Manufacturing Sector:

A Key Driver for Prosperity and Economic Development in Nigeria

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List of Abbreviations

BIS	Bank for International Settlements
BRICS	Brazil, Russia, India, China, and South Africa
CBN	Central Bank of Nigeria
CIT	Company Income Tax
ESG	Environmental, Social and Governance
FDI	Foreign Direct Investment
FX	Foreign Exchange
GDP	Gross Domestic Product
IMF	International Monetary Fund
MSMEs	Micro, Small and Medium Enterprises
NBS	National Bureau of Statistics
OPEC+	Organisation of the Petroleum Exporting Countries plus a few non-members
PMI	Purchasing Managers' Index
R&D	Research & Development
SMEDAN	Small and Medium Enterprises Development Agency of Nigeria
VAT	Value Added Tax

1. Introduction

The growth of the manufacturing sector has been weak and sluggish since its recovery from the Covid-19 Pandemic with an average annual growth of 3.4% in 2021 and 2.5% in 2022, culminating in the sector's contribution to Nigeria's GDP falling far short of globally competitive levels, averaging 10% in its annual contribution to GDP in almost 2 decades. With escalating global and domestic challenges, the growth of the Nigerian manufacturing sector has been hampered, resulting in its underperformance when compared to other countries which has made it evidently necessary to reassess growth strategies within the sector, and resolve critical concerns.

This publication highlights the importance of Nigeria's manufacturing sector, present an overview of the global and domestic macroeconomic environments, and how they contribute to the manufacturing sector's key difficulties. We also present our recommended roadmap for industrial growth before concluding with a primary focus on engines for industrialization and sustainable growth in Nigeria, with an emphasis on specific issues to be taken into consideration.

2 Importance of Manufacturing

Manufacturing is a key driver that propels progress in a nation's economy. It's a powerful force that revolves on the growth, productivity, and competitiveness trajectories. A nation's overall economic growth can greatly depend on robustness and performance of the manufacturing sector. We examine the various aspects of manufacturing's critical importance and why it is essential to the development of a more prosperous economy. Some of the areas that reflects this importance include:

Employment Opportunities

The manufacturing sector is a high labour-absorbing sector that can create direct employments for people like operators of machineries, technicians and engineers in the manufacturing sector. The sector can also create indirect employment for supply chain actors in other sectors of the economy such as raw materials suppliers, logistics and transportation, farmers, miners etc. According to the World Bank, industry employment accounted for 13% of total employment in Nigeria in 2021, necessary development and investments in the sector can increase the ratio.

Government Revenue Generation

Manufacturing helps to expand the tax base (number of taxable people and entities) and tax returns as taxes are paid by both manufacturers and workers ultimately increasing the nation's revenue. The manufacturing sector currently accounts for about 30% of Nigeria's Non-Import VAT and 26% of its Company Income Tax. Given its potentials to empower skills development, facilitate increased export & global competitiveness and enhance infrastructural development, manufacturing can influence the revenue generation across other sectors.

Economic Diversification and Reduced Oil Dependency

The Nigerian economy is heavily reliant on revenue proceeds from the oil sector to the neglect of other important sectors. This is evident in the use of oil price benchmark as an underlying assumption in the preparation of national budget and the fiscal tensions that arise when global oil prices crash. Consequently, the economy is vulnerable to negative oil price shocks/volatilities. The manufacturing sector not only has the potential to reduce the dependence of the economy on oil, but to also insulate the economy from the distasteful fiscal/budgetary risks associated with negative oil price shocks.

Regional Economic Development

Manufacturing helps to drive local economic development in regions especially in rural areas where the facilities are situated, resulting in greater employment opportunities, infrastructural development and improved standard of living for the local communities. This can also improve intra-trade within the African region at large.

Import Substitution & Export Promotion

The NBS puts the total import bill of Nigeria for 2023Q2 at approximately 5.8 trillion naira. The manufacturing sector can help drive import substitution strategies that will switch these demands to the local economy by developing globally competitive products to reduced imports, conserve foreign exchange, spur economic growth and raise standards of living. In addition, the manufacturing sector can be used as an engine for export promotion to earn more foreign exchange from international markets thereby supporting the diversification drive of the economy through increased exports. However, Nigeria recorded a total export value of about 7 trillion naira, just 2 trillion naira higher than its import bill for the same period of reference. This margin positions Nigeria as an economy operating at the subsistence level at best.

Stimulation of Favourable Trade Balances

By promoting exports and meeting local demands for products, the manufacturing sector can help reduce/eliminate persistent trade deficit problems and improve the nation's trade balance thereby strengthening the competitiveness of the economy.

Infrastructural and Human Capacity Development

Developing the manufacturing sector requires major investments (big push) to close infrastructural gaps. These investments are usually channeled into infrastructures like power supply, transport and communication networks and other supporting facilities. These investments which create an enabling environment for manufacturing to occur will benefit not only the manufacturing sector, but also the overall economy by attracting more investment, reducing wastages and lowering production and transportation costs.

In addition, at the initial stage of development and as the manufacturing sector continues to expand, major investments are channeled to skills development programs, vocational training and capacity building within the sector which would potentially help to improve the quality, effectiveness and employability of the Nigerian labour force.

Transfer of Technology, Research and Innovation

The skills required to build and sustain the manufacturing sector are mostly of high sophistication. Organizations and Individuals with such high-level skills are usually attracted to work with indigenous people for technical constructions and other implementations. The result is a transfer of technological innovation over time. The transfer of technology and innovation can have ripple effects on other sectors in the economy with expansionary effects on the economy.

The manufacturing sector also drives innovation, research and development and if companies in the manufacturing sector invest in research & development to improve products, enhance production processes and also develop new technologies then these R&D activities enhance the capacity of scientists, researchers, engineers and also create employment opportunities for them.

3

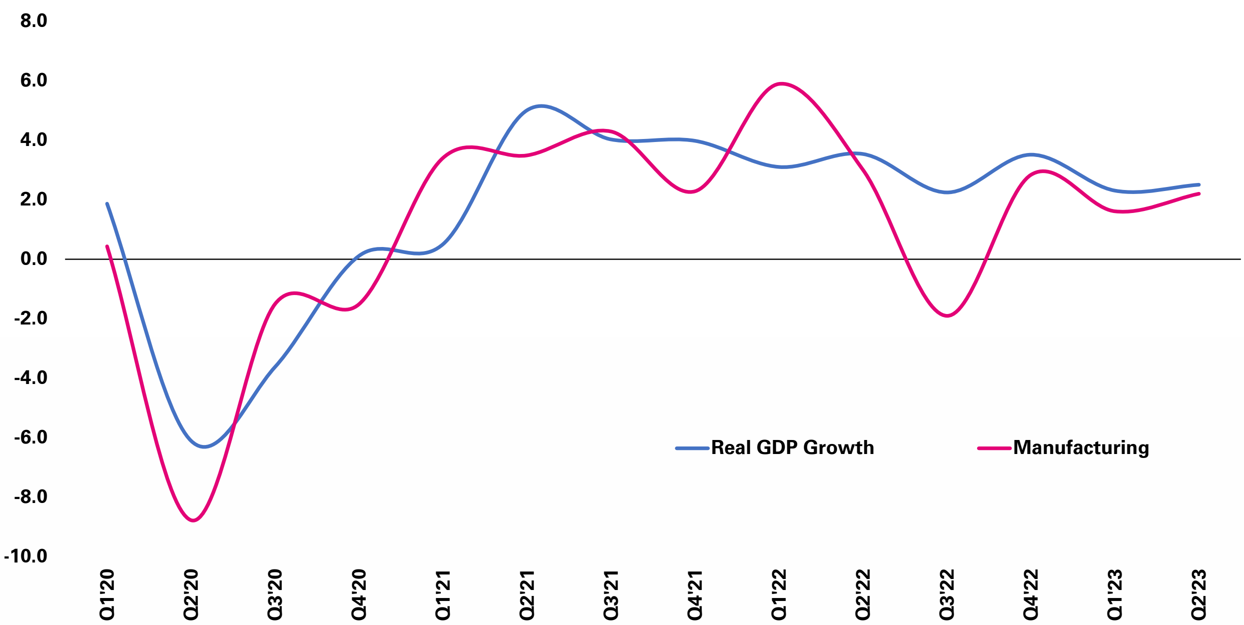
Current State & Performance of the Manufacturing Sector in Nigeria

To improve proper implementation and push towards the overall development of the manufacturing sector and Nigeria, it is crucial to understand how the industry has fared in the wake of the pandemics that disrupted the global economy and created supply chain constraints. Here are some of our top findings about the present situation and performance of Nigeria's manufacturing industry:

Sluggish Growth

The COVID-19 pandemic had a significant impact on the manufacturing sector's growth rate in Nigeria. In Q2 2020, the sector recorded its lowest growth rate since 2016, with a negative growth rate of -8.8% and has been recording a weak and sluggish growth since its recovery recording an average annual growth of 3.4% in 2021 and 2.5% in 2022, similarly as at Q2-2023, the growth rate stood at 2.2%.

Figure 3.1: Manufacturing Sector Growth

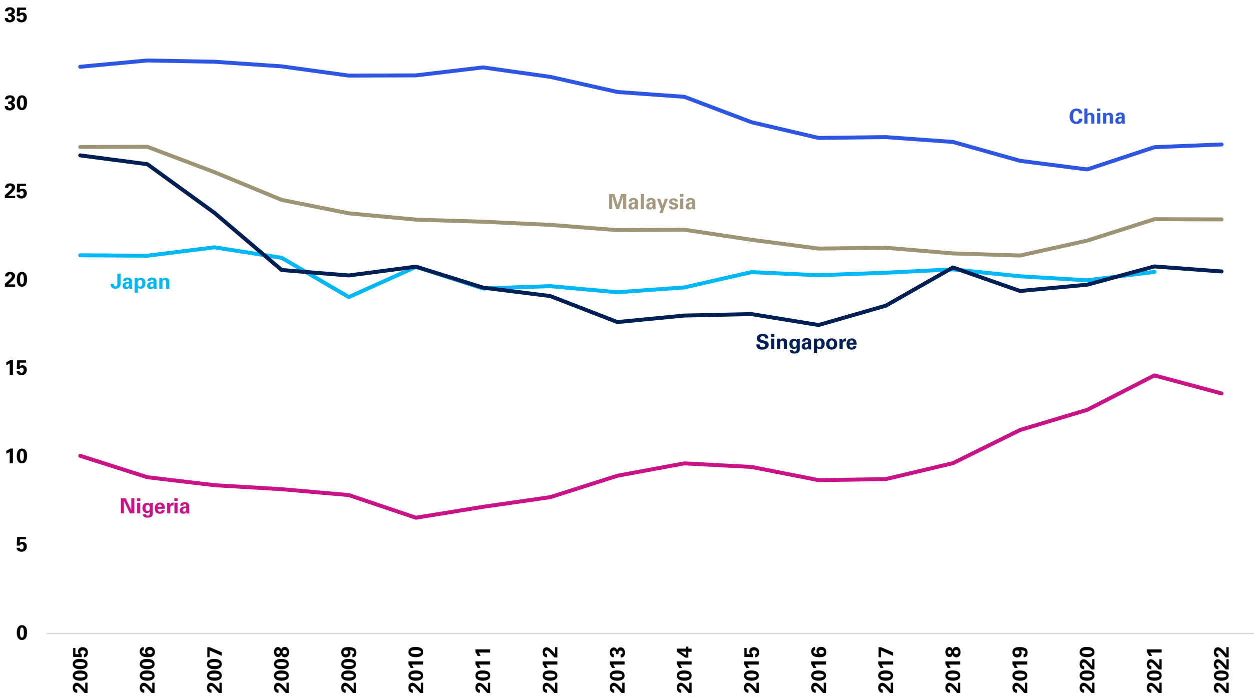


Sources: *NBS, KPMG Research*

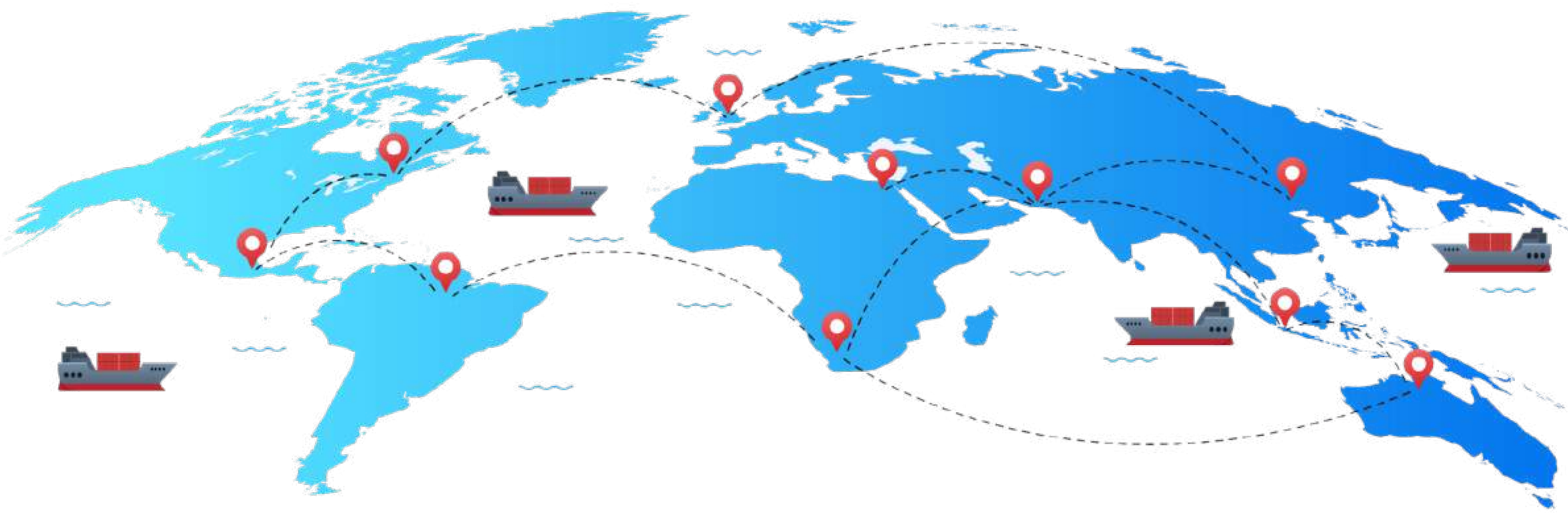
Low Contribution to GDP and Exports

The contribution of the manufacturing sector to Nigeria's GDP still falls far short of globally competitive levels, averaging about 10% annually in its contribution to GDP for almost 2 decades. In Q2-2023, the manufacturing sector contributed 8.6% to the GDP and for the past two years the manufacturing sector contribution to GDP has been between 8.4% - 10.2% on a quarterly basis which seats far below the manufacturing sectors of some selected economies as shown in Figure 3.2. The food, beverage, and tobacco sub-sector accounted for about 4.7% of the GDP for 2022, while the cement and textile sub-sectors contributed 3.1% and 2.7%, respectively.

Figure 3.2: Contribution of Manufacturing to GDP (%)



Sources: *World Bank & KPMG Research*



Lack of Depth and ESG Concerns

Furthermore, the manufacturing sector in Nigeria also underperforms in its contribution to exports as the sector accounted for only 6.4% of total exports recorded in 2021 compared to other countries where manufacturing accounts for over 70% of exports according to the World Bank.

Some other countries such as China, Japan, Malaysia and Singapore have experienced significant growth in their manufacturing sectors which have been fueled by several factors and strategies they employed. The manufacturing sector lacks depth as most of its growth are driven by few sub-sectors. In 2022, for example, only three sub-sectors accounted for about 76% of manufacturing GDP.

In addition, growing global ESG concerns, and technological shifts are gradually making products of sub-sectors such as plastic and rubber products, motor vehicles and assembly less attractive.

Figure 3.3: Manufacturing Exports (% of Exports) 2021

Sources: *World Bank, KPMG Research*

Table 3.1: Contribution of Manufacturing Sub-Sectors in 2022

Top-Performers		
Sub-Sector	**% of Manufacturing GDP**	**Share of GDP (%)**
Food, Beverage and Tobacco	34.02%	4.69%
Cement	22.75%	3.14%
Textile, Apparel and Footwear	19.61%	2.71%
Total (%)	**76.38%**	**10.54%**

Other Sub-Sectors		
Sub-Sector	**% of Manufacturing GDP**	**Share of GDP (%)**
Non-Metallic Products	6.44%	0.89%
Motor vehicles & assembly	3.86%	0.53%
Chemical and Pharmaceutical Products	2.90%	0.40%
Plastic and Rubber products	2.65%	0.37%
Other Manufacturing	2.44%	0.34%
Wood and Wood Products	1.95%	0.27%
Basic metal, Iron and Steel	1.92%	0.27%
Pulp, Paper and Paper Products	1.33%	0.18%
Oil Refining	0.07%	0.01%
Electrical and Electronics	0.07%	0.01%
Total (%)	**23.62%**	**3.26%**

Sources: *NBS, KPMG Research*

4 Roadmap for Industrial Growth

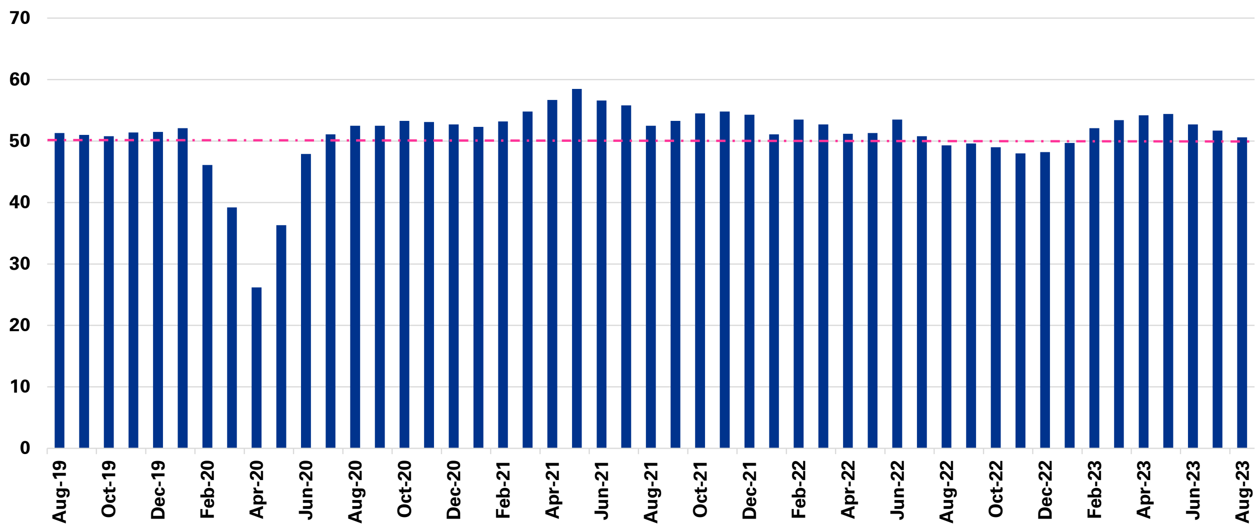
4.1 Current State of the Nigerian Macroeconomy

The current macroeconomic environment in Nigeria has been constrained by different global and domestic factors which in turn are limiting the growth and development of the manufacturing sector. The following are some of the key factors that contribute to this constraint:

- Slowing growth
- Inflation to remain high and global tightening to continue
- OPEC Oil cut and rise in oil prices
- Geopolitical tensions and De-globalization
- BRICS admitting 6 new members
- Shrinking Global FDI and Capital flows
- FX pressures and Debt Vulnerabilities

In a world contending with the profound impacts of the pandemic, Russia's invasion of Ukraine, and a growing cost-of-living crisis, the global economy has displayed a slowing growth. According to the JP Morgan Global Purchasing Managers' Index (PMI), global growth is on a decline and this trend is likely to worsen. The PMI record for August 2023 was at 50.6 which is about 0.6 point away from the 50 points which indicates a neutral or no change in economic activity within the surveyed sector. Below the benchmark of 50, the lower PMI may signal a closer move towards recession for the global economy if it persists into two consecutive quarters. The slowing growth that followed the relatively higher post-pandemic growth rebound has led Economists to predict that the global economy may be heading closer to a recession. However, we believe based on available data that global growth is, in fact, returning to its pre-pandemic level.

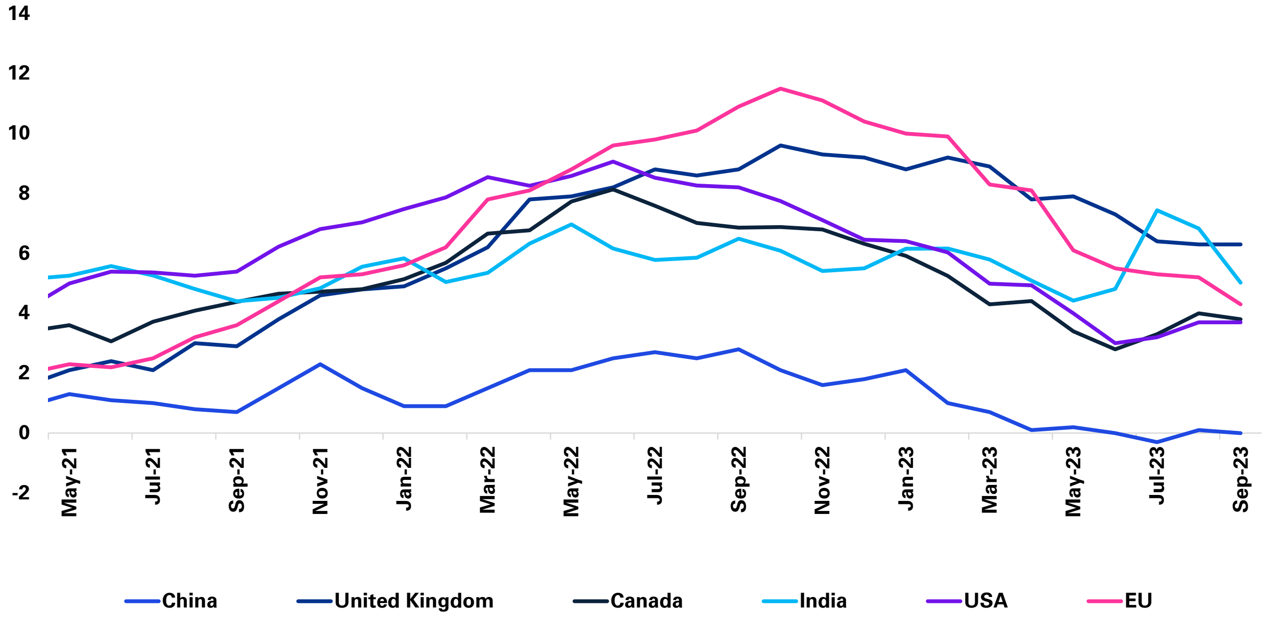
Figure 4.1: JP Morgan PMI Slowing in Last Few Months



Sources: *JP Morgan, KPMG Research*

In an attempt to moderate rising inflation globally, Central Banks have continued to hike interest rates. Despite the initial success recorded in pushing inflation back, many countries have experienced a considerable slowdown in their inflation rates in the last few months. According to the International Monetary Fund (IMF), global inflation is expected to progressively drop from its decades-high of 8.7% in 2022 to 6.9% in 2023 and 5.8% in 2024.

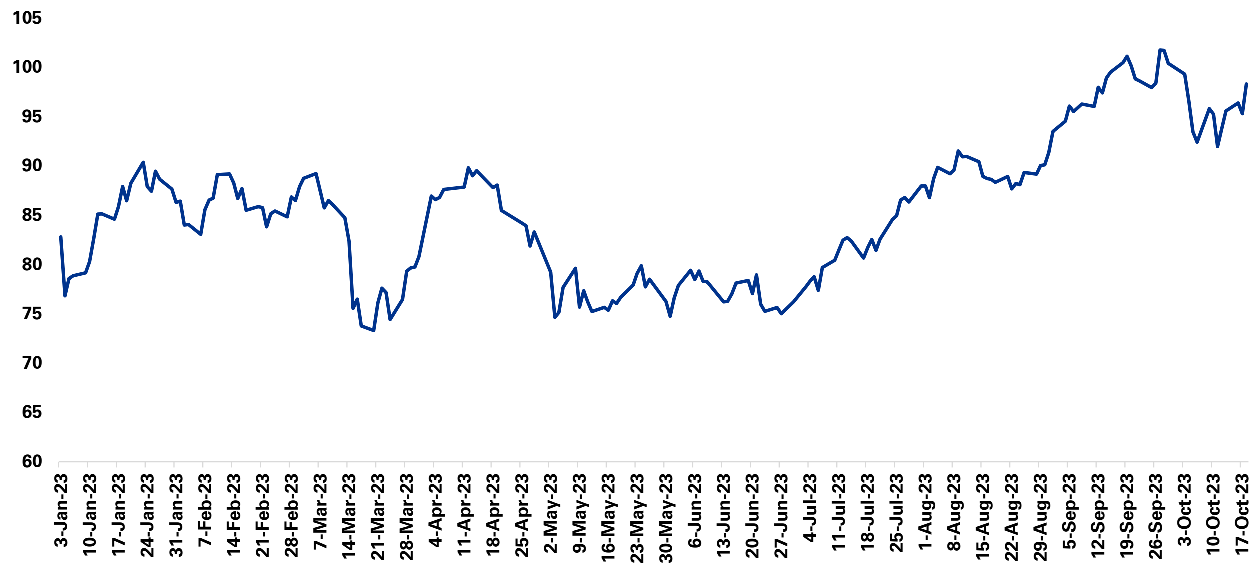
Figure 4.2: Inflation Across Selected Countries



Sources: *BIS and KPMG Research*

Furthermore, as a result of the prolonged supply cuts from OPEC+ (the Organisation of the Petroleum Exporting Countries plus a few non-members) nations, oil prices have continued to rise. Further OPEC supply cuts which had earlier caused slower growth and higher global inflation could spark increases in energy and commodity prices that would undo the progress made in cutting down global inflation, especially as winter draws near since higher heating demands during the season can drive energy prices up.

Figure 4.3: Crude Oil Price is on the Rise Approaching US$100bpd



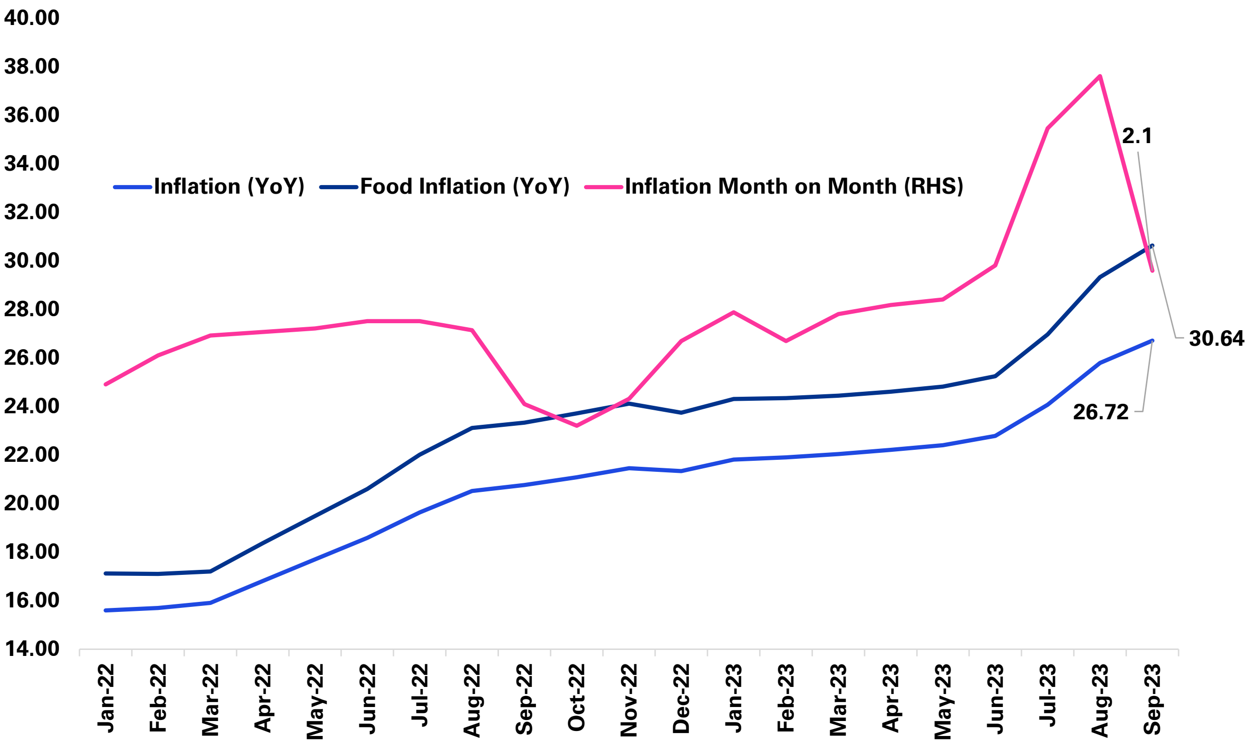
Sources: *CBN, KPMG Research*

The global economy faces even more serious risk in 2023 and beyond from geopolitical tensions such as the war in Russia and Ukraine, tensions between US and China, the Taiwan and China conflict, the war between Israel and Palestine, and military coups in several African nations. The potential of more severe commodity trade fragmentation is significant, and deglobalization might be fueled by nationalist movements, supply chain disruptions, the expansion of emerging economies like China, and rising commodity prices. There is also the concern about the strengthening of the BRICS (Brazil, Russia, India, China and South Africa) with Brazil pushing publicly for the end of the dollar dominated transactions and arguing for a new reserve currency and admit new members from North Africa, South America, Middle East, pointing to plans to decouple the global economy from the stranglehold of the West.

COVID-19 caused the initial disruptions to the global economic characterized by supply chain disruptions leading to slow and declining growth, high inflation, declining capital flows and FDI, rising global unemployment/ underemployment, however, the start of the war has sustained those macroeconomic challenges which has kept the global economy from recovering properly and the continuation of those tensions and conflicts are arguably the biggest threat to the outlook for the global economy.

To combat rising inflation, many central banks throughout the world tightened monetary policy to restore price stability, which had a considerable impact on rebalancing aggregate demand. As inflation continues to fall and central banks retain a tight posture, many nations are nearing the end of their tightening cycles, and little extra tightening is required to avoid premature easing. The inflation rate in Nigeria which has continue to increase couple with the removal of subsidy, has made businesses often faced with higher costs of production, rising prices of raw materials and energy as their profit margins are squeezed thereby making it more challenging for businesses to operate. Increasing inflation rate has also reduced the purchasing power of consumers thereby constraining household consumption expenditures and reducing demand for goods and services.

Figure 4.4: Inflation rate (%)

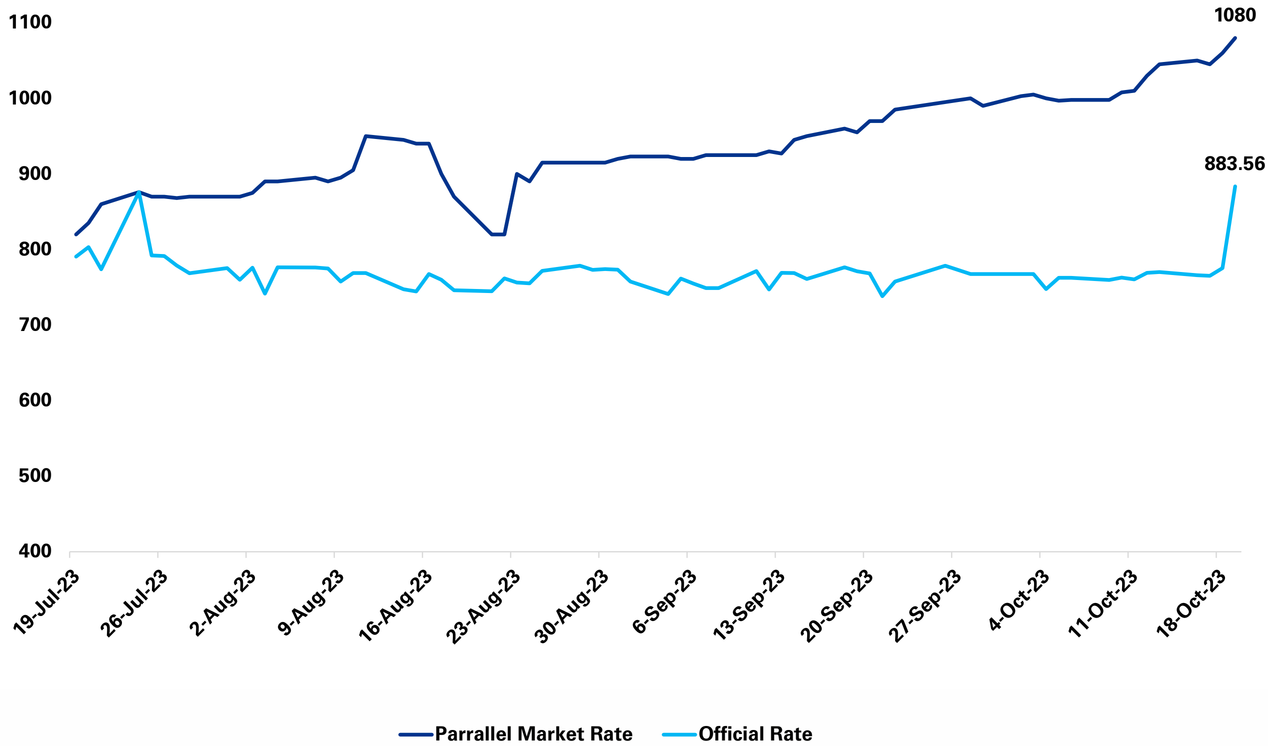


Sources: *NBS, KPMG Research*

High and unstable FX has affected the Nigerian economy thereby creating a daunting growth notably reducing foreign investment into the country, leading to higher import bill and decreased export revenues and since the transition to a managed float, the Naira has depreciated against the Dollar by more than 80% between June and October 2023 in which the Naira reached an unprecedented high of N1,200/$1 and N815/$1 in the parallel and official market respectively.

Consequently, there might be a possibility of increased costs to businesses from FX losses from having to deal with a higher FX rate in between the financial year they may not have budgeted for. Therefore, the urgent need to guaranty long term FX availability and shore up foreign reserves and stabilize the FX exchange rate is substantially tied to our ability to produce more competitively and export more as well as attract FDI in which all these are linked to growth of the manufacturing sector in Nigeria.

Figure 4.5: Naira/USD Exchange Rate



Sources: *CBN, Nigeriagalleria & KPMG Research*

4.2 Key Challenges of the Manufacturing Sector

The manufacturing sector in Nigeria faces several key challenges that are impacting its growth and sustainability. Some of the significant challenges are:

a. Infrastructure Deficit and Competitiveness

Nigeria has a large infrastructure deficit with total infrastructure stock amounting to 30% of GDP, falling short of the 70% international benchmark set by the World Bank by 40%. This infrastructure gap raises the costs of the manufacturing sector in Nigeria and dampens their competitiveness in the world market. Closing Nigeria's huge infrastructure gap which hampers the growth of the manufacturing sector will require a sustained expenditure of $14.2 billion annually or 12% of GDP over the next decade (Nigeria currently spends $5.9 billion).

b. High Inflation, High Production Costs and Demand Destruction

High and increasing inflation in Nigeria erodes the purchasing power of consumers and increases the cost of inputs for manufacturers which has led to a decline in consumer demand for manufactured goods as people become more cautious with their spending. Manufacturing requires various inputs, such as raw materials, energy, labor, and transportation and when production costs rise, manufacturers face challenges in maintaining competitiveness and which have squeezed their profit margins.

By mounting an upward pressure on production costs and lowering consumer purchasing power, inflation complicates investment decisions by bringing higher uncertainties to the sector that is already exposed to market risks.

c. Multiple and High Tax Rate

The heavy tax burden on the manufacturing industry, increases operational costs, discourages investments, increases compliance complexities and lowers competitiveness. This has increased the overall cost of doing business in Nigeria. The burden of taxes, including corporate income tax, value added tax (VAT), custom duties and other levies have all reduced the manufacturers profitability as most of them are now allocating substantial portion of their revenue to tax payments.

d. Limited Access and High Cost of Finance and Insecurity

The dearth of credit limits the ability of the manufacturing sector to raise finance for expansion. Access to affordable and adequate fianancing is crucial for manufacturers, especially for capita-intensive investments. Limited access to finance, high interest rates and difficulty in obtaining credit hinders investment and growth in the manufacturing sector particularly for MSMEs. In addition, widespread insecurity disrupts input supply chains and raise the prices of critical inputs.

e. Policy Inconsistency and Implementation

The policy environment also adversely impacts the manufacturing sector. These usually take the form of poor policy design and implementation, bureaucratic delays and policy inconsistencies caused by changes in government. The manufacturers also require stable policy framework to plan their business strategies and make informed decisions, inconsistency or frequent changes in policies may disrupt their production plans, investment decisions and market strategies.

4.3 Roadmap for Industrial Growth

Developing a roadmap for manufacturing and industrial growth in Nigeria necessitates the design and implementation of strategies that address the reoccurring pain points of stakeholders in the manufacturing sector which involves the collaborative efforts of government, industry associations, educational institutions, and other stakeholders. Some of these areas are thematically organized as follows:

a. Infrastructure Development

To spur the manufacturing sector to a globally competitive level, Nigeria needs to make massive investments in key infrastructure to enhance its transportation, power, logistics, and other supporting infrastructure. To this end, Nigeria requires a sustained expenditure of $14.2 billion annually or 12% of its GDP over the next decade to close its huge infrastructural deficit.

b. Capacity Development, Technology Adoption and R&D

There is also the need to constantly close the skills and technology gaps of the manufacturing sector by continuously investing in capacity development programs and trainings and promoting the widespread adoption of advanced technology in manufacturing processes. Research and Development (R & D) should also be leveraged to drive advancements in manufacturing processes, product development, and technology adoption.

c. Improve Access to Finance and Markets

In terms of access, the manufacturing sector is limited by two access dimensions – financial and market access. It is therefore crucial to increase the availability of affordable private sector-led financing options for new and existing manufacturers and strengthen the market linkages of manufacturers by pursuing strategies which expand market opportunities, enhance competitiveness, and facilitate exports.

d. Promotion of Sustainable manufacturing

Growing environmental, social and governance (ESG) concerns must also be put into consideration in driving economic prosperity through manufacturing by promoting environmentally friendly practices, such as adopting renewable energy sources, manage waste, reduce the overall carbon footprint of manufacturing processes, and ensure responsible sourcing of raw materials. Thus, regulations must be put in place to ensure that investors and stakeholders remain compliant with ESG guidelines.

e. Policy Reforms

Evidence from top manufacturing giants of the world, like China, emphasize the catalytic role played by the policy environment in enabling the manufacturing sector making it a global powerhouse, but Nigeria remains below par amongst most countries in the world in the quality of its policy environment. Therefore, the implementation of critical reforms that will enable the manufacturing sector are necessary. Notably, we recommend that reforms that improve the ease of doing business, simplify regulatory procedures and establish transparent systems, encourage entrepreneurship, and support manufacturing growth in general should be prioritized.

f. Support for Small and Medium Enterprises (SMEs)

SMEs are inarguably the lifeline of the manufacturing sector because of the important roles they play across diverse manufacturing value chains. In addition to providing a large chunk of the inputs required by the manufacturing sector, SMEs also serve as important market conduits linking manufacturers to their product markets. Therefore, it is important to equally support and enable the growth of SMEs as this will significantly amplify the gains realizable from the manufacturing sector.

g. Collaboration and Partnerships for Development

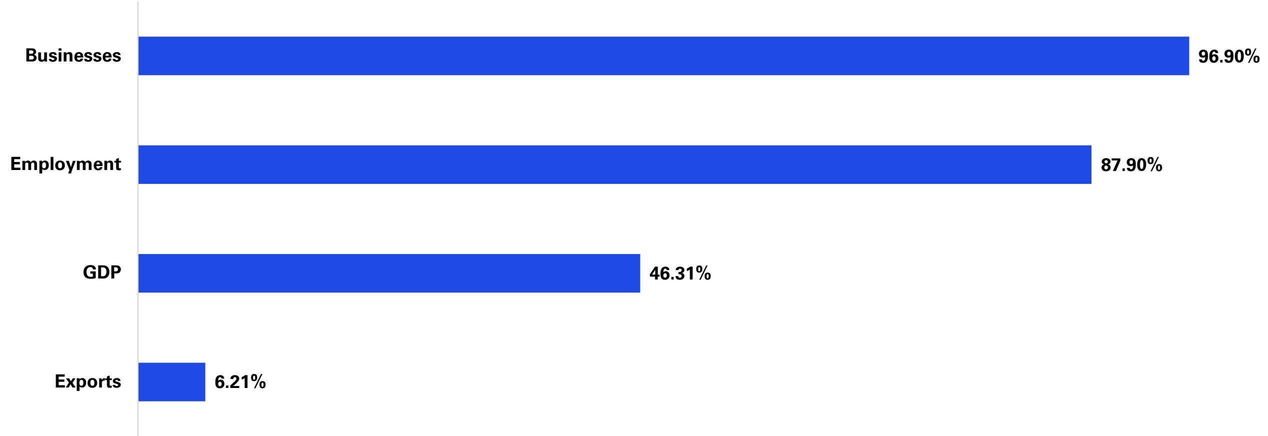
Successfully developing the manufacturing sector and positioning it as an engine for economic growth will require collaborative efforts from the government, the private sector, educational institutions, communities, and other stakeholders. This is necessary to enhance rapid infrastructural development using pooled resources, promote investment risk-sharing, allow for inclusion, and ensure greater accountability.

5 Conclusion

In conclusion, manufacturing sector plays an important role in driving prosperity and economic development in Nigeria as it serves as the foundation for industrial growth in which an enabling environment must be created to support its growth and sustainability. Therefore, recognizing the importance of MSMEs in Nigeria as drivers of this growth is the key.

5.1 MSMEs: Engines for Industrialization and Sustainable Growth

Figure 5.1: Performance Snapshot of MSMEs in Nigeria



Sources: *SMEDAN, NBS & KPMG Research*

Despite the documented decline in the numbers from 41.5 million in 2017 to 39.6 million in 2020 due to the impact of the Covid-19 pandemic on businesses, Micro, Small and Medium Enterprises (MSMEs) remain crucial for unlocking the potentials of the manufacturing sector in Nigeria. The manufacturing sector (22.5%) is only second to the Wholesale and Retail Sector in its composition of SMEs. Also, the highest (21.6%) formal employment generated by MSMEs are concentrated in the manufacturing sector.

In addition, MSMEs have strong backward linkages with the manufacturing sector as they supply raw materials and semi-finished products to manufacturers operating in various value chains in the economy. MSMEs also provide forward linkages to the manufacturing sector by connecting manufacturers to their markets locally and internationally when they act as distributors, wholesalers, retailers and exporters. Thus, MSMEs which constitute more than 96% of businesses in Nigeria are important drivers of manufacturing sector and economic growth that account for over 46% of GDP and more than 87% of employment in the country.

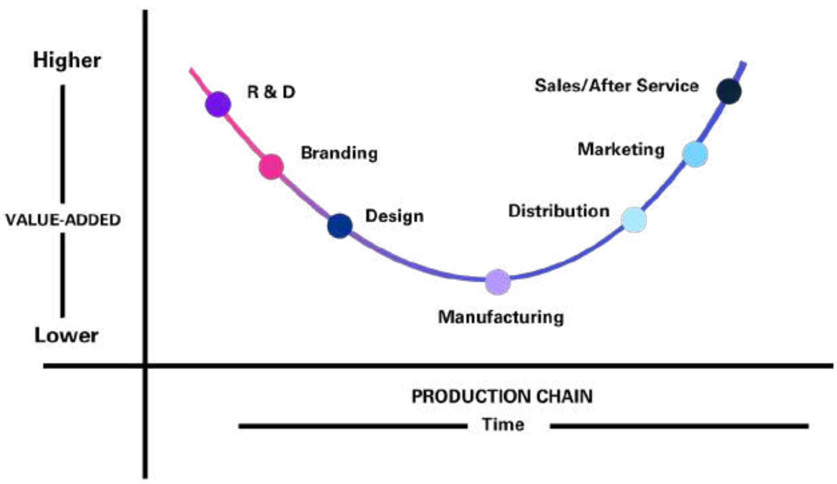
However, MSMEs are still largely limited in their access to resources as seen in their low access to finance and lack of Infrastructure; capacities as MSMEs owners have huge skill gaps, generally low technology adoption and Innovation, and poor R&D; unfavourable policy environment manifesting in multiple taxation, ease of doing business, and rising security concerns; and their vulnerability to macroeconomic shocks like inflation and devaluation as MSMEs lack the sophistication to detect and develop effective responses to economic shocks, demographic shifts and preferences. Therefore, as critical enablers of the manufacturing sector, there is a need to address the challenges confronting MSMEs.

5.2 Matters Arising: Key Considerations

We conclude our discussion by directing our focus to insights from the "Smiling Curve" which highlights a major shift in how nations add value and remain competitive in the manufacturing process.
Lessons from the "Smiling Curve" of Stan Shih demonstrates that successful and competitive nations add more value to their products in both the conception and marketing stages of the value chain than the middle or physical stage of manufacturing.

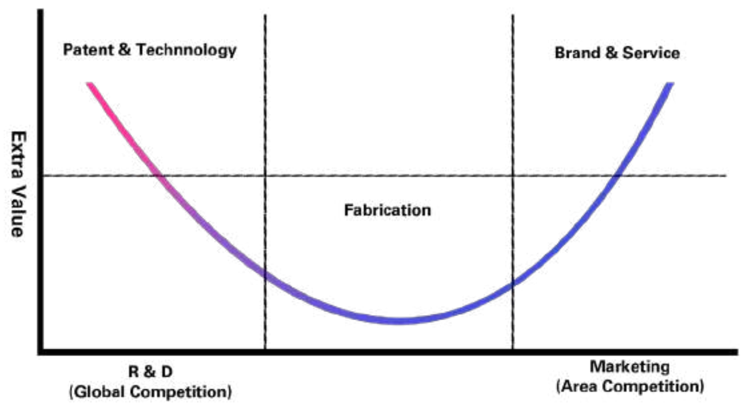
The curve shows that higher values are captured in the early design, branding and R&D stages. Similar higher value is also added in the distribution, sales and marketing phase of the manufacturing value chain. Far less value is captured in the physical manufacturing phase of production. Specifically, we note that only about a third (1/3) of the total value added to a product comes from physical manufacturing.

Figure 5.2: The Smiling Curve 1



Source: *Stan Shih, 1996*

Figure 5.3: The Smiling Curve 2



Source: *Stan Shih, 1996*

Therefore, for Nigeria to effectively add and capture value in its manufacturing value chain to drive prosperity, then it must rise beyond physical manufacturing by deploying technology, R & D and innovation-led approaches in all manufacturing processes; adopting adaptive marketing, branding and sales models by constantly rethinking and reinventing its marketing, branding and sales models to enable the manufacturing sector compete more efficiently in the global space; and avoiding a blind adoption of dated development plans that do not reflect the disruptive departures from traditional manufacturing approaches, apart from not reflecting the unique challenges of Nigeria.

Shih, S. (1996). Me-Too Is Not My Style: Challenge Difficulties, Break Through Bottlenecks, Create Values. The Acer Foundation, Taipei

Contact Us

Dr. Yemi Kale
Partner & Chief Economist
KPMG West Africa
E: oyeyemi.kale@ng.kpmg.com

Olumide Olayinka
Partner & Head
Advisory
KPMG West Africa
E: olumide.olayinka@ng.kpmg.com

Adama Mohammed
Partner & Head
Audit - Consumer Industrial Market
KPMG West Africa
E: mohammed.adama@ng.kpmg.com

Contributors

- **Busayo Olanrewaju-Afuye**
  Associate, Research and Insights
  KPMG Nigeria
- **Fatai Shuaib**
  Associate, Research and Insights
  KPMG Nigeria
- **Festus Ogunbayo**
  Analyst, Research and Insights
  KPMG Nigeria

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