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May 2014

Nigeria's renewal: Delivering inclusive growth in Africa's largest economy

Prepublication document

The McKinsey Global Institute

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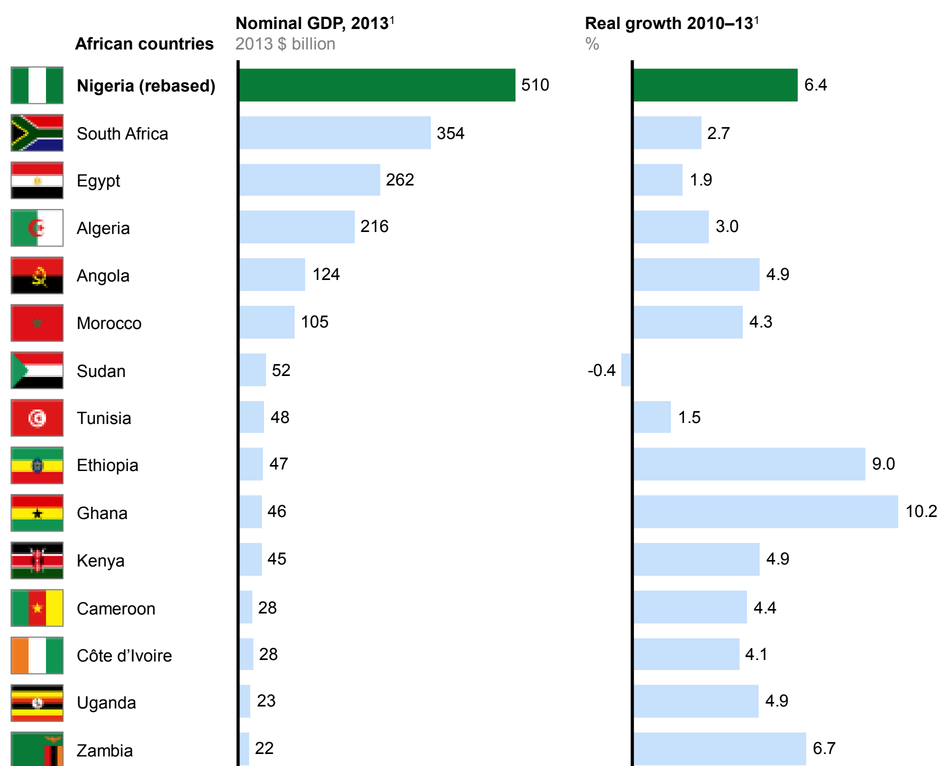
Executive summary

In this briefing paper, we focus on the immense economic and social potential of Nigeria and how this potential may be realised. While recent global attention has focused on violent unrest in certain areas of the country, less has been written about the significant economic progress that has been made in recent years. Nigeria has long been recognized as the largest African nation, due to its 174 million inhabitants, but is only now acknowledged as the continent's largest economy, too. Until this year, the extent of Nigeria's economic success had not been reflected in official data, which were based on 1990 price levels and a 1990 view of the economy's structure, which significantly under-counted GDP. In April 2014, the government began to release "rebased" data that show GDP of $454 billion in 2012 and $510 billion in 2013 (compared with the $259 billion and $270 billion that were reported previously), confirming Nigeria's lead over South Africa as the continent's largest economy (Exhibit E1).

Exhibit E1

"Rebasing" confirms that Nigeria is the largest economy in Africa



1 Economic data for some countries in 2013 estimated by the IMF.
2 Data for Nigeria rebased GDP are based on basic prices, the headline figure used by the Nigerian Bureau of Statistics.
SOURCE: IMF; Nigerian National Bureau of Statistics; McKinsey Global Institute analysis

In the following pages we look at how Nigeria can live up to its great potential. We examine the opportunities and challenges for the private sector as well as the measures that government and the social sector would need to undertake. Among our major findings:

- Since 2010, Nigeria's GDP growth has been driven primarily by productivity, which has contributed more (58 percent of total growth) than labour-force expansion.[1] Most GDP growth is coming from beyond the resources sector, in sectors such as trade. However, historical weaknesses in the agricultural sector and a poorly functioning urbanisation process have prevented most Nigerians from benefitting from this growth.

- Growth in four key sectors could result in additional GDP of more than $500 billion in 2030. Trade and infrastructure are likely to contribute the bulk of this growth, with the balance from manufacturing and agriculture.[2] Resources continue to make important contributions, including by supplying government revenue and exports, but account for only 14 percent of GDP.

- Nigeria's consuming class could grow to 160 million in 2030 in a population of 273 million—more consumers than the current populations of France and Germany combined.[3] Sales of consumer goods could more than triple by 2030, to almost $1 trillion. For example, Nigeria is projected to have the eighth-highest absolute sales growth in the world for bottled water from 2012 to 2020. Capturing this opportunity will require a granular approach to market opportunities—selecting the right cities and the right timing, while developing the key capabilities required to operate successfully in Nigeria.

- Strengthening government capabilities will be essential to making growth more inclusive. On health and literacy metrics, Nigeria lags behind other developing nations that spend a similar proportion of GDP in these areas. By employing well-established global practices to improve delivery of programmes and projects, Nigeria can achieve better results. In Nigeria, six elements are crucial to delivering programmes and services more effectively: empowering capable leadership, prioritising programmes, intensifying pressure to perform, using delivery units, building critical skills, and leveraging external stakeholders.

This briefing paper represents a preliminary analysis of the government's new data, which include restated results only from 2010 through 2013. Later this year we will release our full report on the Nigerian economy, which will provide further analysis.

1 By "productivity", we mean GDP generated per worker.

2 Retail and wholesale trade, as per the national accounts, which consist of the sales (but not the manufacturing) of consumer goods.

3 We define the consuming class as households with annual incomes above $7,500 per year. The average household size is 4.7 people.

Nigeria's renewal: Delivering inclusive growth in Africa's largest economy

The economies of Africa are now squarely in the sights of global investors and business leaders. Following economic booms in Asia and Latin America, Africa now holds the greatest potential for the type of transformational growth that can lift millions out of poverty, provide new fast-growth markets, and deliver superior investment returns. The McKinsey Global Institute has previously documented many of these opportunities in Lions on the move in 2010, Africa at work in 2012, and Lions go digital in 2013.

As the largest economy in Africa—in population, and now also in terms of GDP—Nigeria should be an attractive target for global investors. However, Nigeria has had a troubled history and suffers from a tarnished global reputation, related to issues such as corruption and civil unrest, which raise questions about whether it can continue to build on its recent success. We acknowledge the many challenges that Nigeria faces—particularly the quality of infrastructure and the inclusiveness of growth. But we also find that out-of-date misconceptions about Nigeria persist and these do not reflect its recent accomplishments. For example, Nigeria is no longer just a petro-economy—86 percent of GDP now comes from activity outside the resources sector. And contrary to widespread perception, the country has been surprisingly stable from an economic and political perspective; GDP has grown steadily and the current democratic regime has been in place for 15 years, with its fourth presidential election scheduled for next year.

The truth is that there are no simple truths about Nigeria. Its large, youthful population and its many cities provide the foundation for sustainable growth and rising productivity. In most developing nations, the process of urbanisation has been a reliable source of productivity and GDP growth: citizens move from low-productivity subsistence agriculture in rural areas to cities, where they are employed in more productive manufacturing and service jobs. Yet today Nigeria is one of the few places where the farm-to-factory transition has not yet moved most workers into more productive and remunerative activities. As a result, rather than lifting the economy, urbanisation has placed greater burdens on it. Productivity and GDP per capita are both growing at healthy rates today, but despite strong GDP growth between 1999 and 2010, poverty did not decline materially.[4]

Nigeria's recent growth is often poorly understood

Nigeria earned a reputation for erratic growth and instability in the decades following independence in 1960. Within a half-dozen years, Nigeria descended into civil war, which was followed by three decades of military coups and dictatorships, alternating with brief periods of civilian rule. After the collapse of oil prices in the 1980s, Nigeria accepted an International Monetary Fund rescue package. Religious and ethnic divisions have led to continuing strife in some

4 Based on pre-rebased GDP figures.

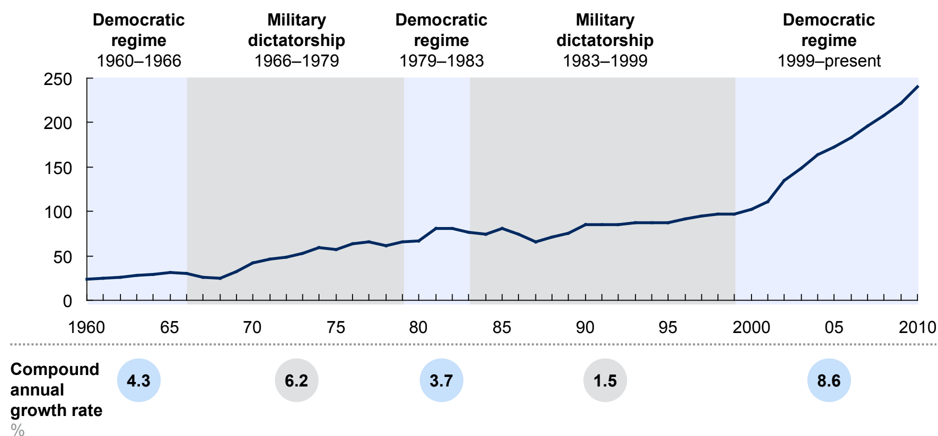
regions. This history has created an impression of Nigeria that reflects neither the substantial progress the country has made in the past decade nor the factors that point to sustained, stable growth in coming years. Exhibit 1 shows that despite these periods of historical instability, growth in Nigeria has accelerated since 1999 due to a number of fiscal and political reforms creating a more stable framework for growth.[5]

Exhibit 1

Nigeria achieved a dramatic increase in economic growth since 1999 under civilian rule

Periods of military rule

Nigerian economic output, 1960–present (based on pre-rebased historical GDP)
Real GDP
2013 $ billion



1 Note that currently rebased GDP is available only post-2010, so this chart uses the official GDP statistics based on 1990 structures and should be considered indicative only for the period between 1990 and 2010.
SOURCE: Conference Board Total Economy Database; World Bank; McKinsey Global Institute analysis

One of the most important under-appreciated changes in Nigeria is the growing size and strength of its consuming class. While median income is just $680 per year and 43 percent of the population lives below the poverty line, the number of households in the consuming class is growing rapidly. In 2013, an estimated eight million households had income of more than $7,500 per year—the threshold for what McKinsey Global Institute (MGI) considers as "emerging consumers", with sufficient income to meet all basic necessities and have money to start buying more and better food as well as health and education services. By 2030, the consuming class could include just over 34 million households and an estimated 160 million people. Today, Nigeria's consumer market is worth about $400 billion per year and could reach $1.4 trillion by 2030, with food and non-food consumer goods accounting for $1 trillion of the total.[6]

Given Nigeria's large population and rapid population growth, it is often assumed that labour-force changes (the number of people entering the workforce every year) are the main driver of GDP growth. However, labour productivity has grown by 3.6 percent per year since 2010 and now contributes the greatest share of GDP growth (Exhibit 2).[7] However, while labour productivity has been improving,

5 This slide is based on pre-rebased GDP data as the newly released government data go back only to 2010.

6 Includes spending on consumer goods, housing, telecom, transport, health care, and education.

7 By "labour productivity", we mean GDP per worker. This can be driven by increasing the capital per worker and so is related to the concept of "capital productivity".

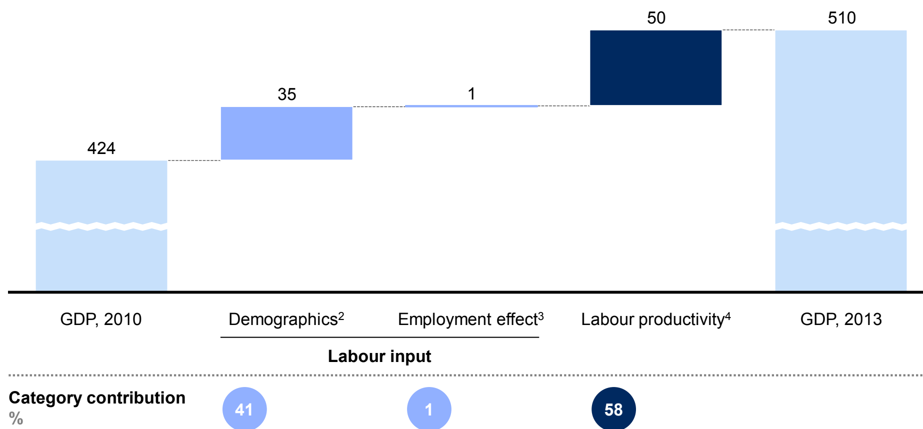
Nigeria is still far behind other major developing economies. At less than $9,500 per worker per year, Nigerian output is 58 percent less than the average of seven large developing economies. Nigeria also has a low ratio of employment to population. In Nigeria, the employment-to-population ratio is only 31 percent, compared with 52 percent in Brazil, 46 percent in Indonesia, and 48 percent in Russia.[8] Due to its low productivity and its low employment ratio, Nigeria has the lowest GDP per capita of seven peer economies (Exhibit 3).

Exhibit 2

Productivity has been the largest driver of Nigeria's growth since 2010

Contribution to GDP growth, 2010–13[1]

2013 $ billion

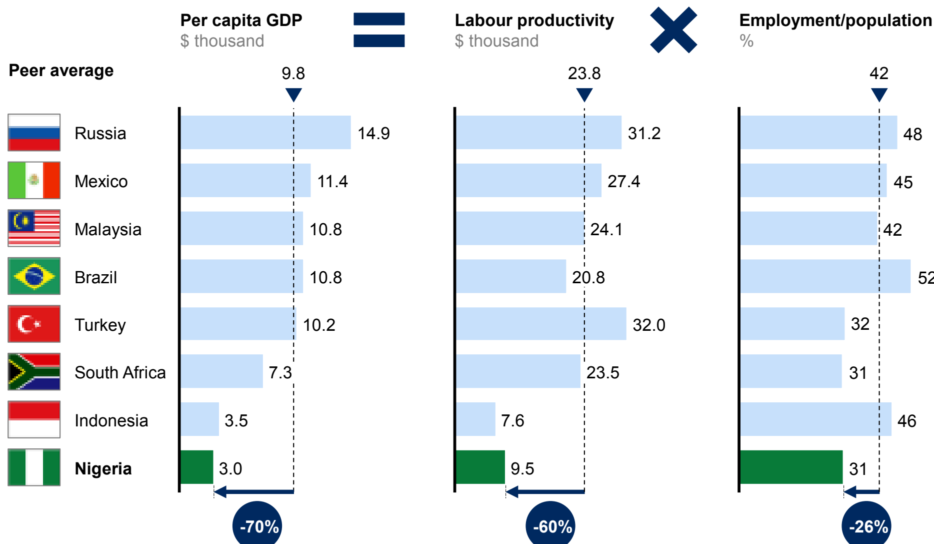


1 GDP at basic prices; the preferred measure of Nigerian NBS was used.
2 Based on the growth of population.
3 Changes in workforce participation and employment rates.
4 Labour productivity effect is growth in labour productivity, measured by real GDP per employee.
NOTE: Numbers may not sum due to rounding.
SOURCE: Nigerian National Bureau of Statistics; Conference Board; McKinsey Global Institute analysis

Exhibit 3

The gap in per capita GDP between Nigeria and other developing economies is driven mainly by labour productivity

2013



SOURCE: Nigerian National Bureau of Statistics; IMF; The Conference Board; McKinsey Global Institute analysis

8 Note that the employment-to-population ratio is not a measure of unemployment, since it also depends on the share of the population that is of working age and participating in the workforce.

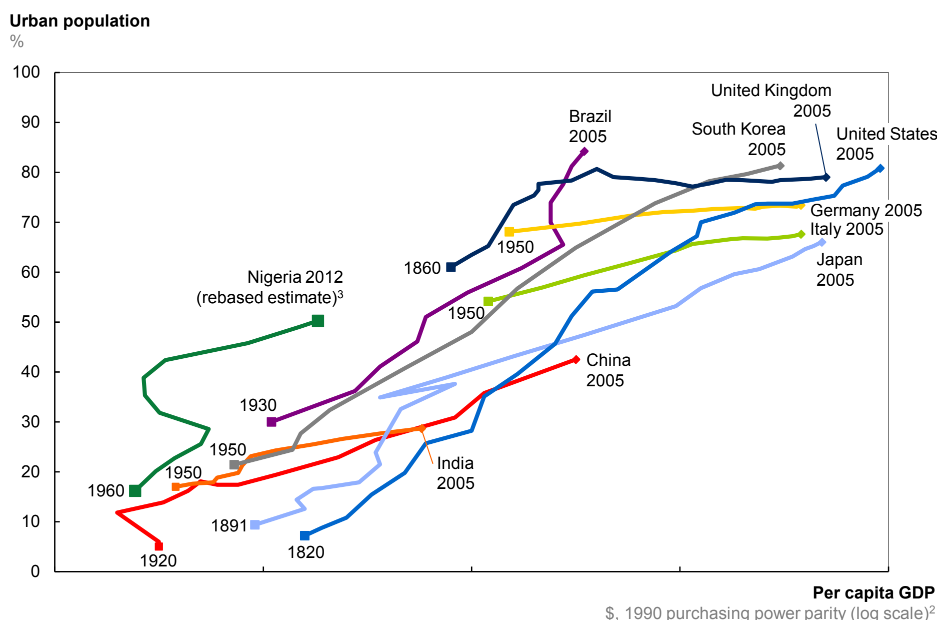
Nigeria's low productivity is to a large degree the result of its unusual experience with urbanisation, which is not transforming the economy in the way it has done in other transitioning nations (Exhibit 4).[9] Typically, as people move from agriculture into employment in urban manufacturing and services, they become more productive and earn higher wages, which raises living standards in both the city and the countryside. High urban wages attract more workers to the cities and reduce rural populations. City dwellers send remittances to their families at home, who invest in productivity improvements, such as fertiliser and mechanised tools. However, in Nigeria, people migrating to the city often face unemployment or find jobs in the informal sector, where wages are low. This also has negative implications for the agriculture sector. We discuss the underlying causes of this later in this paper.

Productivity is also being held back by poor infrastructure, which increases the costs of doing business. The "core infrastructure" stock in Nigeria is worth only 39 percent of GDP, compared with an average of 68 percent in other economies examined by MGI. Nigeria has a fifth of the roads per kilometre that India has and one-third the power generation capacity per person.[10]

Exhibit 4

Urbanisation is typically correlated with growth in GDP per capita, but this link is weak in Nigeria

Per capita GDP and urbanization[1]



1 Definition of urbanisation varies by country; pre-1950 figures for the United Kingdom are estimated.
2 Historical per capita GDP series expressed in 1990 Geary-Khamis dollars, which reflect purchasing power parity.
3 Estimate of rebased GDP numbers extrapolated from the four years of data available at the time of publication.

SOURCE: Population Division of the United Nations; World Bank; Angus Maddison via Timetrics; IHS Economics and Country Risk; census reports of England and Wales; Gail Honda, "Differential structure, differential health: Industrialization in Japan, 1868–1940," in *Health and welfare during industrialization*, Richard H. Steckel and Roderick Floud, eds., NBER, 1997; Paul Bairoch, *The economic development of the Third World since 1900*, Methuen, 1975; McKinsey Global Institute analysis

9 Note that Nigeria's low level of GDP per capita for its large urban population is mostly due to a deterioration in GDP per capita that occurred between 1980 and 1995 during the military regime.

10 *World development indicators 2012*, World Bank, 2012.

While the oil and gas sector has many opportunities to improve productivity, the large share of the economy that exists outside oil and gas is where the productivity gap to other countries emerges.[11] Every non-resources sector of the economy has lower productivity in Nigeria than in South Africa (Exhibit 5). In some sectors, the gap is particularly striking. In the manufacturing sector, for example, Nigerian output is just $5,100 per worker per year, while it is more than $27,000 in South Africa. In trade, productivity is a third of South African levels and within utilities, an area where Nigeria has long underinvested, productivity is just 18 percent of the level in South Africa.

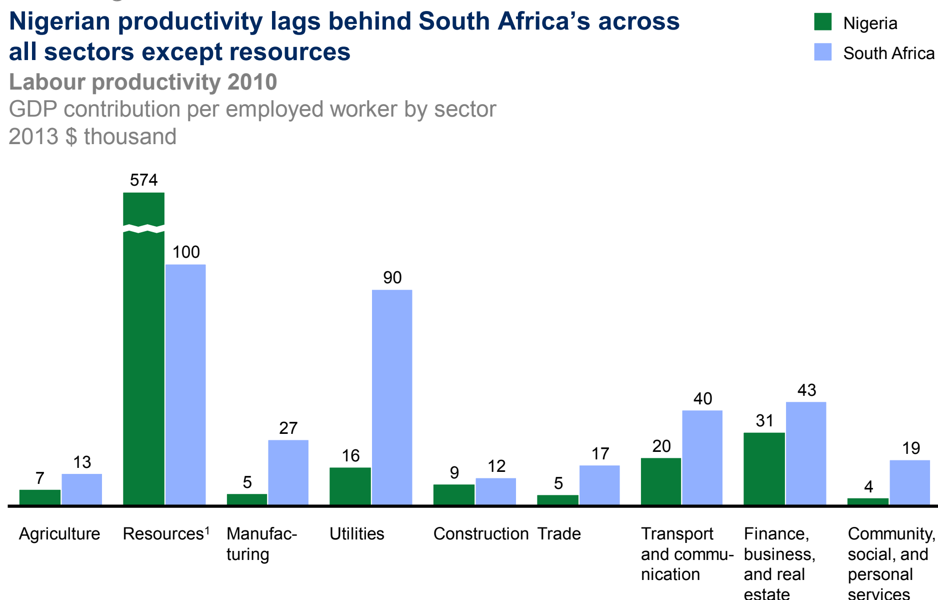
Exhibit 5

Nigerian productivity lags behind South Africa's across all sectors except resources

Labour productivity 2010

GDP contribution per employed worker by sector

2013 $ thousand



1 Nigeria has much higher productivity in resources because oil and gas is more capital-intensive than mining, which is the largest part of South Africa's resources sector.

SOURCE: Nigerian National Bureau of Statistics; Statistics South Africa; Badan Pusat Statistik; World Bank; McKinsey Global Institute analysis

One misconception, often held by those outside Nigeria, is that oil and gas is the dominant sector and the engine of growth in the Nigerian economy, as it is with several Middle Eastern economies. The recent rebasing exercise demonstrates that the natural resources sector is a smaller share of the economy than previously understood (see Box 1, "Rebasing: the changing structure of Nigeria's economy").

11 Nigeria's high resource productivity come from the sector's being dominated by oil, compared with South Africa, which has a large and more labour-intensive mining component.

Box 1. Rebasing: the changing structure of Nigeria's economy

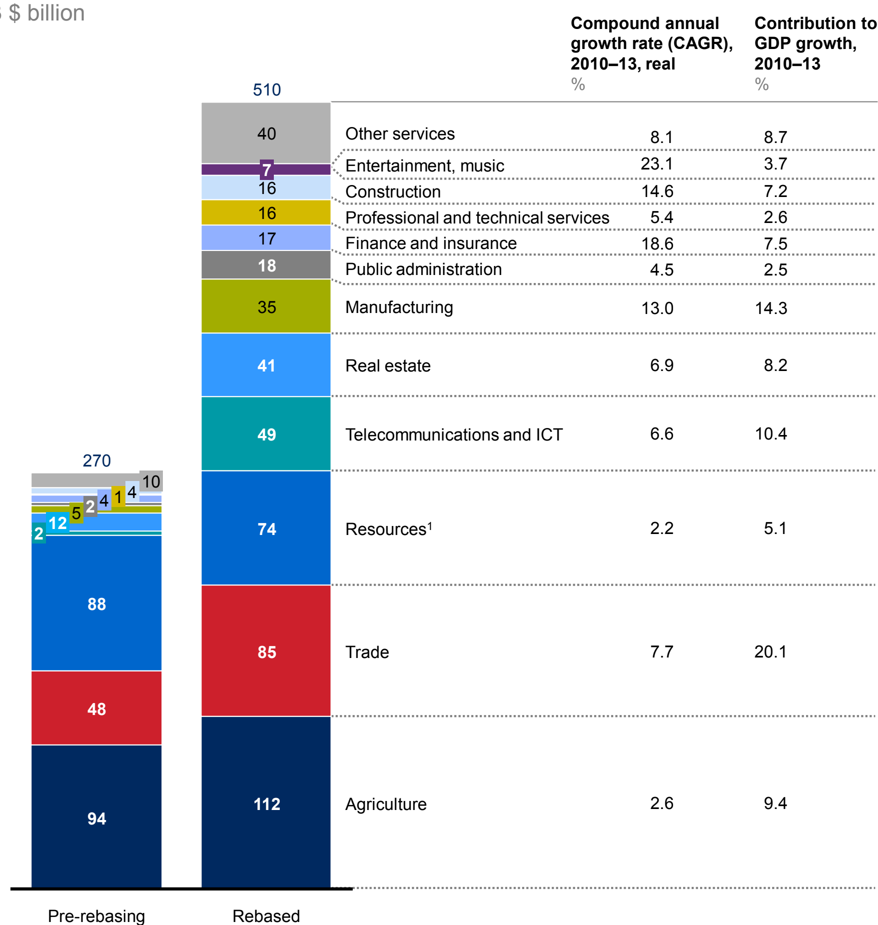
The recent rebasing exercise by the Nigerian National Bureau of Statistics, supervised and validated by the World Bank, International Monetary Fund, and African Development Bank, provides an updated assessment of the structure, growth, and price levels in the economy (Exhibit 6). Most of the increase in GDP due to rebasing has come from changes in manufacturing, real estate, communications and other services, which are all growing rapidly. However, restated real annual growth in agriculture at 2.6 percent is less than the previously reported 14 percent. The resources share of the economy has more than halved from 33 percent to 14 percent. The National Bureau of Statistics estimates a preliminary overall growth rate of 6.4 percent for GDP at real prices.

Exhibit 6

Rebasing shows more accurately the contributions of sectors such as agriculture, trade, and resources

Nominal GDP, 2013

2013 $ billion



CAGR, 2010–13 %	Pre-rebasing	Rebased
Nominal	7.7	13.8
Real	7.0[2]	6.4

1 Resources do not include oil refining, which is included in manufacturing.
2 For pre-rebased real CAGR, we use 2010–12, as real 2013 was unavailable.
NOTE: Numbers may not sum due to rounding.
SOURCE: Nigerian National Bureau of Statistics; McKinsey Global Institute analysis

While Nigeria is among the nations that MGI classifies as "resource-driven" economies, 86 percent of GDP is outside the resources sector.[12] The majority of GDP is actually in services, and agriculture is the single largest sector, contributing 22 percent of GDP. When we compare Nigeria with other oil-producing developing economies, we see that the resources sector of Nigeria represents a relatively small share of GDP (Exhibit 7). Furthermore, oil production has dropped in recent years and the sector is now growing by about 2.2 percent a year, compared with 6.4 percent for the economy overall.

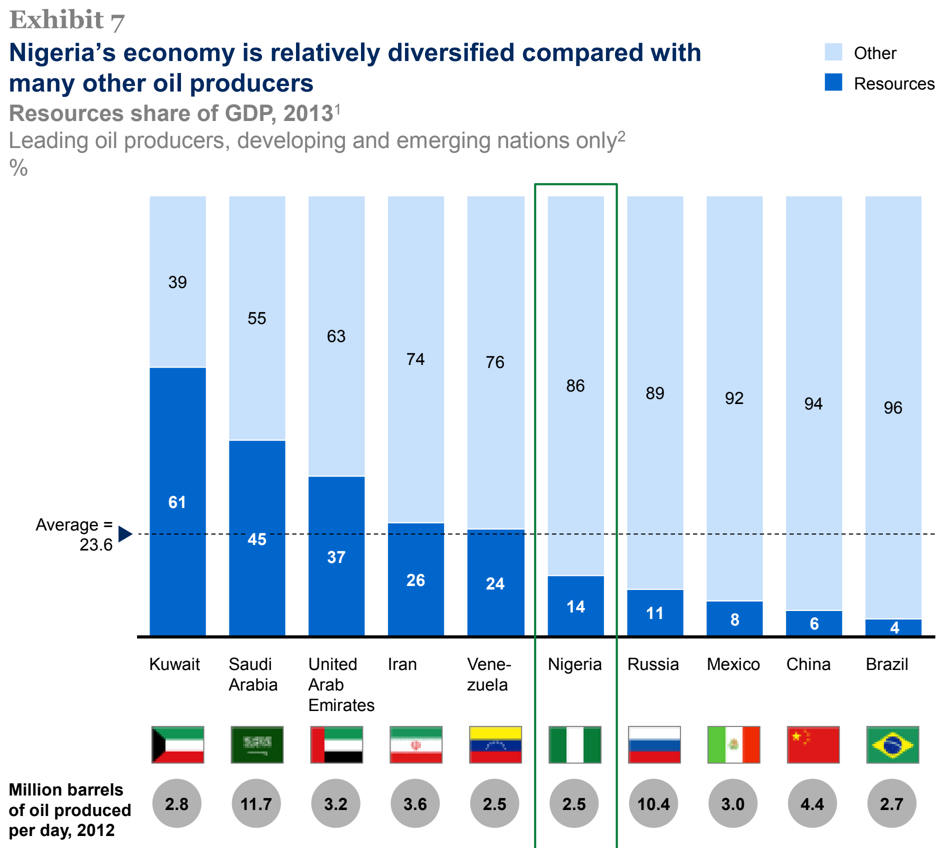
Exhibit 7

Nigeria's economy is relatively diversified compared with many other oil producers

Resources share of GDP, 2013[1]

Leading oil producers, developing and emerging nations only[2]

%



1 Calculated at basic prices. Data estimates by IHS Economics and Country Risk for some countries, as 2013 numbers were not available for all.
2 Developing or emerging nations as defined by IMF.
NOTE: Numbers may not sum due to rounding.
SOURCE: IHS Economics and Country Risk; Nigerian National Bureau of Statistics; US Energy Information Administration; McKinsey Global Institute analysis

Nonetheless, Nigeria remains highly dependent on oil. Some 75 percent of federal revenue comes from taxes on the oil and gas sector, and oil and gas make up more than 90 percent of exports, providing the critical source of foreign exchange to support Nigeria's consumption of imports. Also, oil revenue ultimately ends up as earnings for individuals, so that rising oil revenue from higher oil prices contributes to increased consumption.

12 MGI defines countries as being resource-driven if resources accounted for more than 20 percent of total exports, or more than 20 percent of government revenue, or more than 10 percent of GDP. See *Reverse the curse: Maximizing the potential of resource-driven economies*, McKinsey Global Institute, December 2013, for more details.

Recent growth has failed to reduce poverty rates

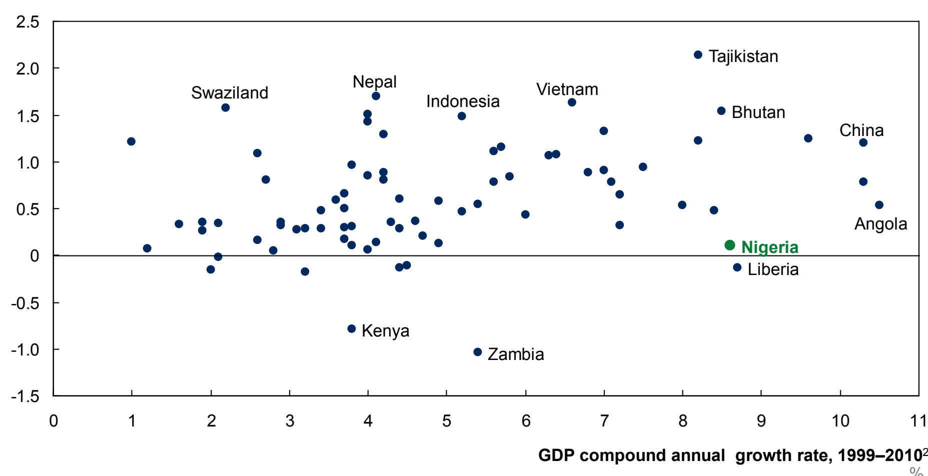
One common perception about Nigeria is accurate: the benefits of economic growth have not been shared across the population. Recently, there has been some progress in reducing poverty, but between 1999 and 2010, there was little improvement in poverty despite strong economic growth (Exhibit 8).

Exhibit 8

Despite rapid GDP growth, Nigeria has made little progress in reducing poverty

Historical economic growth (pre-rebasing exercise) vs. change in poverty[1]

Annual decrease in poverty rate, 1999–2010
Percentage points



1 Only countries with a 1990 poverty rate above 5% were included in analysis.
2 Based on "pre-rebasing" GDP data for Nigeria.
SOURCE: PovCal.Net; World Bank; McKinsey Global Institute analysis

SOURCES OF RURAL POVERTY: A BROKEN AGRICULTURAL MODEL

Poverty persists in both rural and urban areas, but mostly for a different set of reasons. We find three main drivers of rural poverty in Nigeria.

- **Low productivity.** Agricultural production has grown by 2.4 percent a year since 2000, barely keeping up with population growth.[13] The value of agricultural production has improved in part due to a shift to more valuable crops, such as cassava and yams (and away from less valuable crops such as beans, millet, and sorghum). Crop yields have also risen, but much of the improvement merely has made up for declining yields during the 1990s. As a result, yields remain well below benchmarks; for example, cereal yields are less than a third of those in China, Indonesia, and Brazil. These low yields reflect the low level of sophistication and poor farming practices of Nigeria's smallholder farmers, who have limited education about farming practices and have been unable to invest in seeds. Nigerian farms use an average of 6 kilograms (kg) of fertiliser per hectare of arable land, compared with 550 kg in Indonesia, 180 kg in China and India, and 18 kg per hectare in Ghana.[14] The limited investment in critical farming inputs reflects a lack of access to affordable capital. Only 25 percent of farmers use formal banking,

13 FAOStat, UN Food and Agriculture Organisation, 2012.

14 *World development indicators 2012*, World Bank, 2012.

compared with 82 percent of salaried workers in Nigeria.[15] Only 2.8 million out of 14 million farmers took out loans in 2012 to buy fertiliser, livestock, or seeds. The Agricultural Transformation Agenda, the most comprehensive reform of the agricultural sector that Nigeria has undertaken, includes a series of initiatives aimed at increasing competitiveness in agriculture and reducing reliance on imports. These reforms are too recent to be reflected in GDP numbers, but there are indications of early success. For example, food imports by Nigeria decreased from $13 billion in 2012 to $11 billion in 2013.[16]

- **Poor market access.** The way that fresh food and agricultural commodities are distributed in Nigeria sharply limits the share of value that farmers receive when goods are sold. The first cut occurs on the way to market, during which 20 to 50 percent of produce is lost to spoilage, higher than the average rate for either Latin America (3 to 14 percent) or the rest of sub-Saharan Africa (8 to 18 percent).[17] Nigeria lacks the proper infrastructure to keep produce fresh (in chilled trucks or rail cars) and get it to market quickly (via good roads and reliable train service). Currently smallholder farms (plots of less than 2 hectares), which make up more than 85 percent of Nigerian cultivated land, also lack access to processing, storage, and marketing facilities. At the end of harvest season, farmers often sell produce to traders, who have the capacity to store the food until prices are higher. Such middlemen capture 40 percent of the margin from rice production compared with only 32 percent captured by the farmer. In beef production, farmers capture only 24 percent of the margin. Nigerian farmers also fail to capture additional value from processing raw crops into higher-value products. For example, in Nigeria only 10 percent of cassava is processed into flour, sweeteners, and industrial products (the rest is used for direct human consumption), compared with 85 percent in Brazil and 95 percent in Thailand.[18] Farmers could potentially do some of this processing themselves, and they are also likely to capture greater value if demand increases due to downstream processing.

- **Population growth.** Unlike other fast-growing economies, in Nigeria, the rural population has continued to grow—by about 2.7 percent annually since 2000.[19] However, the amount of land under cultivation has not expanded as quickly, so that cropland per worker has actually been falling by 1.7 percent per year, restricting potential productivity increases linked to scale benefits.[20] Another effect of the rising rural population is to reduce the positive effects that urbanisation can have on farm incomes. Typically as cities and manufacturing capabilities develop, improved farming implements and machinery become more widely available and the cost of acquiring them is often partially underwritten by remittances from family members who have moved to the city. In Nigeria, however, poor employment and low wages in the cities and too many people back home in rural areas to support leave little remittance money for investments.

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15 *Access to financial services in Nigeria survey*, EFInA, 2010.

16 Note that real impact may be smaller due to increased illegal imports from neighbouring countries to avoid increased tariffs.

17 Jenny Gustavsson et al., *Global food losses and food waste: Extent, causes, and prevention*, UN Food and Agriculture Organisation, 2011.

18 FAOStat, UN Food and Agriculture Organisation; UN Conference on Trade; International Centre for Tropical Agriculture.

19 Canback & Company, 2013.

20 FAOStat, UN Food and Agriculture Organisation, 2012.

SOURCES OF URBAN POVERTY: HIGH INFORMALITY AND HIGH COSTS OF LIVING

In Nigeria, urbanisation has not had the strong effects on incomes that have occurred in other developing countries. In Nigeria's cities, formal job creation and skill development have been weak, and, as a result, urban incomes remain low. We identify three major reasons for this:

- **Informality among small business.** Nationally, 32 million Nigerians are employed in small or medium-sized businesses, the vast majority of which are informal enterprises, averaging only 1.8 employees per firm. Nigerians launch businesses outside the formal economy for two reasons: they have little access to formal employment, and they can avoid taxation and regulatory burdens with little risk of being caught or prosecuted. In addition, there are few incentives to operate formally. A key reason to formalise in most countries is to be able to enforce contracts, but Nigeria's ineffectual judicial system does not guarantee such protections in practice. As a result, businesses must rely on social trust, vastly limiting the range and size of transactions a business can contemplate.

  The economy pays a large price for informality. In Nigeria, productivity in urban-oriented work such as manufacturing and trade is actually less than agricultural productivity (Exhibit 9). One economic study found that one standard deviation in the size of the informal sector leads to a decline of one to two percentage points in the rate of per capita GDP growth.[21] In countries with high informality, it is rare to see a strong cohort of fast-growing small and mid-sized businesses that have access to capital and can drive job creation and innovation. In Nigeria, revenue from informal enterprises flows to the individual owners, meaning capital is not retained in the business and used for investment. Formal enterprises, by contrast, have a greater tendency to make capital investments, such as increasing store size or buying new machinery to raise labour productivity. Companies operating outside the formal economy have poor access to credit to build a business and invest in productivity-improving equipment and technology or to protect themselves from economic shocks. Some 85 percent of small businesses are funded with personal savings, and less than one-tenth receive bank loans; 98 percent are entirely uninsured.[22] The National Enterprise Development Programme (NEDEP), launched in February 2014, includes reforms aimed at addressing the constraints faced by small businesses and encouraging formalisation. The NEDEP is a promising new programme, but its benefits have yet to affect the broad economy.

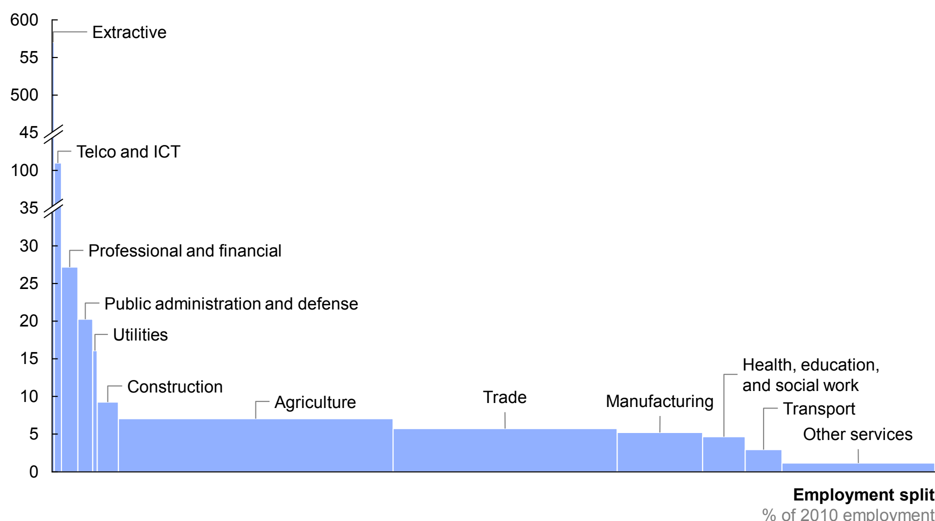
21 Ana Maria Oviedo, Mark R. Thomas, and Kamer Karakurum-Ozdemir, *Economic informality: Causes, costs, and policies—a literature survey*, World Bank, 2009.

22 *Survey report on micro, small and medium enterprises (MSMEs) in Nigeria*, Nigerian Bureau of Statistics and Small and Medium Enterprises Development Agency of Nigeria, 2010.

Exhibit 9

The productivity of urban-based sectors, such as trade and basic manufacturing, is lower than that of agriculture

Labour productivity
GDP contribution per employed worker by sector, 2010
2013 $ thousand



SOURCE: Nigerian National Bureau of Statistics; McKinsey Global Institute analysis

- **A lack of permanent hiring by large businesses.** Informality is not restricted to small, informal corporations. Major companies in Nigeria often hire workers off the books, sometimes engaging workers on a day-to-day basis to avoid taxes and circumvent regulatory burdens associated with formal contracts. This happens despite the relative flexibility of Nigeria's employment law, partially due to the excess supply of labour. Also, hiring full-time workers on formal contracts requires employers to comply with union-negotiated pay scales that can be significantly above market wages. While companies may save on wages, there are costs of informal hiring for employers and employees, including low commitment on both sides, low morale, and low productivity. Companies that use irregular, informal labour are much less likely to invest in training, and employees move from job to job without acquiring skills. This limits a worker's opportunities to join the formal economy, raise productivity, or earn higher pay.

- **High cost of living.** The effects of low incomes of many Nigerians are compounded by high costs of living in urban areas. Poor urban Nigerians are squeezed by the costs of food, housing, and transportation. Land is scarce, and the housing stock is limited in many of the large cities, such as Lagos and Port Harcourt. Public transportation is extremely limited, and road systems in Nigeria's cities do not have the capacity for traffic flows, particularly during commuting hours. Traffic delays are exacerbated by poor maintenance and poorly functioning traffic signalling systems. Nigeria is not the only country whose cities have congested roads, but many other nations are investing aggressively in rail and rapid transit systems.

If Nigeria can address the structural issues that lead to rural and urban poverty, it could create the link between GDP growth and poverty reduction seen in other developing economies. If structural reforms are made and implemented properly, and GDP growth averages 6.4 percent per year (as it has done over the past three years), we estimate that by 2030, more than 30 million Nigerians could escape poverty.

Nigeria is well positioned to benefit from global trends

Nigeria is well-positioned to benefit from a number of macro trends that are building in the global economy, such as the shift of demand to developing economies and the explosion of digital technologies. It could also be hurt by certain trends, such as the development of energy sources that would reduce demand for Nigerian oil. In addition, several potentially positive trends, such as urbanisation, could turn out to be negative if Nigeria does not adopt appropriate reforms and build needed capabilities.

- **Demand shifts.** Developing economies are already the fastest-growing markets for manufactured goods. MGI estimates that annual consumption in developing economies will rise from $12 trillion in 2010 to $30 trillion in 2025 and that it will account for nearly 50 percent of the world's total, up from 32 percent in 2010.[23] Some 1.8 billion people could be added to the ranks of the global consuming class, and, with the appropriate reforms, Nigeria could be well-positioned to meet this demand, within its own borders and beyond.[24]

- **Uncertainty in the resource sector.** Global investment in resources is set to double over the next 20 years to meet rising needs for fuel and other commodities.[25] However, with advances such as hydraulic fracturing and horizontal drilling opening up previously inaccessible reserves, Nigeria might not benefit fully from rising demand because of policies that make it less attractive than other potential development sites as well as operating challenges such as oil theft. Oil production has already declined by 7 percent, from 2.6 million barrels a day in 2011 to 2.4 million in 2013. If Nigeria cannot attract new investment in oil and gas projects, production could continue to fall—reducing both government revenue and the balance of trade, and weakening the broader economy.

- **The spread of the digital economy.** The number of mobile Internet users in Africa is expected to double by 2030. In nations such as Nigeria, smartphones are the primary form of Internet access. There are currently more than 100 million mobile phone subscribers and 50 million Internet connections in Nigeria, making it the largest mobile market in Africa. The number of mobile

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23 Yuval Atsmon, Peter Child, Richard Dobbs, and Laxman Narasimhan, "Winning the $30 trillion decathlon: Going for gold in emerging markets", *McKinsey Quarterly*, August 2012.

24 *Urban world: Cities and the rise of the consuming class*, McKinsey Global Institute, June 2012. In that report MGI defines the consuming class as individuals with sufficient income for significant consumption beyond daily necessities, about $3,600 per year in 2005 purchasing power parity terms. For our analysis of Nigerian consumers, we use a slightly different definition.

25 *Reverse the curse: Maximizing the potential of resource-driven economies*, McKinsey Global Institute, December 2013.

subscribers has been increasing by 23 percent per year since 2007.[26] Mobile Internet can enable citizens in even the most remote regions of developing nations to leapfrog into the digital economy by using their smartphones for e-commerce, banking, and payments. However, Nigeria is behind other developing economies in deriving economic value from the Internet. We estimate that the Internet contributes less than 1 percent of GDP in Nigeria, a third of the contribution in Senegal.[27]

- **Urbanisation.** As noted, urbanisation has not yet produced the expected benefits in Nigeria. However, urbanisation is expected to continue at about 4 percent per year, which would mean that 62 percent of Nigerians could be living in urban areas by 2030. If Nigeria can link urbanisation to rising productivity and incomes in that period, urbanisation could contribute an additional $640 billion to GDP by 2030. This is based on the urbanisation experiences of Brazil, South Korea, and the United States—countries in which GDP per capita rose by an average of 5.3 percent for every percentage point of urbanisation.[28]

NIGERIA HAS STRENGTHS THAT CAN HELP IT RIDE GLOBAL TRENDS

We find that Nigeria is well-positioned to ride many of the secular trends that we outline above. It has a strategic location, with access to other developing economies and an ocean port. It has a global megacity, a young and growing population, and a tradition of entrepreneurism. And, thanks to its oil and gas exports, Nigeria is in a much stronger fiscal position than many other economies in Africa.

- **Advantageous regional and global location.** Nigeria is situated in the heart of West Africa and in a good position for trading and collaborating with Europe and North America. International companies see Nigeria as a launching platform for expansion across West Africa and ultimately the rest of the continent. Nigeria is only a short detour from the major trade routes connecting Europe with South Africa and Brazil. Nigeria's working day overlaps with the working day of more than one billion people living in Europe, the northeast corridor of America, and Brazil's future megacities.[29]

- **Coastal mega-city.** Lagos is one of only two costal megacities in Africa (the other is Cairo). Historically, being coastal has been associated with higher economic growth rates.[30] Lagos is a favourable location for trade, tourism, and industry. Nigeria could derive greater benefits from its coastal location by reforming port operations and streamlining customs processes. Lagos has also benefitted from a state government often cited as among the most competent and effective in Nigeria. With the right reforms, there is a possibility

26 *World Telecommunication Indicators Database*, International Telecommunication Union, 2012.

27 *Lions go digital: The Internet's transformative potential in Africa*, McKinsey Global Institute, November 2013.

28 This is an analysis based on a correlation between urbanisation and growth; there are multiple interacting causes of economic growth, only some of which are associated with urbanisation. Therefore these growth numbers should be considered indicative only.

29 According to the World Bank, *World Development Indicators 2012*, the population of Brazil, the eastern United States, and Europe is 1.18 billion.

30 Paul Collier, "Africa: Geography and growth", *Journal TEN*, Federal Reserve Bank of Kansas City, Fall 2006.

that Lagos and its surrounding region could thrive, even if there are structural challenges elsewhere in the country.

- **Economies of scale.** Nigeria is home to one in four people in sub-Saharan Africa, providing local companies with the potential to develop economies of scale without having to navigate international barriers. Nigeria's size also provides a domestic market that is large enough to draw international attention and investment.

- **Entrepreneurial population and talented diaspora.** Nigerians are very entrepreneurial. According to the Global Entrepreneurship Monitor, 21 percent of individuals run their own businesses, and 81 percent of people see entrepreneurship as a desirable career choice.[31] Nigeria ranks in the top 10 countries for these measures. The return of a talented diaspora to Nigeria could be accelerated. An estimated 17 million Nigerians live overseas and already contribute remittances that account for approximately 10 percent of Nigeria's GDP.

- **Macroeconomic stability.** While large oil exports are often seen as a mixed blessing in developing economies, they provide Nigeria with the advantage of a secure public budget and a positive balance of payments. As a share of rebased GDP, public debt has shrunk to 11 percent of GDP. Nigeria could continue to maintain its macroeconomic stability, especially with the use of a prudent benchmark oil price in its budgets.

- **Young population.** Many aging advanced economies, particularly in Europe, face the prospect of slow growth due to flat or declining populations, but Nigeria and other developing economies have large and growing working-age populations, which can be drivers of growth. Nigeria already has the ninth-largest workforce in the world, and by 2030, the number of Nigerians of working age (15 to 64) is expected to be 50 percent higher than today. At current labour participation rates (56 percent) that could add 0.8 percent per year to GDP; if labour participation rates can be raised to Indonesian levels (68 percent), labour inputs could add 1.0 percent to annual GDP in 2030. However, if millions of young people coming into the labour force cannot find jobs, Nigeria could experience rising poverty rates and higher risk of social upheaval.

To take full advantage of these strengths, Nigeria needs to overcome some major challenges, such as poor infrastructure, barriers to doing business (such as excessive bureaucracy and corruption), and low skill levels. Infrastructure continues to be a major challenge, constraining growth across all sectors. In Nigeria, the electric power infrastructure is inadequate and unreliable, forcing companies to supply their own auxiliary power with expensive diesel generators. Nigeria also has a housing deficit of 17 million units, pushing up urban rents and contributing to a high cost of living.

Despite recent improvement, Nigeria still has a reputation for widespread corruption. It ranks 144 out of 177 countries on Transparency International's 2013 Corruption Perception Index. Corruption not only deters foreign investment, but it also hinders organic growth, acting as an additional and unpredictable tax on

31 *Adult population survey data*, Global Entrepreneurship Research Association, London Business School, 2013.

companies. For manufacturing firms in Nigeria, paying bribes raises the cost of doing business by an estimated 3.2 percent of sales.[32]

Low levels of skills in the workforce reduce the effectiveness of employees. For example, 70 percent of federal civil servants have only high school education or less and fewer than 5 percent have modern computer skills.[33]

Growth in four key sectors could contribute close to $800 billion to GDP by 2030

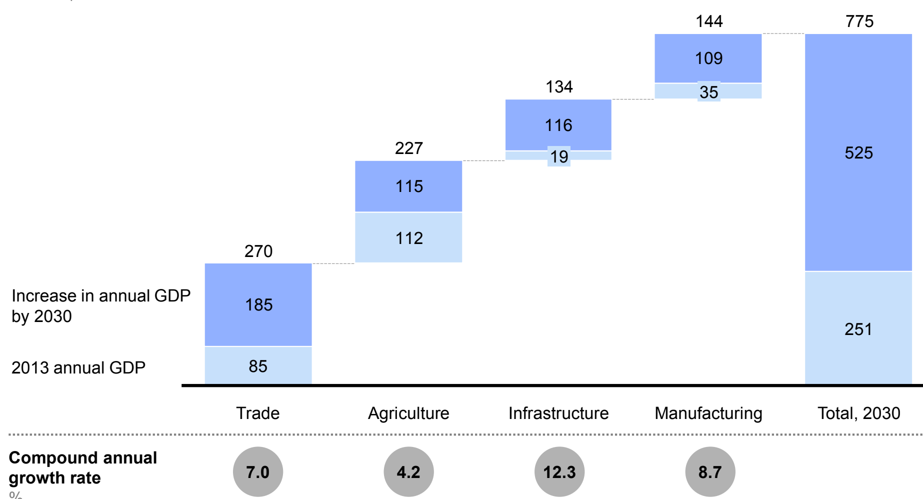
Drawing on the government's rebased data from 2010 to 2013, we have performed a bottom-up analysis of the potential GDP contribution from four key sectors by 2030. The selected industries—trade, agriculture, infrastructure, and manufacturing—will be among the most important in driving GDP and productivity and contributing to inclusive growth in Nigeria. We estimate that together these four industries could account for $775 billion of GDP by 2030, up from $251 billion in 2013 (Exhibit 10). In our full report, to be released later this year, the McKinsey Global Institute will project the upside potential for the entire Nigerian economy based on the latest set of rebased data.

Because we have considered the growth in only these four sectors, we cannot, at this stage, project the potential for the full Nigerian economy, as other sectors will also play an important role and would expand at different rates.

Exhibit 10

Four sectors—trade, agriculture, infrastructure and manufacturing—could add more than $500 billion to GDP by 2030

GDP contribution
2013 $ billion



NOTE: Numbers may not sum due to rounding.
SOURCE: Nigerian National Bureau of Statistics; IHS Economics and Country Risk; FAOStat; World Bank; C-GIDD; McKinsey Global Institute analysis

32 Giuseppe Iarossi and George R. G. Clarke, eds, *Nigeria 2011: An assessment of the investment climate in 26 states*, World Bank working paper number 71891, 2011.

33 Olukemin Lawanson and Babatunde Adeoye, "Public sector reforms: Implications for human resource management in Nigeria", *British Journal of Arts and Social Sciences*, volume 13, number 11, 2013.

WHOLESALE AND RETAIL TRADE

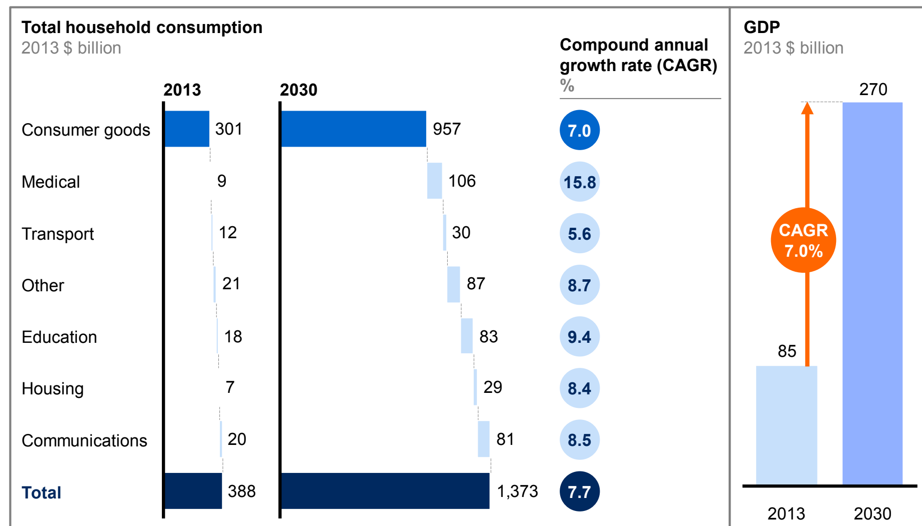
We estimate that wholesale and retail trade could continue to show strong growth to 2030—about 7 percent a year—resulting in annual industry contribution to GDP of $270 billion by 2030, up from $85 billion in 2013 (Exhibit 11). This growth would be driven primarily by rapidly rising household consumption as Nigeria's average income rises along with continued strong GDP growth. Based on our analysis, household consumption of consumer goods could grow by 7 percent a year to 2030, which should result in a similar growth rate in wholesale and retail trade.

Exhibit 11

Growth in consumer goods purchases should raise trade GDP from $85 billion to $270 billion by 2030 at annual growth of 7.0 percent

Total consumption is expected to reach $1.3 trillion, with food spend remaining high as most consumers are emerging and middle class

Trade GDP could rise from $85 billion in 2013 to $270 billion in 2030



SOURCE: C-GIDD; Nigerian National Bureau of Statistics; IHS Global Insight; McKinsey Global Institute analysis

Nigeria's burgeoning consuming class could particularly have an impact on demand for a range of food and non-food products. Sales of food and beverages, for example, are expected to rise by 6.7 percent per annum over the period, while sales of non-food consumer goods such as household and personal care products—a far smaller category—are expected to grow at more than 10 percent per year. Together, sales in these categories could contribute $185 billion a year more to GDP by 2030, reaching a total of $270 billion. Food will continue to account for the largest share of total consumption in 2030 since the majority of new consumers will be in the entry-level strata of the consuming class where food spending still represents a relatively high proportion of total income. However, as incomes rise, the share of consumption devoted to food should decrease from just over 70 percent in 2013 to just over 60 percent in 2030, creating greater potential for spending in other categories.

The new wave of consumers in Nigeria represents a huge opportunity for consumer-facing businesses such fast-moving consumer goods or retail banks. But to capture the full potential, these companies need to improve productivity and target the most important pockets of consumer demand in cities across Nigeria. Today companies in the trading sector have low productivity—about $4,800 of output per worker per year in 2010 vs. $16,800 in South Africa. This accounts for 32 percent of Nigeria's overall productivity gap to South Africa.

Several factors limit productivity in the trade sector. In retail, for example, securing land and developing new modern-format stores can be expensive and time-consuming, and there are significant challenges in supply chain management, given poor infrastructure and the limited number of large-scale local suppliers. In addition, the high costs of manufacturing in Nigeria present margin challenges when catering to a nation of value-conscious consumers.[34] Nigeria will need to address these challenges to realise the potential for GDP growth in the trade industry.

AGRICULTURE

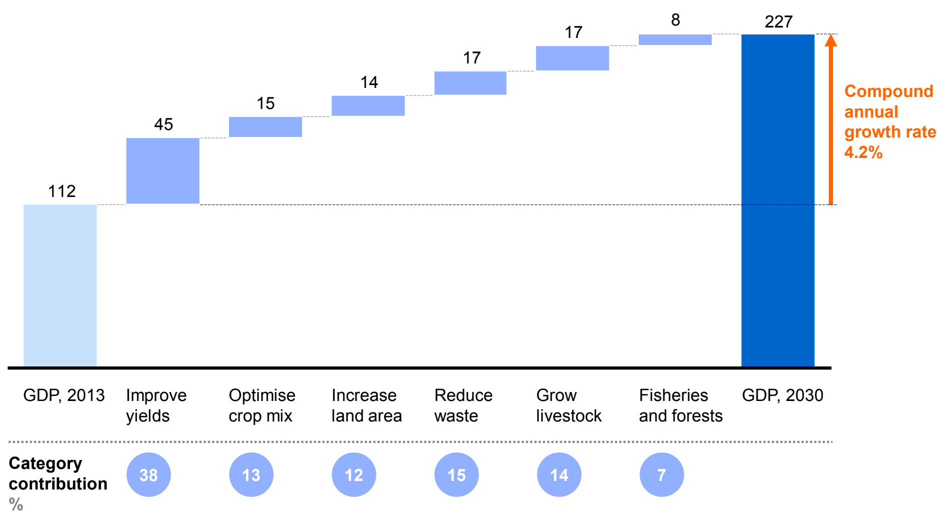
Nigeria could more than double agricultural sector output, from $112 billion per year in 2013 to $227 billion by 2030, raising the annual growth rate to 4.2 percent from 2.6 percent in recent years (Exhibit 12). Capturing this potential would require a four-pronged approach—boosting yields, shifting more production into high-value crops, reducing post-harvest and distribution losses, and increasing scale in production.

Exhibit 12

Nigeria's agricultural output could double by 2030, based on increased cultivation area, higher crop yields, and higher value crop mix

Projected GDP growth in Nigeria's agricultural sector

Real value added, basic prices, 2013 $ billion



NOTE: Numbers may not sum due to rounding.
SOURCE: FAOStat; Global Agro-Ecological Zones; McKinsey Global Institute analysis

The biggest opportunity in agriculture is improving crop yields, which accounts for 39 percent of the upside potential. Rice yields in Nigeria today are only 71 percent of South African levels and 36 percent of Brazil's. Cassava yields are half Indian levels. We believe yields could reach approximately half their ecological potential (based on soil and climate types, as determined by the UN Food and Agriculture Organisation), rising by around 40 percent on average and creating overall value of $45 billion per year by 2030. In order to increase yields, Nigeria needs to build on the work of the Agricultural Transformation Agenda to ensure that Nigerian farmers can gain access to the fertiliser, equipment, and other inputs needed to raise yields to levels of other large developing economies.

34 *Africa's growing giant: Nigeria's new retail economy*, McKinsey Consumer and Shopper Insights, December 2013.

Agricultural output can be improved further by shifting crop mixes away from lower value crops (such as sorghum and millet) to more high value-added crops (such as fruits, vegetables, and palm oil). Currently, crop choice is often determined by cultural or historical factors. By shifting 15 percent of the land area within each state to higher-value crops, Nigeria could raise agricultural output by $15 billion per year in 2030.

In addition, there is potential to significantly increase the amount of land under cultivation of high value crops in each state, without requiring further deforestation. To do this, Nigeria would need to reduce barriers to adding farmland, such as ineffective systems for determining land ownership, which have historically limited additions to farmland. In Nigeria, 76 million hectares of non-forested land are available for agriculture, of which only 55 percent is currently used as cropland. By addressing land titling issues, Nigeria has the potential to increase farmland by 0.7 percent a year without requiring further deforestation (the rate expected by the FAO across sub-Saharan Africa), adding six million hectares of farmland without clearing more forest by 2030.

Currently, small Nigerian farmers lose as much as half their harvests of certain crops to spoilage and waste, due to lack of access to markets and affordable storage. Together with improving rural infrastructure (such as improved roads), we believe this could reduce waste in the food distribution system to Latin American levels.[35] Finally, our growth model assumes that livestock cultivation continues to grow at strong historical rates (6.2 percent per year), while fisheries and forestry grow in line with peer countries at 5.0 percent annually.

If Nigeria can fulfil its aspiration to re-accelerate growth in agriculture, the sector can once again be a key driver of overall economic growth as well as a strong force in reducing poverty. Rising farm incomes, driven by higher productivity, would play a significant role in reducing rural poverty, while supporting a more effective urbanisation process, leading to reductions in urban poverty as well.

MANUFACTURING

Manufacturing in Nigeria is at a relatively early stage of development, contributing $35 billion, or about 7 percent of GDP in 2013. It has, however, achieved strong growth recently, with output rising by 13 percent per year from 2010 to 2013. We expect the growth rate to moderate over the longer term; double-digit growth rates are seldom maintained over a 20-year time horizon. From 1990 to 2010 China and Vietnam were the only economies of significant size that were able to maintain manufacturing value-add growth rates above 8 percent (11.8 percent and 10.6 percent, respectively).

We believe Nigeria is more likely to follow the pattern seen in high-growth developing countries such as Indonesia, Malaysia, and Thailand during their periods of strongest expansion in manufacturing. The contribution of manufacturing to GDP at the start of these countries' growth periods is much more like that of Nigeria today than those of China or Vietnam in the early 1990s. During 18 years of rapid industrialisation and accelerating development

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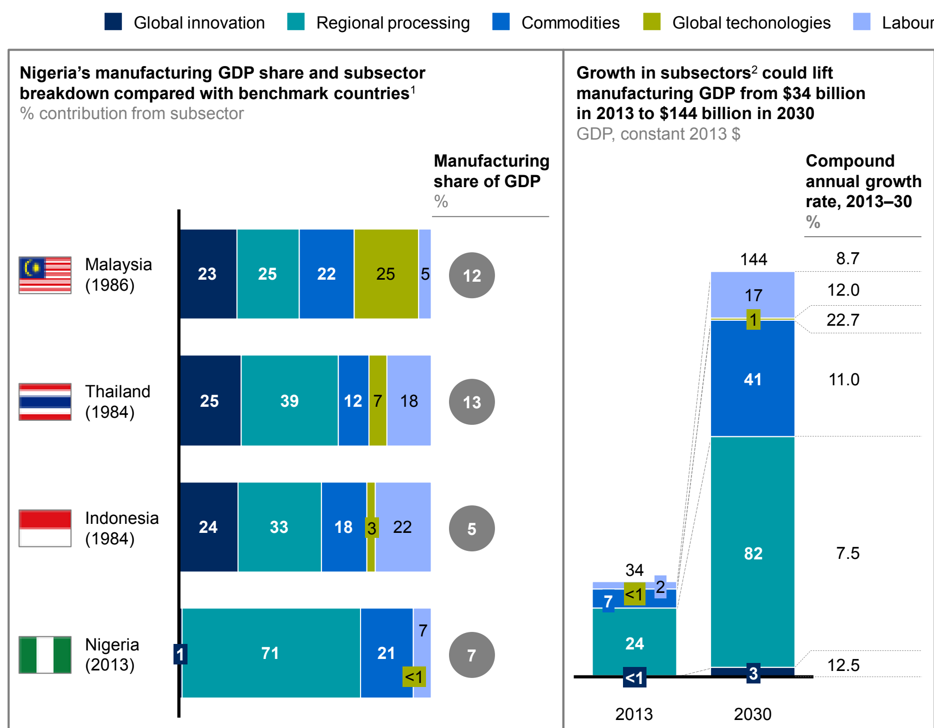
35 Waste, as estimated by the FAO, varies by crop. Sub-Saharan African levels of waste vary between 8 and 18 percent for post-harvest losses and from 13 to 43 percent across the whole value chain (agricultural, post-harvest, processing, packaging, and distribution). Latin American levels vary between 3 to 14 percent for post-harvest losses and from 11 to 37 percent across the whole value chain.

in Indonesia, Malaysia, and Thailand, manufacturing grew by between 8 and 11 percent per year (Exhibit 13). While the starting years for the expansion in these countries varied, all were able to double manufacturing's contribution to GDP in the space of five years, the goal of the Nigeria Industrial Revolution Plan (NIRP). Should Nigeria be able to match the achievements of these countries, we expect it to achieve similar growth, which would result in a fourfold increase in output by 2030, reaching $144 billion per year (at an annual rate of 8.7 percent).

Exhibit 13

Based on the pattern set by countries such as Indonesia, Malaysia, and Thailand, Nigerian manufacturing GDP could grow by 8.7 percent a year



1 Benchmark countries and time periods selected on the basis that they were able to double manufacturing's share of GDP in five years from the starting year—the goal of the Nigeria Industrial Revolution Plan (NIRP).
2 Growth by subsector from each of the benchmark countries used to project Nigerian subsector growth.
NOTE: Numbers may not sum due to rounding.
SOURCE: IHS Economics and Country Risk; NIRP; McKinsey Global Institute analysis

Currently, Nigeria's manufacturing sector is composed primarily of regional processing industries such as food and beverage, rubber, and plastics (71 percent), commodities-intensive industries like refined petroleum and basic metals (21 percent), and labour-intensive industries such as textiles (7 percent). Overall, manufacturing's contribution to GDP today is 7 percent, similar to that of Indonesia at the start of its growth period in 1984. Indonesia's manufacturing sector was also highly concentrated in regional processing, commodities-intensive and labour-intensive subsectors, although Indonesia had a relatively strong presence in global innovation for local markets industries (such as motor vehicles and chemicals). The breakdown of Thailand's manufacturing sector at the start of its transition period shows a high degree of consistency with that of Indonesia. Neither country, however, had established a well-developed global technology subsector (computers, electronics, and medical equipment) in 1984 as was the case for Malaysia in 1986, which had a much smaller base in labour-intensive industries than the other countries.

We see potential for Nigeria to emulate the growth achieved by these three countries across the manufacturing subsectors, leading to a significantly larger manufacturing sector, which would still be concentrated in regional processing, commodities-intensive, and labour-intensive industries. Given Nigeria's small base in 2013, global innovation would likely remain a smaller subsector in Nigeria.

Government support is often a key factor in expanding manufacturing in developing economies. To raise manufacturing output, the government has launched the NIRP, which targets key industries where Nigeria has comparative advantages for special attention. The goal of NIRP is to double the size of manufacturing in the next five years and address obstacles to manufacturing competitiveness in areas such as industrial infrastructure, industrial skills, technology and innovation, product standards, financing, investment climate, and local patronage. Already, new policies have been created to support manufacturing in both the sugar and automotive sectors. The creation of staple crop processing zones provides favourable terms for agribusiness to develop. In addition, NIRP aims to drastically improve access to gas for industrial use, particularly in the north, and establish more industrial parks to encourage investment in local manufacturing.

Nigeria will also need to continue to attract foreign companies to build up Nigeria's manufacturing sector. Foreign direct investment (FDI) brings not only capital, but also capability transfers as local employees acquire skills by working for multinationals. Annual FDI inflows have remained relatively steady, averaging $7 billion per year between 2007 and 2012, making Nigeria the top destination for FDI in Africa. Although the oil and gas industry still accounts for the bulk of foreign investment in Nigeria, a noticeable shift has begun to take place over the past decade. From 2009 to 2013, the services sector received an estimated 51 percent of FDI inflows, up from 12 percent from 2004 to 2008.

For Nigeria to continue this trend and significantly increase foreign direct investment in areas beyond resources, the government will need to do three things:

- **Build a pipeline of attractive investment opportunities.** Companies invest in deals, not in countries. Rather than simply promoting FDI broadly across all sectors, industries should be prioritised based on Nigeria's relative strengths and long-term economic strategy. This should provide investors with specific (and attractive) investment options to consider.

- **Improve the business environment.** A significant barrier to FDI growth in Nigeria is its difficult business environment. Nigeria has one of the poorest reputations globally in such areas as providing electricity for new businesses, registering property, and paying taxes. Providing tax incentives, streamlining business setup process, removing regulatory barriers, prioritising infrastructure development, and investing in local talent can help improve the business environment for foreign investors.

- **Build a world-class investment promotion agency.** International best practice suggests that all efforts to increase FDI in a country should be coordinated by one government organisation that can act as a "one-stop shop" for promotion, cultivation, and ongoing support of companies looking to invest. Singapore established the Singapore Economic Development Board to fulfil this function. In Nigeria, such a body already exists in the form of the

Nigerian Investment Promotion Commission, and so efforts should be focused on strengthening this organisation to improve its effectiveness.

INFRASTRUCTURE

While infrastructure is not defined as a single sector in national accounts, in this analysis we consider core infrastructure sectors (construction, transportation and storage, electricity, gas and steam supply, and water supply, sewerage, and waste management) and real estate. We look at the level of infrastructure investment needed to support expected growth, as well as the economic contribution that could be realised from operation of this infrastructure (except in the case of telecommunications; the analysis of potential GDP contribution from improved telecommunications infrastructure will appear in our full report).[36]

There is a large need for investment in infrastructure in Nigeria. Based on extensive analysis of available data and interviews with stakeholders in the country, MGI estimates that there is potential for investment of $871 billion in core infrastructure through 2030 to support an upside GDP growth scenario. The bulk of this investment would be in electricity and transportation systems, but there is also significant need in telecommunications and water infrastructure. Together these investments would raise the size of the construction sector in 2030 by $41 billion over the 2013 level. Use of improved water, electricity, and transportation infrastructure could contribute an additional $38 billion to 2030 GDP.

Nigeria also presents a large potential opportunity for real estate investment, if effective reforms in the regulation of foreign investment and land ownership can be enacted. India and Indonesia, despite similar income levels, have built significantly more residential, commercial, and industrial space than Nigeria. To close just half the current gap with those two countries by 2030, Nigeria would need to invest a further $644 billion. This would lift the contribution of the real estate sector to GDP by $37 billion to $41 billion in 2030. Between core infrastructure and real estate investments, total infrastructure investments in Nigeria could reach $1.5 trillion between 2014 and 2030 in an upside scenario (Exhibit 14). In total, infrastructure could contribute $134 billion to GDP in 2030, up from $19 billion in 2013, achieving an annual growth rate of 12.3 percent over the period.

To achieve success in its infrastructure development programme, Nigeria can look to examples of other countries that have made large and rapid investments in infrastructure to enable growth. Between 2004 and 2012, China increased its road network by 59 percent, and Malaysia increased its network by 179 percent. From 2007 to 2012, India increased the length of its rail network by 32 percent. From 2007 to 2010, Morocco increased electricity production from renewable sources by 3.5 times.

The Nigerian National Planning Commission is working on a National Integrated Infrastructure Master Plan (NIIMP) that aims to develop infrastructure throughout the country between 2014 and 2043. This effort should prioritise the two most important aspects of infrastructure in Nigeria: power and transportation. Already, Nigeria has made important progress in power sector reform through

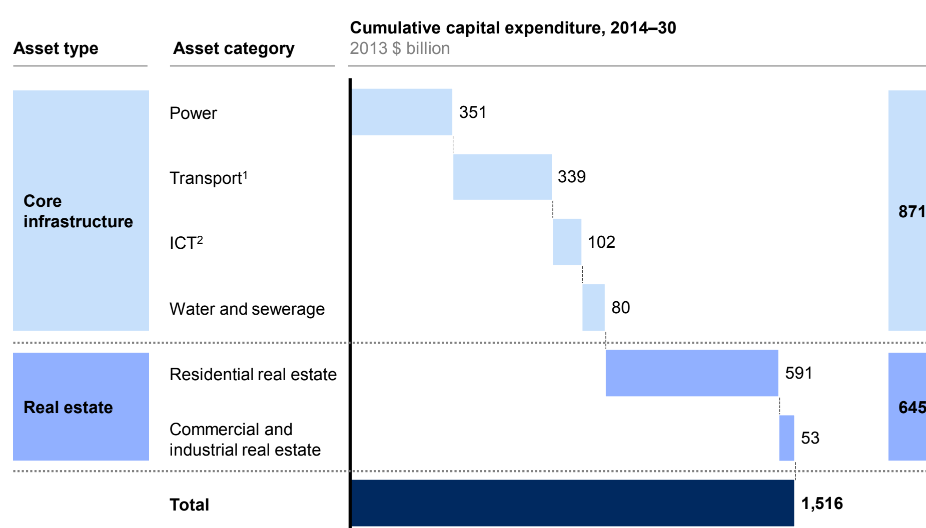
36 Sizing only refers to the additional GDP in the directly related economic sector. Economy-wide effects are not included.

a privatisation programme, under which Nigeria's generation and distribution companies have been privatized and management of the transmission system has been outsourced. It is important to note, however, that ongoing investment in privatised power plants and in the transmission grid will be required.

While the NIIMP focuses on investment needs assessment, financing models, and creating a rigorous execution plan, the government should also focus on putting in place effective local government oversight and on building capabilities. There is also a need for rigorous economic assessment of different infrastructure projects. Chile provides an example of effective infrastructure planning. Its National Public Investment System evaluates all proposed projects on a cost-benefit basis, using standard forms, procedures, and metrics to ensure consistency.

Exhibit 14

In an upside scenario, capital expenditures in infrastructure in Nigeria could rise to $1.5 trillion through 2030



1 Transport includes road, rail, ports, and airports.
2 Information and communication technology.
NOTE: Numbers may not sum due to rounding.
SOURCE: McKinsey Global Institute analysis

OTHER SECTORS

In addition to the four economic sectors we size, other sectors also will play an important role in overall economic growth in Nigeria. Most notably, these include the resources sector, which contributed 14 percent to the Nigerian economy in 2013, and the telecom/information and communications technology (ICT) sector, which contributed 11 percent. The government continues to work on modernising oil and gas industry regulation. The proposed Petroleum Industry Bill, however, has been delayed since 2008, and some private-sector players have raised concerns about the bill in its current form. In addition, vandalism and oil theft continue to drain up to 5 percent of production volumes, and oil and gas production has grown by only 2.1 percent per year since 2010.[37] The telecom/ICT sector, meanwhile, has grown by 8.1 percent per year, primarily as a result of rising telecommunications provision through increased mobile penetration.

37 According to the Nigeria Extractive Industries Transparency Initiative, 5.4 percent of production was lost to theft and vandalism between 2009 and 2011.

Government will need greater focus on improving delivery of public services to drive inclusive growth

For Nigeria to achieve the upside potential in terms of growth and poverty reduction, the government will need to play a central role. It will need to continue and expand efforts to support key industries and it should pursue further improvements in areas such as health care, education, infrastructure, and access to capital. Most importantly, the government can vastly improve its capabilities to design, manage, and monitor the implementation of activities to ensure that its investments deliver the intended results.

In many of the key sectors in Nigeria, major government initiatives are under way and a good deal of innovation is taking place. Yet Nigeria has failed to significantly transform outcomes on a broad scale. There are also large variations in outcomes across the country as well as a large gap between what is spent and what should be achievable for the money, based on what peers have done. In health care, for instance, Nigeria spends $49 per capita in purchasing power parity terms, yet child mortality in the country is extremely high: 127 out of every 1,000 children pass away before their fifth birthday. Ghana and Senegal spend similar amounts on health care, yet the child mortality rate is 74 per 1,000 in Ghana and 63 per 1,000 in Senegal.

These performance gaps present an enormous opportunity for improvement, and Nigeria can draw on international—and some local—examples of success in delivering vital services and programmes to realize improvements. Based on McKinsey experience globally and with the Nigerian public sector, we identify six areas that Nigeria should focus on to improve government delivery: empower capable leaders, prioritize programmes, intensify pressure to perform, use delivery units, build critical capabilities, and leverage external stakeholders.

- **Empower capable leaders.** We find that strengthening leadership will be a key priority for improving government delivery in Nigeria. In a 2011 report, 6,000 civil servants who were interviewed from 100 organisations across the Nigerian government agreed overwhelmingly that leadership and lack of political will were the biggest issues they face in implementing public projects and delivering government services.[38] In recent years, Nigeria has demonstrated instances of successful institutional reform, which illustrate the impact of strong and dedicated leadership. For example, one academic case study cites the reform of the National Agency for Food and Drug Administration between 2001 and 2008.[39] The leadership team reorganised the agency, introduced new regulations for clinical trials, and targeted sources of counterfeit medicine. Under this leadership, the incidence of fake drugs fell from 41 percent to 16 percent. There have been other isolated examples of successful institutional reform across the country at both the federal and state levels. Strong leaders need to be identified, groomed, and empowered to help improve the delivery of public services. Replicating such leadership across the public sector could have a transformative effect.

38 H. Lawal et al., *Civil servant survey report: Voices from the service*, June 2011.

39 Joe Abah, *Strong organisations in weak states: Atypical public sector performance in dysfunctional environments*, June 2012, volume 28 of MGSoG dissertation series.

- **Prioritise programmes.** Given resource constraints, it is important to focus on a small set of programmes that are prioritised for potential return and speed of implementation. By clearly defining outcomes, decision makers can easily identify which programmes deserve the highest priority. For instance, Malaysia invested significant effort in prioritising six National Key Results Areas that were the focus of its Government Transformation Programme, and it has achieved strong results across all six areas. Among the results: the number of low-performing schools fell by almost 50 percent from 2011 to 2012, and about 100,000 people were lifted out of poverty in 2012 alone. Additionally, it is important to establish the right outcomes-based metric for each priority to ensure that delivery efforts have the intended consequences. Administrators must also develop a delivery plan that outlines a target, a work plan for implementation, and ways to mitigate potential risks.

- **Intensify pressure to perform.** Performance improves when it is explicitly managed. But performance management requires accountability, and in Nigeria, accountability is a challenge, partly because the government is highly fragmented, with more than 400 federal agencies. Moreover, the performance-management tools in the civil service are poorly implemented. To improve performance management, target outcomes need to be assigned to individuals, and progress needs to be documented in regular data-based performance dialogues. To enlist public pressure to improve performance, goals and targets must be widely communicated, and updates about progress must be shared. The UK experience in battling street crime provides an example of the potential impact of effective performance management. In 2002, as muggings and robberies were escalating, Prime Minister Tony Blair announced a goal to have street crime under control within six months. He assembled a task force that reported to him and held cabinet ministers individually accountable for progress on goals. Blair attended weekly reviews where he was briefed on progress based on the latest data. Within six months, street crime was down by 10 percent; by 2005, it had dropped by 56 percent.

- **Use delivery units.** To overcome bureaucratic and capability challenges, many governments set up dedicated delivery units. These are government entities that report to the highest levels of authority and are responsible for putting in place a systematic approach for driving progress and delivering results in specific priority areas. These units are usually staffed by highly skilled individuals who monitor progress and support government agencies in delivering prioritised programmes or projects. Delivery units can operate at the national level or within a ministry or programme. National delivery units typically report to a prime minister or president and play a key role in determining the national strategy and key priority areas. National delivery units have yielded strong results in the United Kingdom, Singapore, United Arab Emirates, and elsewhere. Delivery units also can be effective at a state, ministry, or programme level. An example of a programme-level delivery unit is the Nigerian health-care programme Saving One Million Lives, which since 2011 has worked with agencies such as state health ministries to drive implementation.

- **Build critical skills.** To achieve and sustain lasting impact, the skill of the Nigerian civil service needs to improve significantly. Investments in training are necessary but not sufficient. Nigeria offers significant opportunities for civil service training, but it is seen more as a perk than a means to improve capabilities. Capability training not only needs to focus on the right skills to deliver the results; it also must use effective teaching formats that can be scaled across large organisations. One effective approach is "train the trainer", which involves creating a cadre of experts within the organisation that can train other trainers. In Nigeria, it may be necessary to reduce the size of the workforce in the future and to gradually improve remuneration in order to attract the best and brightest into the public service. To develop the needed capabilities in its public-sector organisations, Singapore emphasises recruitment and retention of highly skilled individuals through such practices as awarding scholarships and benchmarking salaries against private-sector employment. Singapore continues to focus on skill building after hiring, and employees are expected to take at least 100 hours of relevant training a year. Each agency is required to develop an annual training road map for every employee.

- **Leverage external stakeholders.** When possible, programmes should leverage external stakeholders such as private industry, development finance institutions, the donor community, and technical implementation partners. Collaborations with outside stakeholders can be very broad, including direct foreign investment and public-private partnerships. To select partners, government should start by identifying internal skills that are lacking and outside parties that can fill those gaps. The second step is building relationships with key players and systematically removing barriers to their participation. By doing so, Nigeria can make the most of external stakeholder capabilities and resources. An example of a programme in Nigeria that benefitted from collaborating with external stakeholders was the Agricultural Transformation Agenda. The programme cultivated relationships with the private sector and development partners such as the World Bank and African Development Bank. The newly created Agribusiness and Investments Unit within the ministry has helped to bring more than $4 billion in private-sector investment into Nigerian agriculture, from companies such as Dangote, Unilever, and Cargill. The unit also secured commitments for a further $3 billion from development partners. Since 2011, the programme has provided subsidies to 4.5 million farmers and reduced agricultural imports by more than $3 billion. Another example of leveraging external stakeholders is the Nigerian Mortgage Refinance Company (NMRC), which was incorporated in 2013 with the goal of developing the mortgage market and providing affordable housing. NMRC is driven by the Ministry of Finance and Ministry of Lands, Housing and Urban Development in partnership with various state governments. The company was seeded with a $300 million loan from the World Bank and has substantial private-sector participation consisting of commercial banks, primary mortgage banks, insurance companies, private equity investors, and international financial institutions. According to government officials, the NMRC will help to reinvigorate Nigeria's housing and construction sectors and create additional jobs for workers such as masons, carpenters, electricians, plumbers, painters, and interior decorators.

A growing consuming class provides excellent opportunities for private industry

Healthy GDP growth and expanding consumption will create new opportunities for private players in Nigeria as the number and buying power of Nigerian consumers grow. Lagos, for example, is projected to be the top city in the world for additions of young entry-level consumers through 2025.[40] This creates a particular opportunity for manufacturers and sellers of fast-moving consumer goods such as food, beverages, and personal and health products. Based on data from other economies on how consumption changes with rising incomes, we see demand in such categories as ready-to-drink beverages poised to accelerate in Nigeria.

Today, the Nigerian consumer goods industry is made up of domestic and global players. In consumer goods retailing, more than 80 percent of sales still go through informal channels, such as small shops, market stalls, and street vendors. However, modern retailers such as Shoprite and Artee/Spar are making inroads, and sales through modern-format stores are growing by 28 percent per year (albeit from a very low base). Nevertheless, challenges remain, as illustrated by the recent exit from Nigeria by South Africa's Woolworths, due to difficulties in managing the supply chain.

The leading competitors in consumer goods include such large multinational players as Diageo (alcoholic beverages), Unilever (food and beverages, homecare, personal care), and Procter & Gamble (household care, beauty and grooming). These companies usually operate through a local subsidiary. International companies with a very strong and traditional local presence include PZ Cussons (personal care, home care, electrical goods, food and nutrition), Dangote Flour Mills (flour, pasta), and La Casera (beverages). Local players include Honeywell (flour, animal food, pasta) and UAC (convenience foods).

Overall, the consumer goods market could grow at an annual rate of 7 percent, more than tripling from $301 billion today to $957 billion in 2030.

WHERE, WHEN, AND HOW TO ENTER CONSUMER GOODS MARKETS

Capturing emerging consumer demand will require smart choices about where, when, and how to enter Nigerian markets. In terms of where to enter consumer markets, Lagos remains by far the largest market, with almost 1.5 million households with annual incomes of more than $7,500 in 2013 (Exhibit 15). However, many other cities also have sizable consumer populations and growing purchasing power, as illustrated by the fact that combining the number of households with annual incomes greater than $7,500 in the top six cities outside Lagos provides an equivalent size market. In Port Harcourt, for example, per capita consumption already exceeds $5,500 a year, while per capita consumption in Lagos is only $3,200.

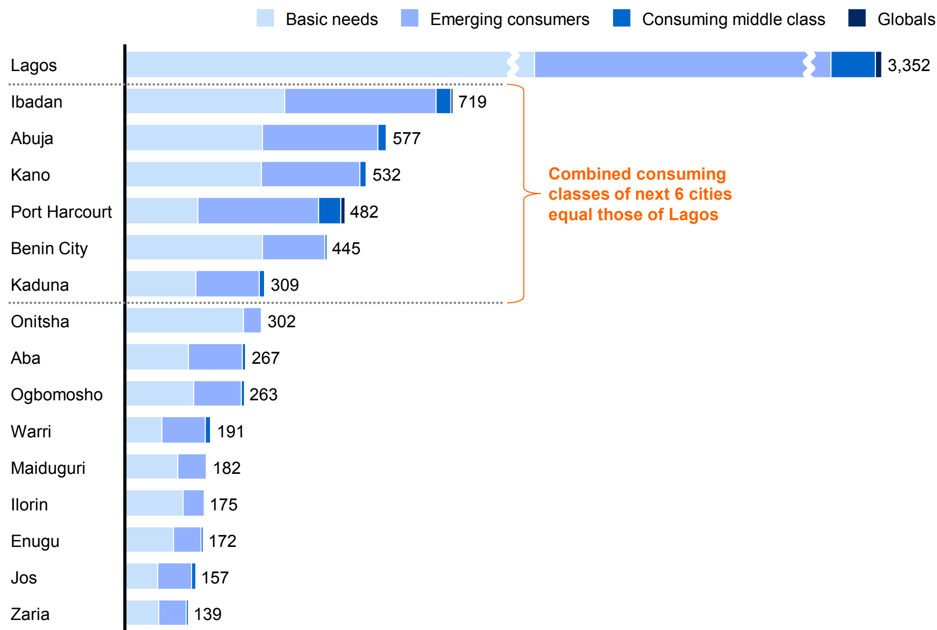
40 *Urban world: Cities and the rise of the consuming class*, McKinsey Global Institute, June 2012.

Exhibit 15

Lagos has the largest consuming class, but the next six cities combined also have about 1.5 million consuming households

Number of consumers in major Nigerian cities, by income class, 2013[1]

Thousand households



1 MGI Urbanisation income classification used: "Basic needs" are households with incomes under 2005 $7,500 per annum; "emerging consumers" are those with incomes of $7,500 to $20,000; "consuming middle class" are those with incomes of $20,000 to $70,000; "globals" are those with incomes above $70,000.

NOTE: Numbers may not sum due to rounding.

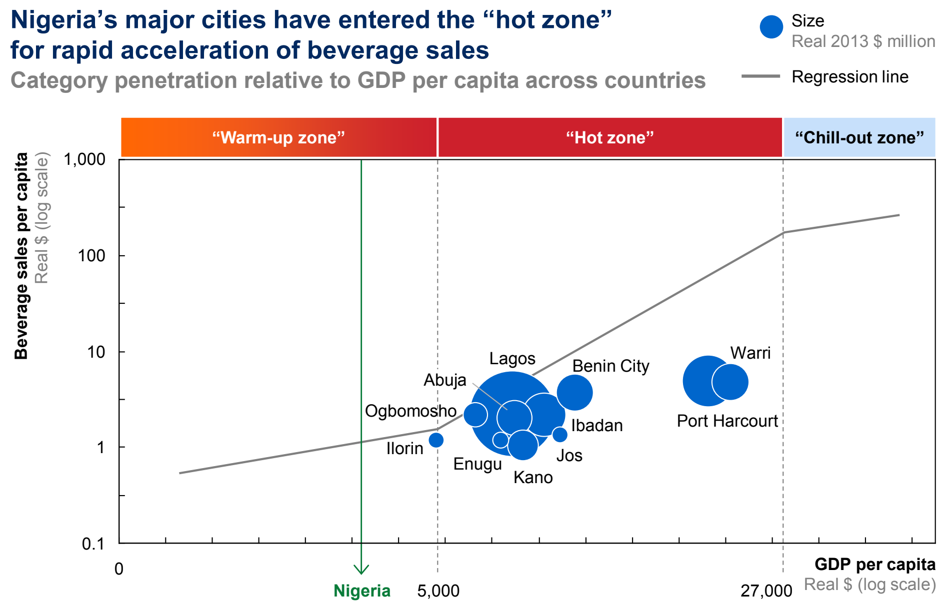
SOURCE: Canback Dangle; McKinsey Global Institute analysis

To gauge the optimum timing for ramping up products and categories, we rely on McKinsey "S" curve analyses. This shows the pattern of accelerating uptake of certain goods when economies reach specific levels of income. To illustrate this, packaged beverages such as juices, ready-to-drink products, and other drinks (excluding carbonated soft drinks and beer) will hit the "hot zone" at GDP per capita of $5,000 (Exhibit 16). After that threshold, sales of these beverages can be expected to grow rapidly—by 1.84 percent for every 1 percent rise in GDP per capita. That would be more than twice the growth rate for these products in the "warm-up zone," where the multiple is 0.73 percent for every 1 percent rise in GDP per capita. While Nigeria as a whole is still some way from the "hot zone" level of GDP per capita, in cities such as Port Harcourt and Warri, sales in this category are nearing the end of the high growth phase, while in Abuja, Lagos, Ibadan, and Kano, significant sales ramp-up can be expected.

Exhibit 16

Nigeria's major cities have entered the "hot zone" for rapid acceleration of beverage sales

Category penetration relative to GDP per capita across countries



	"Warm-up zone"	"Hot zone"	"Chill-out zone"
Growth multipliers[1]	0.73	1.84	1.10
Contribution of each zone to total growth %	4	67	29

1 Average percent increase in category penetration from a 1% increase in GDP per capita, corrected for country fixed effect.

NOTE: Major cities Aba, Kaduna, Maiduguri, Onitsha, and Zaria excluded due to overlaps with other cities with larger sales.

SOURCE: Global Growth Compass; McKinsey Global Institute analysis

CAPABILITIES REQUIRED FOR SUCCESSFUL PRODUCT ENTRY IN NIGERIA

To enter Nigeria's consumer markets successfully, companies will need to deal with a fragmented wholesale and retail environment that favours local players that have advantages in reaching the informal market. New players will need to manage distributors effectively and take a city-level, rather than a national, view of markets. Specifically, companies will need to:

- **Take a granular approach to understanding market opportunities.** The market in Nigeria is highly fragmented—there are more than 250 ethnic groups with their own languages and cultural practices, the population is spread across a wide area with large population centres accounting for a relatively low proportion of the population, and the infrastructure connecting regions is poor. For these reasons, companies need to develop a deeper understanding of this market, potentially more than they usually do for other economies, and develop a set of micro-plans that target specific customer segments and regions. This needs to include data-driven approaches to determine entry timing for markets, targeting customer segments and establishing appropriate price points.

- **Optimise routes to market.** A key challenge is navigating the fragmented retail system and managing distributors effectively. Coca-Cola's Nigerian operations, for example, rely on a large network of independently owned manual distribution centres. Coca-Cola provides both financing and training to create a capable and loyal network with extensive reach.

- **Build the brand.** Companies need to make the most of Nigerians' high brand loyalty through a strong focus on developing a clear value proposition and image. Indomie, a producer of instant noodles, is a great example of a company building a strong brand. It became the dominant instant noodle player in Nigeria by introducing a relevant and affordable product, investing in consumer relationships, building consumer trust, and advertising heavily. By catering to local tastes in the product formulation and advertising in local languages, strong brand identification was created, while Indomie's appeal to mothers and children helped foster a lifelong relationship between customers and the brand.

- **Be prepared for a long-term commitment.** It may take longer than in other markets for investments in Nigeria to bear results, and the challenges, especially in the short term, are likely to be formidable. This implies that companies need to be prepared for the long haul and play an active role in building and shaping the business environment. Companies may need to share the burden of expanding infrastructure capacity and may need to provide training, given the limited ability of the government to provide these "enablers". Procter & Gamble, for example, created a "Top Development Candidate" programme to identify and develop promising graduates who are trained in locally relevant leadership skills and are eligible for accelerated promotion.

- **Actively manage stakeholders.** Companies need to ensure that stakeholders, especially government agencies and regulators, are managed effectively. To improve its relationships with local stakeholders, the retailer Massmart follows a strategy of understanding the Nigerian culture, hiring and procuring locally, and pursuing corporate social investments to gain the community's trust.

To reach its maximum potential, Nigeria will need a systematic approach to improving the environment for growth and enabling leading industries to reach their full potential. A fast-growing consuming class can supply the demand, which will create new opportunities and employment. As the past decade has shown, however, GDP growth alone will not lift Nigerians out of poverty. To make sure that another decade does not go by in which a rich Nigeria grows richer and the poor do not progress, Nigeria will need to make it a national mission to ensure that growth is inclusive.

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