PROJECT POLICY BRIEF

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Origins of the Mammoth: Emergence and Evolution of Large High-Growth Firms in Nigeria

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In developing economies, small firms dominate the labour market, but they are generally less productive, less likely to grow and more likely to fail. Larger, more persistent, and productive firms are essential to support growth and structural transformation. To understand how large firms emerge and grow, this research project analysed firm-level data from Nigeria. The findings suggest that older firms tend to exhibit higher growth rates over time, especially when co-located with an export processing zone. This finding highlights the importance of policies that promote firm survival. Such policies could be an effective means of supporting long-term growth and industrial development.

Introduction

Structural change depends heavily on the accumulation of productive capabilities in a country, a process that takes place more rapidly in larger firms. However, because of the tough business environment, small and necessity-driven firms dominate the private sector in African countries (Andreoni et al, 2021; McKenzie, 2017). This makes the case of some large formal firms that exhibit sustained growth and job creation potentials very interesting. But limited systematic evidence exists on the factors that account for the emergence and progression of these outliers. This project examined the emergence and evolution of large industrial firms in sub-Saharan Africa, using firm-level data from a sample of the largest manufacturing firms in Nigeria.

The rationale is fairly straightforward: if we know what systematically characterised today's large industrial firms when they were born, then it will become easier to design industrial policies to facilitate the emergence of similar firms. This rationale yields a key question: what are the structural, political, and entrepreneurial factors that explain the emergence and evolution of large firms in sub-Saharan Africa? The study is set in Nigeria given the country's sheer size relative to other countries in sub-Saharan Africa. the evidence obtained will have relevant implications for other African (and developing) countries.

Policy Context

According to the 2022 Nigeria MSME Report, 97% of the 40 million MSMEs operating in Nigeria by the end of 2022 were micro-sized. The modal MSME has only one employee, is less productive and far less likely than a large firm to survive and grow. The MSME report, in fact, notes that while

MSMEs in other emerging markets like India, Brazil, Mexico, Peru, and Indonesia outlive their founders and grow over time, the majority in Africa do not. The proliferation of MSMEs is explained by two main factors: necessity-driven entrepreneurship due to unemployment, and a harsh economic environment that stunts business growth and transition. Despite this reality, policies oriented towards the private sector in Nigeria remains focused on simply multiplying the number of firms without consideration for size.

Methods

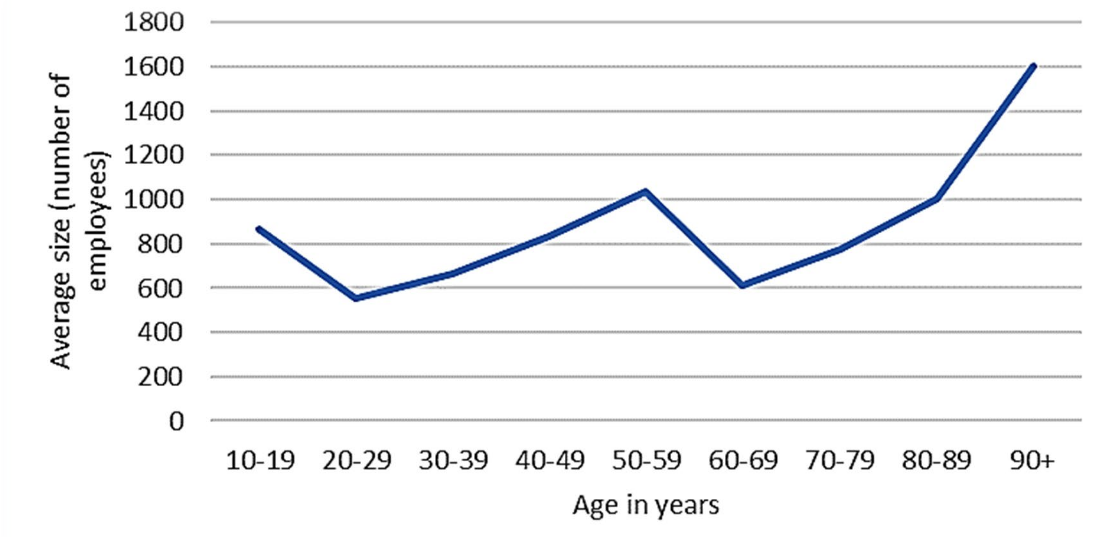
To answer the research question, a stratified random sample of 106 manufacturing firms in Nigeria with at least 100 employees was selected. The profile of these firms was first constructed from secondary sources. The firms were then contacted to answer specific questions which, in combination with the secondary information, helped to describe the emergence and growth path of Nigeria's largest industrial firms. The sampled firms have an average of 754 employees.

Main Findings

Of the 106 firms, only three were started between 2000 and 2005; the rest being at least 25 years old. On average, the older firms are larger (Figure 1). The apparent correlation between age and size conforms with the hypothesis that firms grow as they age, one which finds support in the existing literature. From a policy standpoint, therefore, it seems logical to pursue firm survival since older firms tend to exhibit higher growth over time. In a resource-constrained environment like Nigeria, the modal firm is born small even if it has growth aspirations. Such firms need to survive long enough to accumulate the capabilities required to operationalise their growth aspirations.

Most of Nigeria's limited manufactured production and exports are now contributed by the relatively few large firms. But the country's economy has historically been driven by commodity exports. Given this history, some of the current large firms in the country have roots in the trading sector, in consonance with the so-called 'trader turned manufacturer' story. For instance, Dangote Cement, a member of the Dangote Group that started with trade of primary agricultural produce, produced 61% of Nigeria's cement in 2019 and exported 0.7 megatonnes of cement in 2021. Thus, while it is reasonable to directly encourage the emergence of manufacturing firms, there may be potential gains in the long-run persistence and diversification of trading enterprises.

Figure 1: Distribution of firm size by age



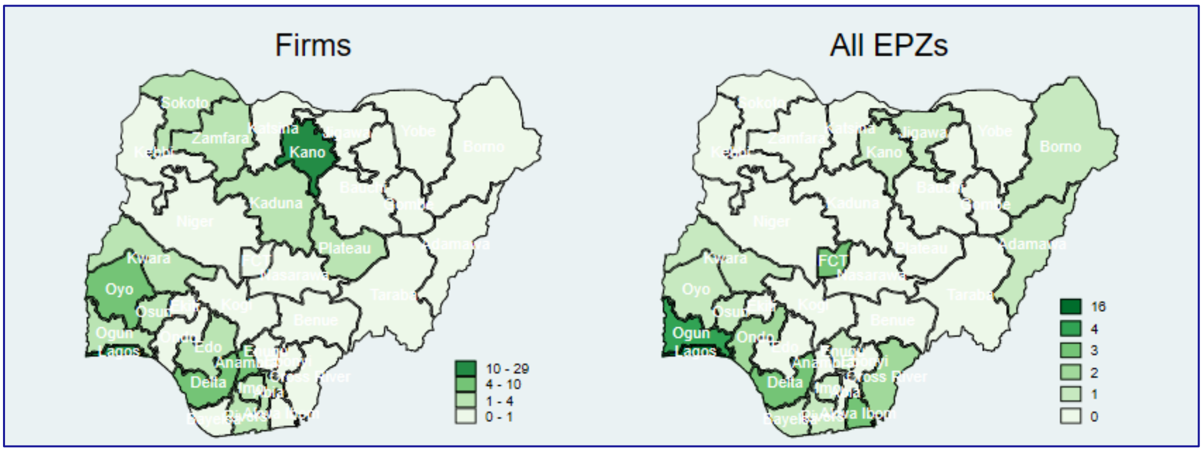
Spatial economic policies and industrial agglomeration are known to be good for structural change and industrialisation. In addition to several organic industrial estates and clusters, Nigeria has over 50 export processing zones (EPZs), 24 of which are currently active. Indeed, the spatial distribution of the large firms correlates with the spatial distribution of the EPZs (Figure 2). The correlation is particularly pronounced in the southern part of the country. There is however no evidence to suggest a causal relationship between the geography of EPZs and that of the large firms.

Rather, evidence points to an endogenous relationship between the two: the same factors that informed the choice of EPZ location make the locations attractive to firms. Thus, while positive externalities and spillovers from the EPZs are favourable to firm growth, the siting of the EPZs is not a random choice but an endogenous one that is biased towards locations which already favour firm survival and growth. Take Lagos, for instance. Most of the EPZs are situated there because of its advanced logistics, transportation and human capital infrastructure. Firms are attracted to this location for these same reasons. Clearly, investments in the business environment, particularly in infrastructure that support productivity, will facilitate structural change through firm growth.

Policy Implications

The findings of this study offer some directions for private sector development policy. Firstly, transparent policies that aim to identify and nurture potential 'winners', that is, small and medium-sized enterprises (SMEs) that exhibit growth potential. Secondly, policies that encourage the development of industrial clusters and agglomerations may assist in the emergence of large firms. However, policymakers must carefully develop these policies to ensure that they actually support firms with high growth and innovative potential. These policy implications apply not only to Nigeria but also to other developing countries seeking to encourage industrialization and structural change.

Figure 2: Correspondence between the spread of EPZs and spread of the largest firms



Moving Forward

In addition to the patterns already highlighted above, it is worthwhile to explore within-firm micro-processes that shaped the emergence of the ‘mammoth’ firms. This is important because the growth of firms requires the development of certain capabilities, but the process is presently poorly understood in sub-Saharan Africa. This project will develop in this direction.

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