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The investment potential of Nigeria's middle class (summary)

For PDF II
July 2019

FUSION
CONSULTING

Overview of study objectives and research methods

This decade has seen increasing popular and policy attention to the concept of an emerging 'middle class' in Nigeria and elsewhere. At the same time, emphasis is being placed on promoting domestic private sector investment linkages to help the growth of the MSME sector and its positive impacts on the lives of poorer Nigerians.

The aim of this study, commissioned by DFID's Policy Development Facility (PDF II), is to establish at least approximately the size of the relevant middle class and the scale of funds it has available for retail investment, which could – given the right vehicles – be mobilised to finance MSME activity. It also explores existing middle class investment patterns and preferences, including attitudes towards small business investment. This is intended to provide information to the private sector, government and development partners with which to target specific initiatives at various segments of the middle class.

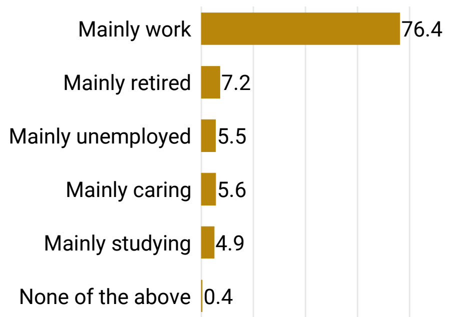
Desk research, face to face surveys and in-depth qualitative interviews were employed for the study. Existing data showed that middle-class wealth and income, as well as the infrastructure and access to information that could help channel it towards new forms of MSME investment, are concentrated in urban locations rather than in rural or semi-rural ones. So, to make best use of our survey resources, we limited our attention to larger towns and cities making up about one-third of the total Nigerian population. Our universe for the study was 24.3 million adults aged 25+ in larger urban Nigeria. 1,956 face to face interviews were conducted with a randomly selected sample from this group. In addition, in-depth interviews were conducted with 101 urban adults and 10 institutional investment providers.

Post-survey weights were applied to the data to ensure accurate representation of the large-urban population by zone, age and gender. Consequently, our findings can be interpreted as representative.

Overview of the middle class

Economic activity and income sources of larger-urban adults 25+

Main economic activity (%)



Just over three-quarters (76.5%) of larger-urban adults aged 25+ report that they mainly work. 5.5% report being unemployed but wishing to do so. Students accounted for just under 5% and retired individuals for just over 7%.

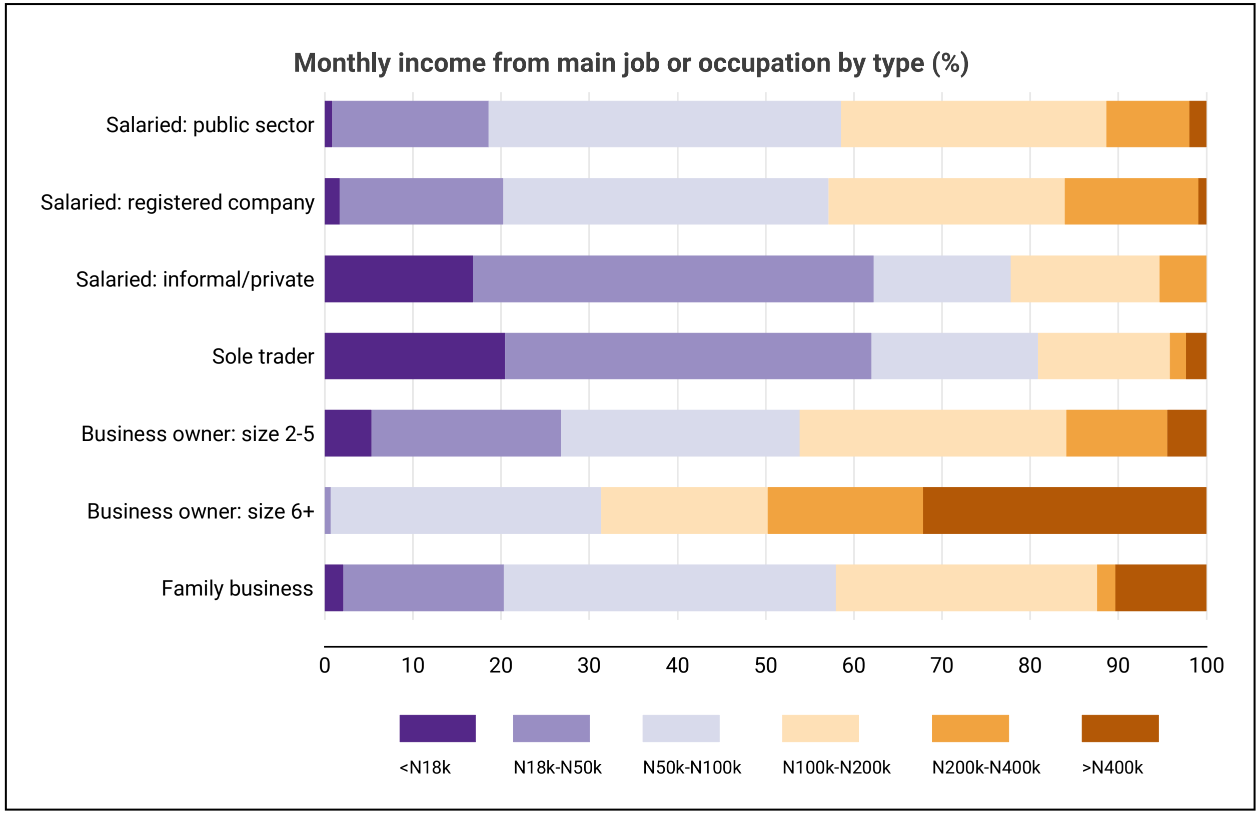
Two in five current workers are in a job that pays a regular salary. The largest group (22%) are on public sector payrolls, while a further 12% are employed by registered companies. A smaller group, 6% of all workers, earn regular pay from an informal business or, in a smaller number of cases, from a private individual or household.

Sole traders i.e. self-employed individuals and wage workers represent 30% of workers overall. A further 29% own businesses employing staff, generally microenterprises with a headcount of 2-5 including the owner. A smaller number own businesses with larger headcounts.

Among current full-time workers, the median reported monthly income from their main job or occupation is in the N50,000-N100,000 range. Around this middle range, a third of full-time workers (34%) earn less, and just over a third (37%) earn more. One in eight adults (12.3%) earns more than N200,000, while fewer than one in twenty (3.8%) nets more than N400,000.

The highest-earning groups on the whole are business owners, particularly those employing larger numbers of workers, although the latter are few within the population. Family business workers, which may include business owners, also have a higher proportion of top-end earners, but again are a small group.

Overall, 21% of the study population have a secondary or side-source of labour income, including 20% of those who mainly work. A quarter (26%) of formal-sector employees (public



or private) have labour income outside their main job, with 15% owning businesses that employ workers, and a further 11% earning from sole activity or moonlighting.

Personal income potentially available for investment derives from non-labour as well as labour sources. These non-labour sources include income-generating assets such as financial or business investments, land and property, as well as pensions and intra-household and family transfers including remittances from abroad. In general, the levels of non-labour incomes reported are small compared to the labour incomes.

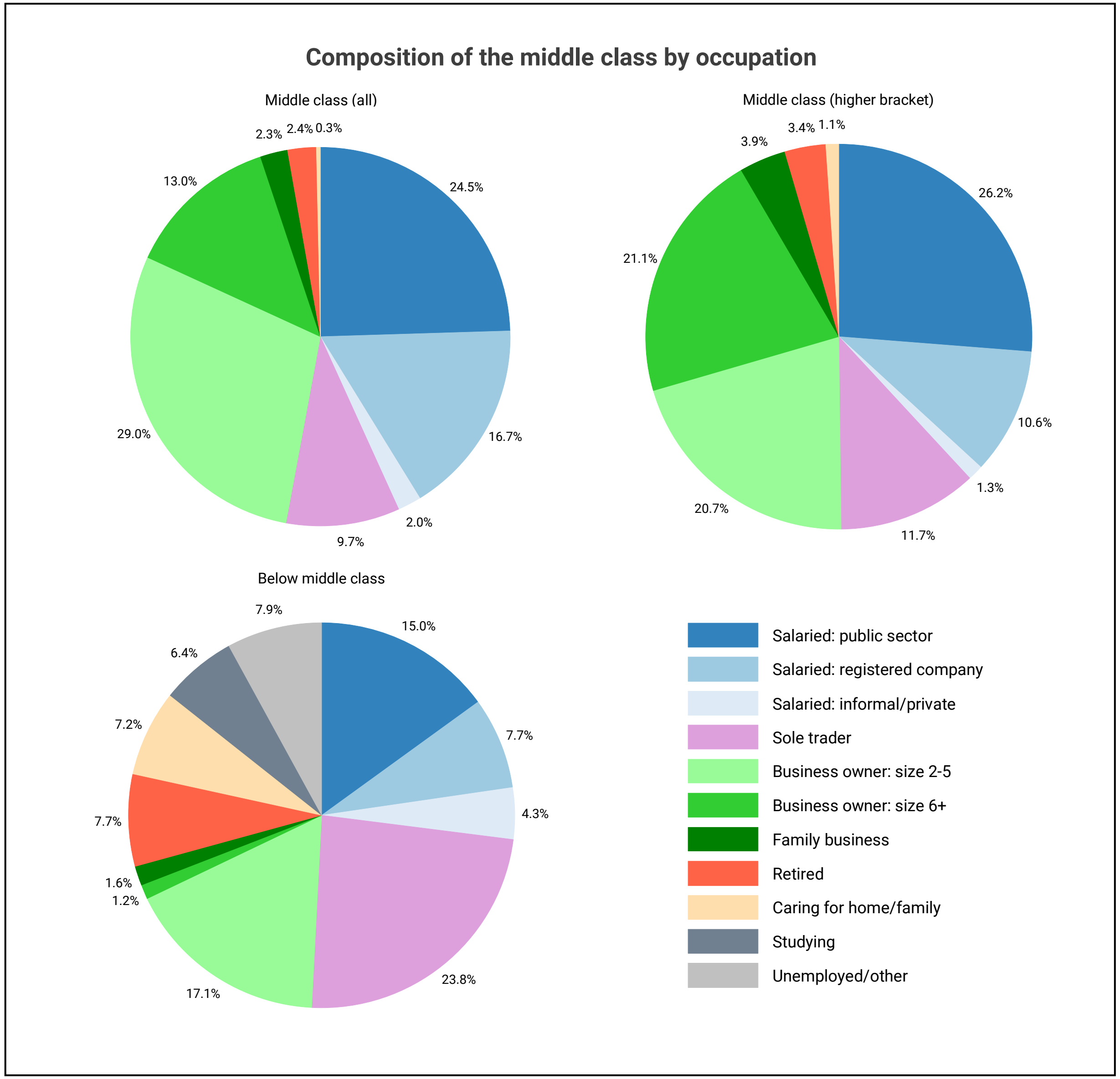
Size of the middle class

For our purposes, the relevant middle class are those with an income from all sources sufficient to leave them with surplus funds that are or could be financially invested. Of course, resources potentially available for investment in the MSME sector do not necessarily derive from earnings and other financial income but could consist of accumulated physical and financial wealth or one-off gains. However, because of the sensitivity of this information to respondents and the volume of topics covered by our survey, we did not attempt to survey these exhaustively (for instance by asking about valuables, or the market value of any land owned), or to include them in our analytical definition of the middle class.

We defined income thresholds to identify a lower and higher economic middle class. These thresholds were labour and non-labour incomes of circa N200,000+ monthly (lower threshold) and circa N400,000+ monthly (higher threshold) from all sources. The thresholds are intuitively reasonable and agree well with other information obtained from the survey.

Using these thresholds, we estimate that there are 4.0 million adults above the lower threshold, which equates to 2.0% (one in fifty) of Nigerians. Above the higher threshold we estimate that there are 1.3 million, or 0.6% (one in 120) of the population.

Respondents below our lower middle class threshold express below-average income adequacy: 25% just get by, and 30% say their income does not even meet basic needs. By contrast the lower and higher middle class groups express high levels of surplus income, and 23% of the higher middle class bracket say they regularly earn comfortably more than their needs.



Composition of the middle class

The two largest groups in the middle class are business owners on the one hand, and salaried employees in the public and formal sectors on the other. These groups are of the same size, each accounting for 42% of the total. Sole traders (i.e. self-employed individuals) and informal sector workers make up 12% of the middle class, and family business workers just over 2%. Of the 3% of the middle class who do not primarily work, most are retirees.

The composition of the higher-bracket middle class is fairly similar, but with a reduced proportion of salaried private sector workers in favour of the other segments, and a higher proportion of (relatively) larger rather than smaller business owners.

Larger business owners are by far the most likely to meet our definition of middle class: 75% of this group meet the lower threshold and 29% meet the higher threshold, as against 16.4% and 4.5% of the larger-urban adult population as a whole. Micro-business owners (with a headcount of 2-5 including the owner), as well as salaried public and formal-sector workers, and family business workers or owners, are also more likely than average to be middle class: roughly a quarter of each of these groups meet the lower threshold middle class.

In line with their lower representation among the key salaried and business-owning segments of the population discussed earlier in the report, women are underrepresented among the middle class assessed on the basis of personal incomes: 63% of the middle class overall are men and only 37% women.

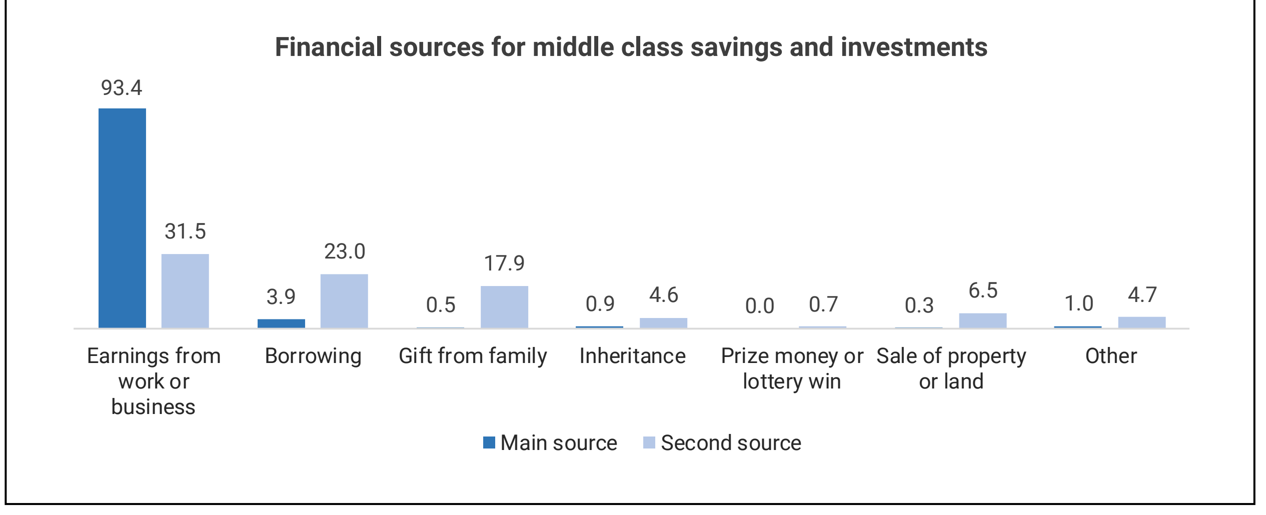
Financial assets and sources

Middle class Nigerians are almost universally banked (97%), whereas the holdings of “advanced” and online financial assets (e.g. mutual funds, T-bills, bonds, crowdfunding and cryptocurrency) are far lower than in the case of cash, bank deposits, and cooperative savings. The most frequently reported are stocks and shares (12.7%) and mutual funds (6.7%).

There is some indication that online investments are more accessible to Nigerians further down the income scale than the other assets considered, at least in a relative sense. In particular, the ratio of non-middle class to middle class investment in online agricultural crowdfunding and cryptocurrency is smaller than for shares, mutual funds and the other forms of investment through financial institutions.

Not only are bank accounts by far the most commonly held form of liquid asset, but the reported values held as bank deposits are generally higher than in other categories. The median middle class bank balance is in the N250,000 – N500,000 range, whereas the median size of reported investment in any of the “advanced” categories (in the relatively infrequent cases where they are held) is lower in the N100,000 - N250,000 range.

Summed across all the savings and investment types, the mean range value of monetary and other liquid holdings among the middle class is between approximately N790,000 and N2.1 million. This range is significantly higher for the higher-bracket middle class.



Grossed up to population level, the findings imply that larger-urban middle class adults aged 25+ have total liquid assets of between N3.2 trillion and N8.4 trillion, most of it in the form of bank savings and deposits. This total is split approximately evenly between the 2.8 million Nigerians in the lower middle class bracket and the 1.3 million in the higher bracket.

Investment attitudes

In addition to being almost universally banked, urban middle class Nigerians have very high rates of Internet connectivity and use, including a significant proportion who bank or perform transactions online. Thus, technological barriers to online investment on the consumer side appear to be low.

There are high levels of trust for investment information from family and friends, bank staff and traditional media sources like television, radio and newspapers, while there are mixed levels for the internet and social media platforms.

Trust is often higher in investments promoted by the private sector than in those promoted by the public sector. Private sector opportunities are perceived to be profit driven and professionally managed. On the other hand, government schemes are perceived to be used to settle political favours and only available to applicants who have people to help them, as well as constantly changing with the administration in place.

The qualitative interviews revealed that cautious attitudes towards investment were the norm, particularly in relation to business investment. Fears regarding the honesty of entrepreneurs and intermediaries were widespread.

Actual and potential investment in MSMEs

28% of the higher-bracket middle class and 17% of the lower-bracket middle class have provided direct finance to one or more businesses in the last two years. The figure among the non-middle class is lower at 10%.

While the incidence of direct business investment rises with economic bracket, there is no difference in terms of the relationship between investor and investee. Overwhelmingly, across all income-based brackets, the businesses funded were owned either by a family member (in around half of cases) or by a friend or other personal connection, including the employer of a family member.

Overall, the survey data confirms that MSME finance (except where successfully obtained from lending institutions) often comes from family and close personal connections, and is often tied to altruism or obligation rather than the expectation of a financial return.

Willingness to invest in MSMEs and sectoral and geographic Preferences

There are some middle class Nigerians who are actively seeking opportunities for profit-oriented direct financial investment in the small business sector. A complaint among them was the lack of information sources to help match would-be investors and investees.

These respondents acknowledge that a web platform listing businesses seeking start-up or expansion funding would be a desirable tool for providing wider access to information and options for investment. However, such a platform would need to be from a trustworthy source and provide verifiable information.

Although about half of the respondents had opinions on the sectors they would prefer to invest in, no dominant theme emerged. One-fifth of these named businesses related to primary agriculture and fishery, and upstream processing. Other areas mentioned included a variety of retail and wholesale trade, small-scale production and some services.

Geographic location of investment matters to middle class Nigerians. The main factors mentioned related to proximity, familiarity, civil security, population density and demand for goods and services. Language and cultural barriers were sometimes also mentioned. The preference is skewed towards the southern and middle belt regions in Nigeria.

Discussion and recommendations

Who are the middle class?

Defined in terms of income from all sources as a measure of their capacity to invest in financial assets and business, the middle class consists overwhelmingly of two groups, namely micro and small business owners employing staff on the one hand, and salaried workers in the government and formal private sector on the other. Solo workers such as freelancers in better paid trades and professions form a third, smaller group.

Other groups, mainly retired public and private sector workers, are a tiny fraction of the middle class, due both to their low number amid a population that is heavily dominated by younger age brackets, and their generally low incomes.

Although there are other middle class groups, our findings imply that **efforts to mobilise middle class wealth and income for investment in the MSME sector should be focused squarely on business owners and higher-earning formal employees where the mass of resources sits.**

Channelling middle class resources for MSME investment

The vast majority of liquid middle class wealth currently sits in bank accounts. Claimed interest in investing in the small business sector among middle class Nigerians is significant, however, and it seems likely that a substantial number would embrace MSME investment given appropriate models and acceptable "ticket sizes" of funds committed.

Farming and agricultural supply chains appear to be promising areas for development activity aimed at fostering middle class investment in small enterprise. In our research, agriculture was the most often spontaneously mentioned sector among middle class respondents interested in investing in MSMEs. Private sector financial innovation (such as "crowdfunding" firms) are already profitably focusing on this area, while previous DFID-funded work has identified further opportunities for farming-related small enterprise that could similarly attract organised investment.

Broadly speaking, MSME demand for finance and middle class demand for investment opportunities can be matched via two channels: direct business investment, and indirect or mediated investment.

Direct investment

Direct investment refers to lending or equity investment in a new or existing MSME. Direct investment typically involves a more or less sizeable individual stake, and acceptance of risk. It is appealing to those with a hands-on business orientation, confidence in their own judgment, and the time and ability to monitor and manage the investment.

Most MSME financing is obtained informally often acting out of altruism or obligation and the businesses concerned may well not prove investable to an outside party motivated only by financial returns. However, there are certainly untapped opportunities for middle class investors to invest directly in small businesses in a way that would be not only profitable but also economically beneficial in terms of employment and wealth creation, particularly since MSMEs are often not well provided for by banks. Our research shows that there is also considerable appetite for such investment among some of the middle class.

A major problem that policy work could address concerns search and matching between would-be investors and investees. Individuals with an active, hands-on orientation towards investing, wishing to find a business or business opportunity in which to make a direct investment, essentially have to do all the legwork themselves in physically identifying existing businesses (let alone businesses seeking investment), even if they have strong preferences for the business type or sector they wish to invest in. In the case of new business opportunities, the scope for matching would-be entrepreneurs with sympathetic investors is even poorer.

This was a forceful and spontaneous complaint among some of our qualitative interviewees wanting to invest directly in new or existing MSMEs. Stakeholders of our study need to address these complaints by looking at how, for example, suitable platforms or directories could be created and publicised. **A well-built, transparent and successful central platform, designed and funded as a neutral public service to private sector business and individuals, has enormous potential to increase direct investment in the MSME sector and go at least some way to improving the reputation of government and its agencies as a force for good among the small enterprise sector and the middle class.**

As well as government agencies, there may be scope for private sector initiative in developing peer-to-peer lending platforms. Our research, both quantitative and qualitative, shows overwhelming reluctance to invest directly in businesses remote from the investor, for fear of not being able to monitor the business and enforce the terms of the investment. There may be opportunities for the private sector in introduction and matching services at a local or regional level.

A second barrier to direct MSME investment concerns the time and effort costs of new business creation. Franchise businesses could alleviate several of these problems and are a promising route to direct MSME investment for middle-class Nigerians of this type, since they provide a relatively off-the-shelf means of investing in the creation of a business under a proven model and with support for ongoing management. Policy involvement in promoting franchising can also be focused on priority sectors for wider economic impact.

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Previous work for PDF II found that the franchising business concept is poorly developed in Nigeria and awareness of its possibilities is low. Our consumer research corroborates the latter finding. Yet franchise models appear to be a good route to investment for middle class Nigerians with a frustrated appetite for business ownership. **DFID should further its work with the franchise sector, not only to identify specific applications of the franchise model with positive development impact and to address policy and regulatory issues, but also to consider how middle class Nigerians could be made aware of the opportunities for investment.**

Indirect (mediated) investment

Indirect investment, via funds operated by financial institutions or through intermediary platforms, could potentially offer much wider access for the middle class to retail investment in the SME or micro sector, and so conversely (and more importantly) better access on the part of such businesses to middle class money as a source of finance.

Such investments can be offered with a range of durations and "ticket sizes", can be pooled to mitigate risk, and can be backed up by insurance. They can therefore be made palatable to middle class investors with a range of risk tolerances and preferences for payback duration, and with a wider range of income levels and regularity (including solo workers such as freelancers).

Availability of such indirect channels, and awareness of those that do exist, currently appear to be low. An embryonic crowdfunding sector is certainly emerging, particularly based around agriculture, but our survey shows that awareness and take-up are not widespread. Meanwhile, our understanding from the financial institutions we spoke to is that they do not offer investment funds focused the (M)SME sector. At the same time, as shown in research commissioned by PDF II, the private equity industry is underdeveloped and in any case requires levels of wealth and income typically well out of reach of even the higher-bracket middle class identified in our research. **There is a natural role for DFID or other stakeholders in bringing together financial institutions, investment firms and insurance providers to consider the design and marketing of retail investment funds or other vehicles that could attract middle class resources to the MSME sector.**

A second issue concerns trust on the part of consumers towards new forms of MSME investment, whether distrust or its opposite. While the owners of these innovative and currently unregulated online platforms are likely to resist falling under financial regulation in order to operate with a free hand, a total lack of industry standards or regulation, combined with the ease with which some Nigerians part with their money, must raise concerns. As we found in our interviews with such firms, consumers sometimes come forward to invest based on no more than social media marketing (e.g. Instagram), and this must raise the near-certainty that copycat scams will quickly emerge if the sector grows to meaningful size. The fallout from such abuse could then bring down a potentially promising channel of middle and sub-middle class investment in MSMEs. **Emerging online investment platforms require a policy and regulatory framework that sufficiently protects consumers and thereby facilitates sustainable growth of the sector.**

Likewise, the credibility of any new investment funds specifically devoted to the MSME sector would be enhanced by the participation of respected development finance institutions. **Co-investment by bodies such as the International Finance Corporation (IFC) and the World Bank in funds accessible to middle-class retail investors could be powerful stimulants for investment in MSMEs.**

Catering for diverse preferences among "the" middle class and its subgroups

Given our identification of two main economic groups within the middle class (small-scale owner-employers and formal sector salaried workers) and our broad separation of investment channels into direct (generally larger-ticket, higher-risk, hands-on) and indirect (smaller-ticket, lower-risk, passive), it is tempting to assume that there is a "market" for direct investments among existing business owners and a "market" for mediated investments among well-paid employees, with fairly uniform investment tastes within each.

In fact, investment preferences are idiosyncratic and cut across occupation types to a considerable degree. For instance, business owners appear to express more reserve than others in investing in the small business sector.

The message for providers is therefore that the middle class needs to be offered a variety of investment terms with respect to risk/reward, payback horizon, sector and so on, from which individuals can self-select.