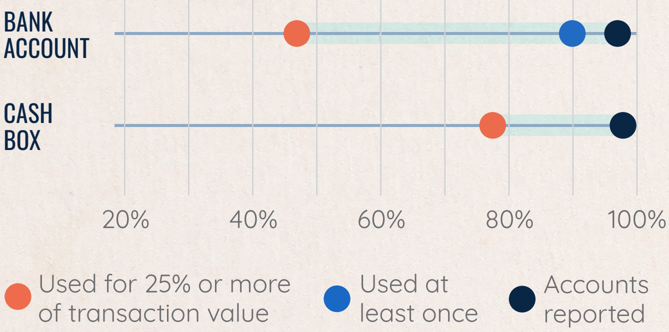
Small firms represent an "invisible middle," different from microenterprises and larger, more professionalized firms. They straddle the line between formal and informal.

- These firms experience significant volatility in revenue through the course of a year; they are neither on a strong upwards or downwards growth trajectory.
- Small firms are a key source of employment, but the jobs they provide are precarious.
- They are "banked" and have access to digital financial services, including debit cards, mobile banking, and ATMs.
- Their access to formal credit is constrained: About half of the firms in the Nigerian sample held loans during the study, but most were from informal sources—suppliers, friends, and family.
- Cash dominates other modes of transaction in this segment (even in Nigeria, where nearly all the small firms own bank accounts, two-thirds still run the majority of their business in cash).

The financial tools they have access to are not sufficient to help them manage the volatility they face. Small firms constantly struggle with liquidity and access to working capital.

BANK ACCOUNT AND CASH USE FOR BUSINESS

In Nigeria, 99% of the small firm owners own a bank account but less than half used it frequently.

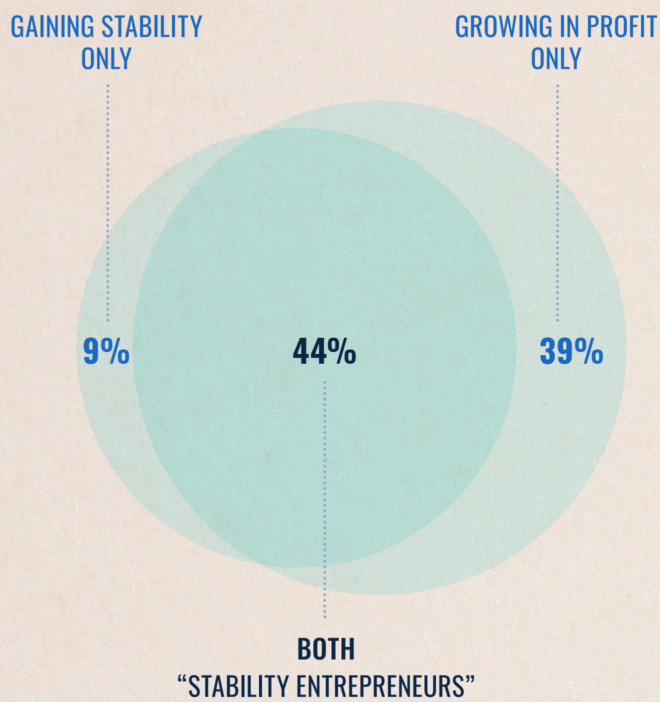


2 THESE FIRMS SEEK GROWTH, BUT WITH STABILITY

Many academic discussions of small firms and their role in local and national economic growth focus on a binary distinction between, for instance, "gung-ho" and "reluctant" or "growth-focused" and "survivor," types of entrepreneurs.

The Small Firm Diaries reveal that these profiles miss a substantial group of these firms: firms with aspirations to grow but also in need of stability. We call these "Stability Entrepreneurs." This population aspires to grow, but cannot take on the additional risk (they already face a great deal of risk) that is necessary for rapid growth. They want step-by-step growth that helps reduce volatility and risk.

WHAT IS YOUR VISION FOR YOUR BUSINESS OVER THE NEXT YEAR?



3 SMALL FIRMS NEED BETTER TOOLS TO MANAGE WORKING CAPITAL AND LIQUIDITY

Most efforts to help small firms have focused on providing loans for equipment or other capital investments. Data from the Small Firm Diaries shows that working capital and liquidity are more important.

Firms closely match revenues and expenses on a month-to-month basis. This helps confirm that they lack working capital/liquidity. Firms rarely take any operating risk that could result in negative monthly cash flow.

Small firm use of supplier finance is another indication of their need for working capital: in Nigeria, they use credit from suppliers at much higher rates than microfinance or commercial bank loans.

OF THE NIGERIAN SMALL FIRMS STUDIED:

79% say access to finance is a barrier

42% say they rarely or never need loans

57% say they would use a loan to address cash flow issues or buy inventory

79% say that savings is their primary risk management measure

37% take loans from their suppliers

4 SUPPORT FOR SMALL FIRMS AND THEIR EMPLOYEES COULD LEAD TO MORE STABLE EMPLOYMENT

We collected data about employment, including from employees themselves, shedding light on a population that is less studied, and more precarious than the firm owners themselves.

The employment picture is different and more volatile than it appears from simple counts of employees. Most workers' pay varies considerably from month to month.

From the perspective of the firms, the number of jobs they offer fluctuates a great deal. In addition, the individuals who fill those positions can change several times during the year.

Across the study, the firms are not able to provide consistent income to workers. In Nigeria, only one-fifth of workers were paid consistently throughout the year, and more than half were paid for less than half the year.

At the same time, small firm workers find it difficult to earn income elsewhere. Nearly half of workers surveyed reported no other source of income.

Two-thirds of the workers we talked to in Nigeria said that they lacked money to meet their basic or food needs at some point during the study. Half reported that a child in their household had not eaten enough in the past week.

RESEARCH PARTNERS

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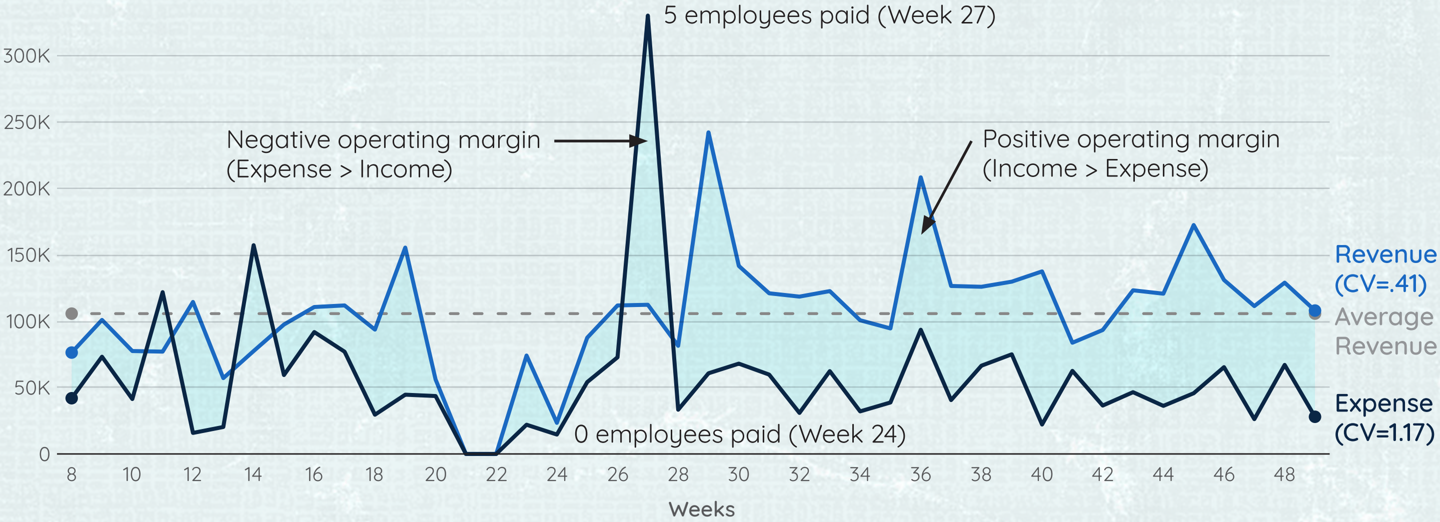
CASH FLOW (NGN) FOR A WOMAN-OWNED BAKERY IN ENUGU, WEEKS 8 TO 49

The financial diaries capture cash flow over time. Here, weekly cash flow data is used to show volatility of revenue, expenses, and operating margin. Qualitative and survey data is layered on top to understand the interplay between firm owner decisions and cash flow.



The coefficient of variation (CV) is a statistical measure of variability in a dataset. We use it to measure volatility of a firm's revenue, expenses, and operating margin. A firm with the same revenue each month would have a CV of 0, as illustrated by the gray dotted line. This firm's revenue CV is .41, meaning that monthly revenues are typically 41% greater or lesser than the average. This firm exhibits slightly less volatility than most firms in the study, which have an average revenue CV of .44.

STUDY RECOMMENDATIONS

FOCUSED ATTENTION ON SMALL FIRMS	Small firms, not just micro or larger firms, deserve specific attention. They are distinct from other types of firms, yet are a critical source of jobs and incomes for low-income groups, and make an important contribution to value chains and economic development
DESIGN POLICIES AND PROGRAMS AROUND ACHIEVING STABILITY	The focus of policies and programs should shift toward reducing volatility and achieving stability. Public and private partnerships to reduce exposure to demand- and supply-side risks as well as training programs focusing on risk and liquidity management would help firms achieve greater stability.
EXPLORE LIQUIDITY AND WORKING CAPITAL LENDING	New products focused on increasing liquidity are desperately needed. Explore models to increase access to trade credit and leverage information and assets (e.g. stock) to unlock working capital.
DEVELOP SUPPORT PROGRAMS FOR EMPLOYEES (NOT JUST FIRMS)	While volatility is passed on to employees, there is no guarantee that greater stability for firms will be passed on to employees. Develop programs and policies that directly support the workers in small firms.

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