

INVESTMENT READINESS PILOT STUDY

BASELINE REPORT

FEBRUARY 2023



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EXECUTIVE SUMMARY

The International Organization for Migration (IOM) Enterprise Development Fund (EDF) is an innovative livelihoods approach that provides economic support to Small and Medium Enterprises (SMEs) with 2–30 employees. The EDF is fit-for-purpose in the context of Iraq, where 60 per cent of jobs are in the private sector, most of which in SMEs.¹ IOM is conducting a study to test investment readiness interventions that aim to increase access of EDF firms to formal credits. This report presents the characteristics of the SMEs enrolled the baseline survey.²

In April 2022, IOM contacted 265 Iraqi SMEs receiving EDF support, of which 203 agreed to participate in the study.³ On average, surveyed firms have 10 workers, and a monthly revenue of 5,800 United States dollars (USD).⁴ Raw materials and salaries are the largest categories of expenditure for SME owners (USD 6,177 and USD 4,938, respectively). Between December 2021 and March 2022, average net profit (that is, revenue minus expenses) was USD 1,891.

Most SME owners use personal savings as the main business financing (77%). However, saving is challenging for surveyed SMEs, mostly because very little income remains after all business expenses are paid (42%). Few firms borrow money through loans from formal financial providers (23%). Furthermore, about 7 out of 10 businesses are not interested in receiving new investors. Although 63 per cent of the surveyed businesses faced financial issues, 84 per cent plan to expand their current production or services.

The main management strategies are maintaining annual records of income, expenditure, cash flows, assets and liabilities (61%), paying bills on time (54%) and asking consumers to share their opinion about the products (37%). For marketing, SME owners use social media (68%), business websites (53%), and word of mouth (42%).

Overall, SMEs use informal channels of credit such as borrowing money from friends and family instead of accessing credit from banks and the private sector.



1 International Labour Organization (2022). *Iraq Labour Force Survey 2021*.

2 IOM will run a follow-up survey in early 2023.

3 Sixty-two SMEs did not complete the survey or could not be contacted, for example for lack of updated contact details.

4 The exact question is: "What are your total sales in United States dollars? (amount of money earned, without accounting for expenses) in the past four months (each)?" SME owners gave answers for the months of December 2021, January 2022, February 2022 and March 2022.

METHODOLOGY AND BACKGROUND DATA

IOM targeted 265 Iraqi SMEs for the study and obtained data for 203 SMEs. The 265 targeted firms were randomly selected from 1,017 SMEs in the EDF programme. Out of the 203 respondents who completed the survey, 92 per cent had already received the first EDF payment when IOM interviewed them. The surveys were collected between 12 April and 24 April 2022. The sample includes information from Baghdad (20%), Basrah (20%), Erbil (18%), Kirkuk (20%) and Sulaymaniyah (20%).

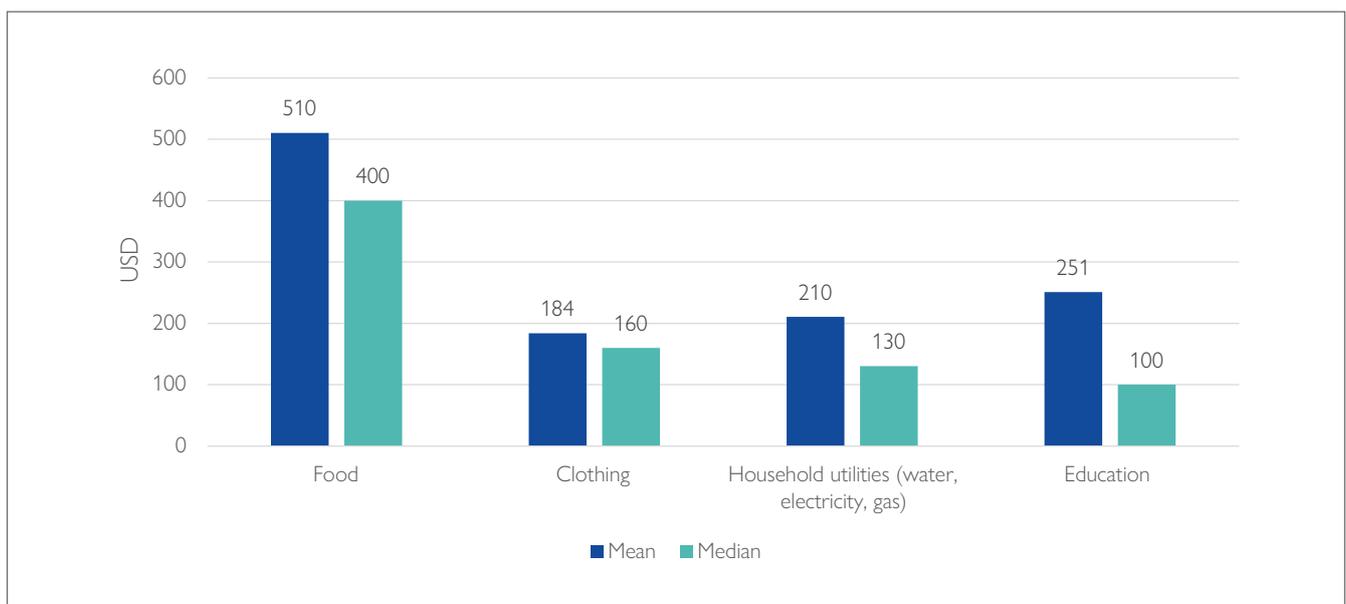
Out of the 203 SME owners, 83 per cent are married and 14 per cent are single. Interviewees had a university degree as the highest level of education (40%), followed by intermediate (15%) and primary school (14%). On average, their households have six members (with median of five), of whom two are children aged 6–17 years. Close to one third of households with children have one or more school age children not attending any educational institutes (39 out of 133). Finally, 55 per cent of the families have at least one income-earning

adult, and 45 per cent more than one family member earning an income.

Most of the surveyed SMEs are based in factories or workshops (59%), at home (22%) or in an office (7%). On average, SME owners work nine hours per day and 57 hours per week. About 81 per cent of the businesses in the sample have only one branch and one workshop. Furthermore, 37 per cent of the SMEs are not registered with either a Ministry or the Chamber of Commerce. Almost all the interviewees plan to renew their registration (87%). Among the SMEs that are registered in an official institution (63%), 88 per cent keep regular accounting books and 69 per cent are registered with the tax authorities. The SME owners registered with the tax authorities (31%) file their taxes alone (65%) and on time (92%), according to self-reported information.

The SME owners in the sample mostly spend their household budget on food, education and utilities (USD 510, USD 251 and USD 210 on average); (Figure 1).

Figure 1: Household Expenditure



Note: Full sample of 203 observations for food, clothing, and household utilities. Only 133 SME owners answered the question on education expenditure.

LABOUR

On average, SME owners have 10 workers, eight of who permanent employees (Table 1). Permanent is defined as those who have been working with a given company for at least six months or have contracts that last for more than half a year. In line with data for other

Arab countries,⁵ surveyed firms have more male than female workers (74%). The mean salary per permanent employee is USD 613, the median is USD 400, and the standard deviation is USD 544 (Table 1).

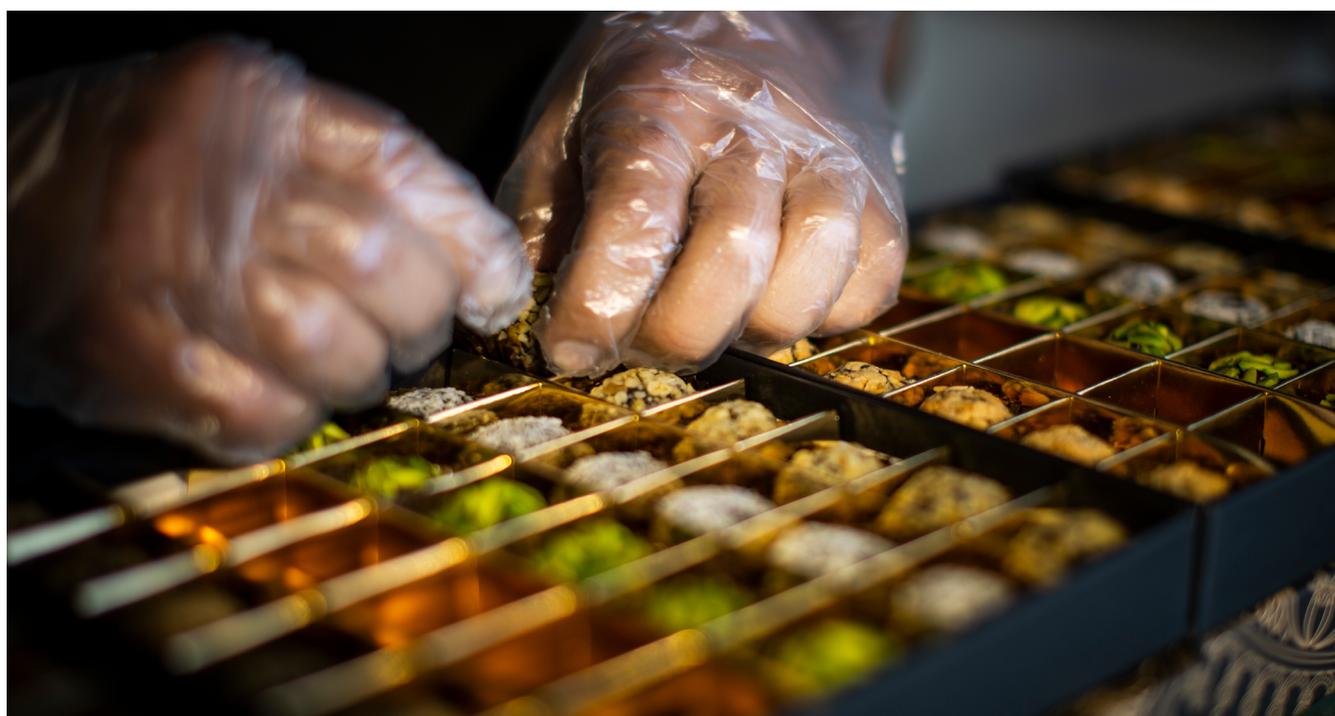
Table 1: Employees and their salaries

Variable	Obs.	Mean	Median	Std. Dev.	Min	Max
Total employees	192	10	7	11	1	100
Permanent employees	192	8	6	10	0	100
Female employees	192	2	0	5	0	40
Male employees	192	7	6	9	0	91
Average salary of permanent employees (in USD)	192	613	400	544	0	2,000

Note: 192 of the surveyed SMEs have employees (95%).

Only 38 per cent of the firms reported that employees get additional benefits or guarantees on top of their salary. Among the 73 surveyed owners provide benefits to workers, 60 per cent issue formal contracts, 51 per

cent pay for sick leave days, 21 per cent pay annual leave days, 19 per cent provide social security and 10 per cent offer maternity leaves.



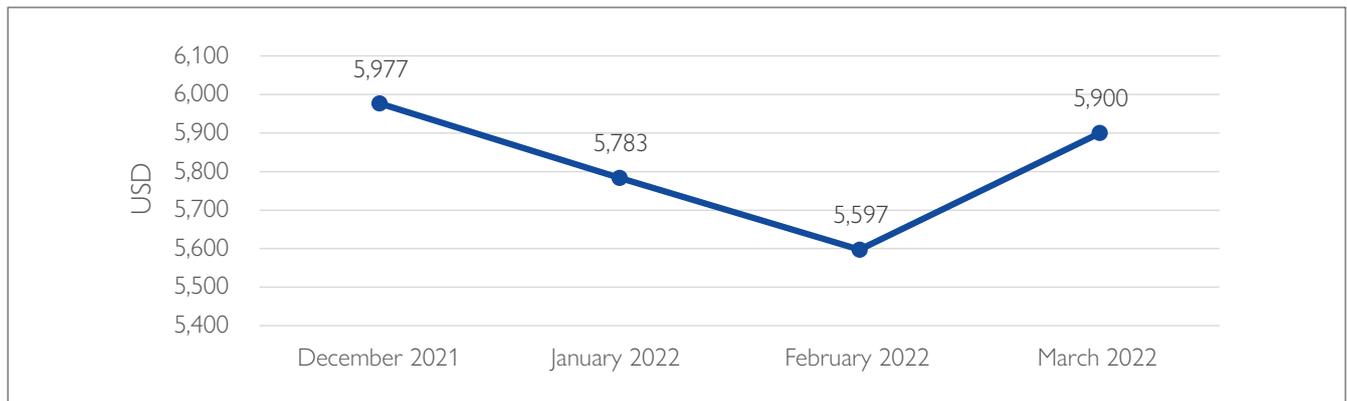
5 United Nations Economic and Social Commission for Western Asia (2020). The Arab Gender Gap Report 2020. Gender Equality and the Sustainable Development Goals. Available from: <https://publications.unescwa.org/projects/aggr/index.html>.

SALES, EXPENDITURE AND PROFIT

On average, the surveyed SMEs earned USD 5,977 in sold goods and services in December 2021, USD 5,783 in January 2022, USD 5,597 in February 2022, and

USD 5,900 in March 2022 (Figure 2). However, the distribution is positively skewed and the median sales are USD 2,000 in the four periods.⁶

Figure 2: Total sales in USD (amount of money earned, without accounting for expenses)

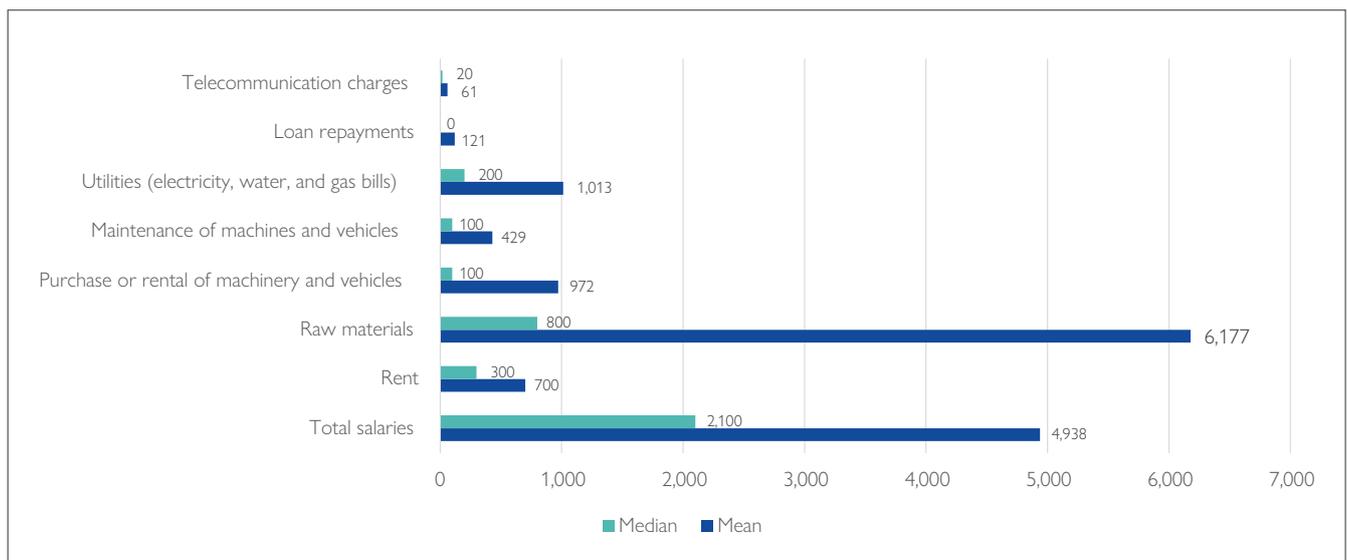


Note: This is a restricted sample of 194 observations with total sales under USD 100,000. Nine firms stated monthly sales of more than 100,000 between December 2021 and March 2022.

In the survey, expenses are defined as all the spending

on business. On average, buying raw materials for the company's operations and total salaries are the highest expenditure for the firms in the sample, USD 6,177 and USD 4,938, respectively (Figure 3). Other categories include utilities (USD 1,013), purchase or rental of machinery and vehicles (USD 972) and rent (USD 700).

Figure 3: Expenditure in March 2022 (in USD)



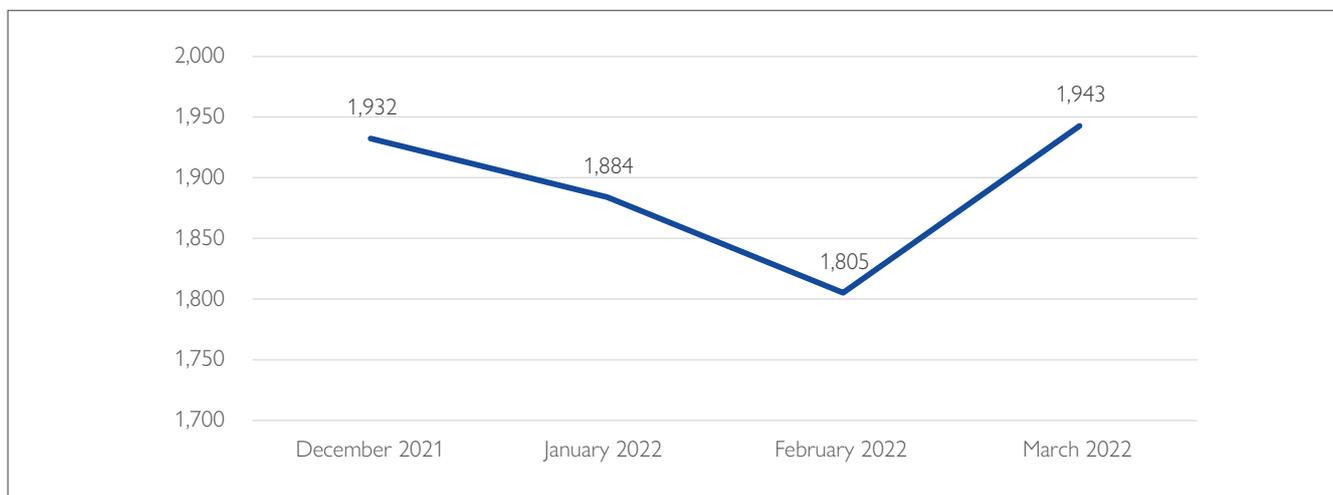
Note: Full sample of 203 observations.

⁶ The standard deviation is about twice the average in four periods: USD 11,087 in December 2021, USD 10,095 USD in January 2022, USD 9,681 in February 2022, and USD 10,683 in March 2022.

On average, the profits go from USD 1,932 in December 2021 to USD 1,943 in March 2022, with a decline in January and February 2022 (Figure 4). As in sales, the

distribution of profits is positively skewed and the median profit is USD 1,000 in the four periods.⁷

Figure 4: Profits in March 2022 (in USD)



Note: Full sample of 203 observations.

SME owners used the profits for business savings, increasing capital, and buying raw materials. About half of the surveyed firms stated that profits increased when comparing earnings from December 2020 to March 2021 with the profits from December 2021 to March 2022 (by 55%). Less than one out of five

businesses reported a decline in profits (19%). The average increase and decrease were 41 per cent and 54 per cent respectively, pointing at significant volatility in profits. Finally, two out of four SMEs did not experience a change in profits (24%).

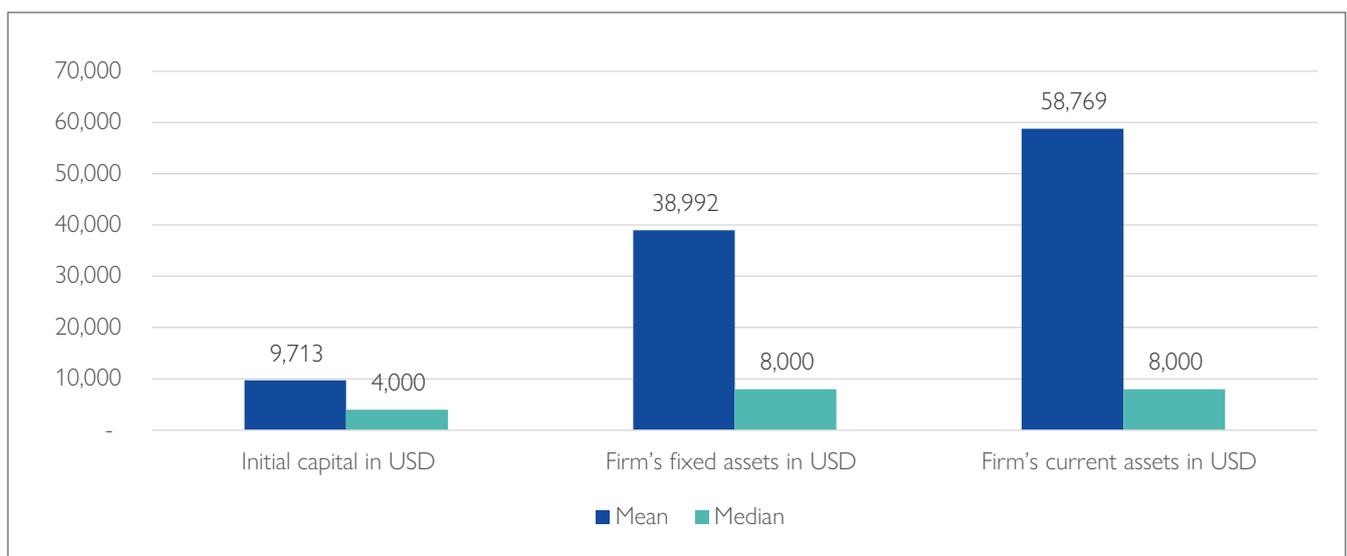
⁷ The decline in February 2022 could be caused by a seasonality factor. See for example Ehrental, J. C. F., Honhon, D., & Van Woensel, T. (2014). Demand seasonality in retail inventory management. *European Journal of Operational Research*, 238(2), 527-539.

SOURCE OF BUSINESS FINANCING AND BORROWING

On average, the start-up capital to open respondents' business was USD 9,713 (median USD 4,000); (Figure 5). At the time of interview, SMEs reported fixed assets worth USD 38,992 and current assets worth USD 58,769 (Figure 5). The distributions of long-term and short-term assets are positively skewed, with half of the SME owners reporting fixed assets in the range of USD 0–9,000, and current assets between USD 0–8,500. Fixed assets are defined for the purposes of the study as long-term assets that a firm owns and

uses in generating its income and are not expected to be consumed or converted into cash any sooner than one year (such as land, building, machinery, manufacturing, equipment, office equipment, furniture, vehicles). The value of an asset is the cost it would represent to replace the asset with another one in similar conditions. Current assets are short-term assets that are expected to be converted into cash within a year. Current assets flow in and out of the business frequently (such as cash, debt, inventories).

Figure 5: Initial capital and assets (in USD)



Note: Restricted sample of 190 observations with assets under USD 100,000.

Most surveyed SME owners report that their business is self-financed (77%). Among the SMEs that are self-financed, the source comes mainly from family or personal savings (89%). The second most used source of financing are loans (22%). Microfinance organizations (62%) and wholesalers (24%) are the most popular sources of loans. A minority of firms in the sample that were able to access loans stated that the process of

obtaining a loan was simple (71%) and have used the loan mainly for operational expenses (69%). Finally, only 4 per cent of the business used community-based savings such as RoSCA, Jamiyah, and Silfa-financed. Despite the different channels of economic support used by surveyed firms, more than three quarters still need more money for their business (79%).

FINANCING FROM PARTNERS

Only 31 per cent of the firms are interested in receiving new investors for their business. Among the 31 firms with partners, 15 are willing to give shares of the firms to new investors. In the last year, 23 per cent of SME

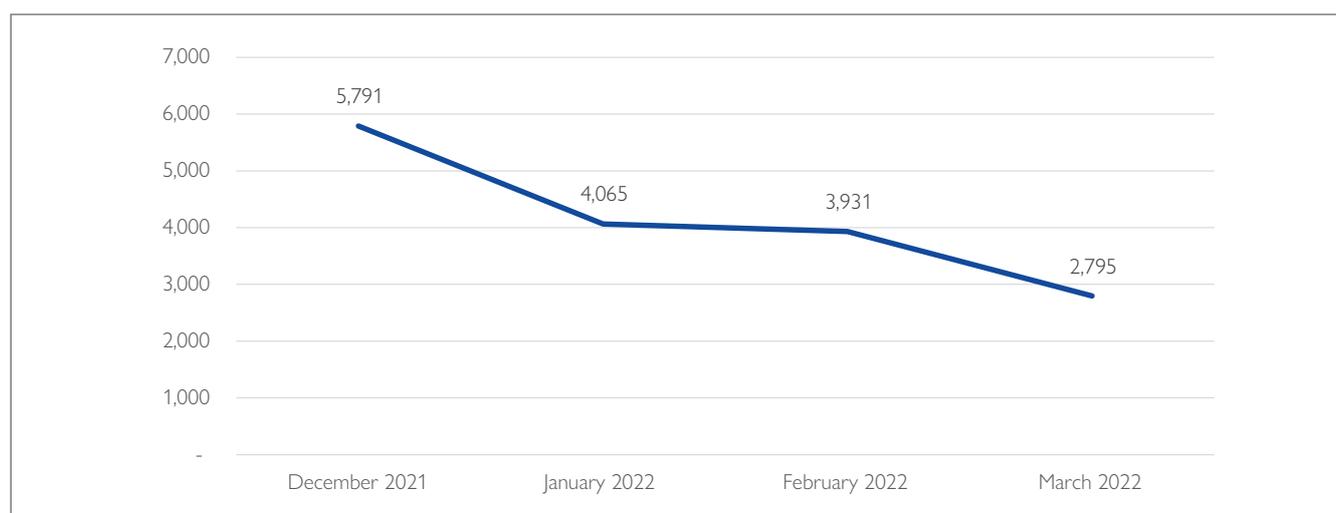
owners reported meeting with an outside investor to make an investment pitch, and 21 per cent of the firms hired consulting services to boost the business.

SAVINGS

On average, the business-related savings were USD 5,791 in December 2021 and USD 2,795 in March 2022 (Figure 6). However, the median was about USD 600 in the different periods. About 66 per cent of the surveyed firms found it challenging to save, mostly

because of income remaining after paying all business expenses being too low (42%), followed by too irregular income (29%), and reinvesting money instead of saving it (26%). However, 92 per cent of SME owners would like to save more.

Figure 6: Business-related savings (in USD)



Note: Full sample of 203 observations.

The preferred saving channel is keeping cash at home (64%), followed by savings in foreign currency (16%), and commercial bank savings accounts (11%). However, about two thirds of the surveyed SMEs do not have a formal savings account with a bank (67%). The reasons

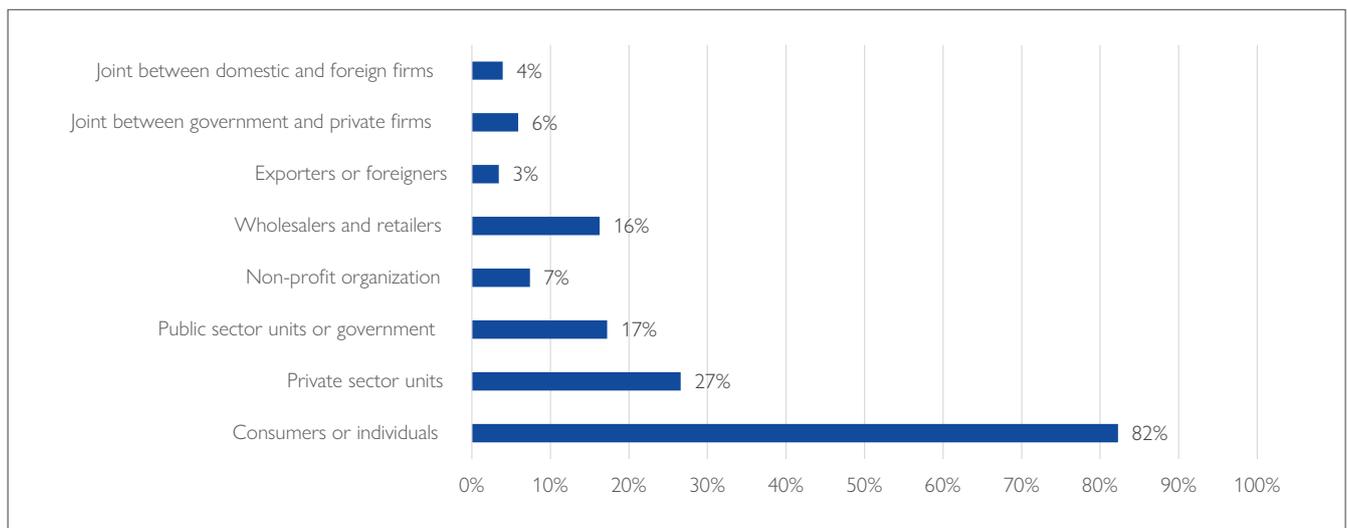
for not using formal savings accounts are lack of trust in banks (42%), a preference for having cash available in case of emergency (39%), and a lack of bank branches nearby (16%).

MARKETING

The main customers of the SMEs in the sample are individuals (82%), followed by other private sector companies (27%), public sector (17%) and wholesalers (16%); (Figure 7). About half of the surveyed firms develop a marketing strategy for their business (48%),

relying on social media (68%), business websites (53%), storefronts (50%), and word of mouth (42%) as the main dissemination channels. Finally, 65 per cent of the SMEs have improved their marketing strategy since they have launched the operation (Figure 7).

Figure 7: Typical customers of SME products and services



Note: Full sample of 203 observations.

BUSINESS MANAGEMENT PRACTICES

In the sample, about one third of the businesses reported that their products or services need intellectual property (IP) protection (32%). Among the SME owners looking for IP protection, 40 per cent are planning to apply for trademark, 35 per cent for patent, and 34 per cent industrial design right.

Business management practices include keeping business accounts separate from personal accounts (51%), getting

financial training (34%), and maintaining annual records of income, expenditure, cash flows, assets and liabilities (61%). Other practices are paying bills and debts on time (54%), asking for customers' opinions about the quality of the firm's products (37%), and checking with competitors to compare prices and products for sale (29%).

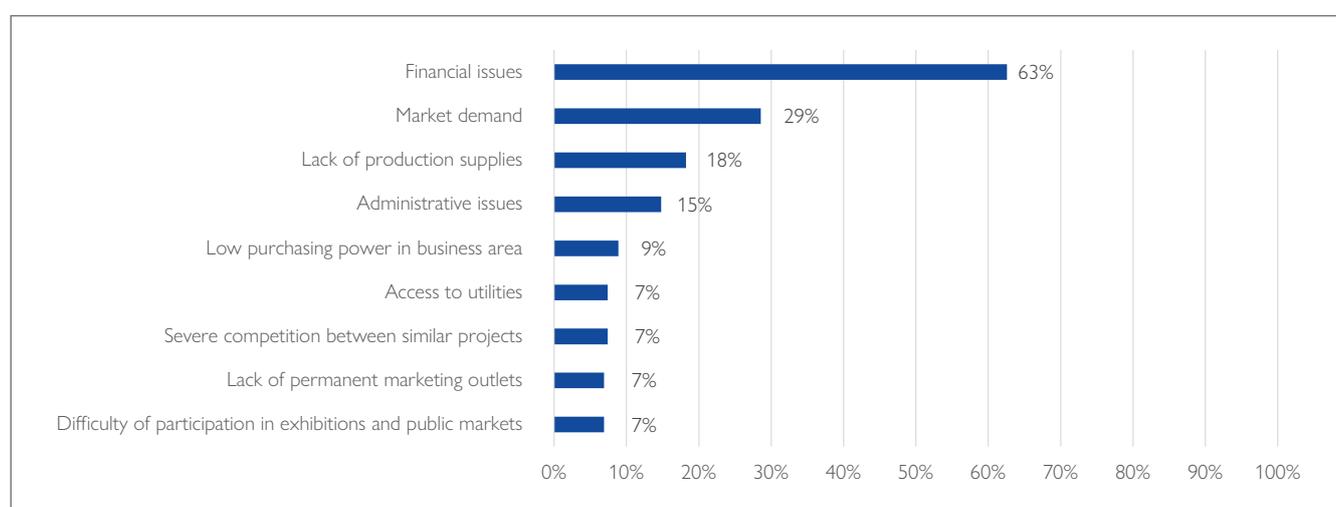
CONSTRAINTS AND EXPANSION

In the sample, financial issues are the main constraints faced by 63 per cent of firms. Other issues include lack of market demand (29%), lack of production supplies (18%) and administrative issues (15%); (Figure 8).

Most of the surveyed owners plan to expand their current production or services (84%), by incrementing

the number of hours worked (96%), project area (96%), new products (95%), assets (92%), use of advanced technology (94%) and exports (92%). The SMEs plan to use private savings (48%), formal loan (16%) and assets' liquidation (12%) for business expansion.

Figure 8: Constraints faced by businesses



Note: Only categories selected by more than 5 per cent SME owners.

CONCLUSION

Job creation through the expansion of non-oil sectors, and development of SMEs through improved skills training, investment and access to marketing and financial services are key priorities set out by the Government of Iraq in the last **National Development Plan** and by the United Nations in the **Sustainable Development Cooperation Framework for Iraq**. This study aims to inform investment readiness for interventions in the framework of these strategic goals.

The data on the SMEs surveyed in the baseline study highlights the need to train firms to access formal loans and financial services. Less than a quarter of businesses can access bank credit or private-sector funding, while

about half of the SME owners in the sample owe money to relatives or friends.

IOM aims to support SMEs with financial grants and training to improve productivity in Iraq. Combining the organization's expertise in finance funds for enterprise development in fragile contexts in the political, economic and security dimensions with the lessons learned from the baseline data, IOM plans to run a randomized controlled trial to determine the best training methods to support SMEs in accessing private financial markets. Such training complements IOM's existing efforts to directly facilitate access to investment capital through the Enterprise Development Fund.



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