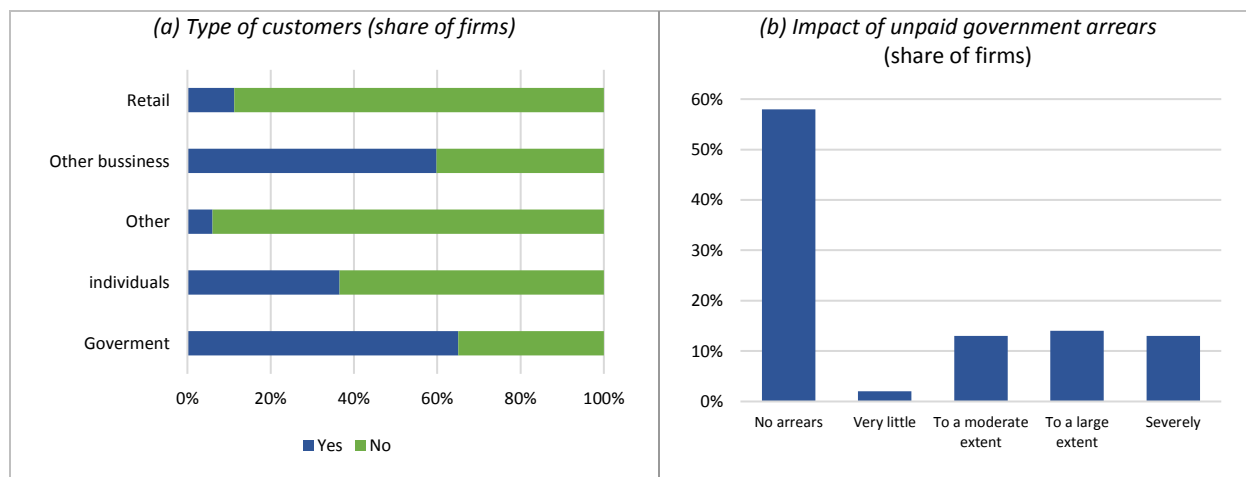


e. Domestic market

The principal customers of the firms in this survey are government entities and other businesses. The government is reported as the principal customer of firms, followed by other businesses. The dependence on other business was more severe in medium and large firms, with a 73 percent, than small firms (58 percent).⁴¹

Figure 14: Domestic demand



Source: RES 2018.

The accumulation of government arrears has been shrinking the liquidity of firms in Iraq. A third of the firms surveyed reported to have been severely to moderately impacted by lack of payment by government customers. Interviews revealed that small and medium building contractors often claim that they are owed arrears worth about 1-year of their pre-crisis revenue. As a result, some contractors intend to abandon public contracts and focus only on private projects. The World Bank Construction Sector assessment noted that many construction firms have closed due to this problem. A representative of building contractors from Basra revealed in an interview that government arrears have not only effected firm liquidity, but productive capital has shrunk as well: *"Skills are there, but many companies have lost or sold machinery. Because of state arrears, some have eaten their capital and stay only by name, like empty shells"*.⁴² Thus, the problem of arrears is likely to be underestimated by the RES.

Informality also remains a constraint to the formal private sector. Given the high level of informal activity, the WBES 2011 found that practices of firms in the informal sector were the fifth leading constraint identified by the formal sector. A high degree of informality in the economy makes it difficult to enforce government regulations and further reduces their impact. This was mainly the case for manufacturing firms and firms located in Baghdad (79 percent). Over 60 percent of firms in Babil and Kirkuk also identified informal sector competition as a serious constraint. Business leaders participating in World Bank-held focus group remarked that even

⁴¹ Statistically significant differences at the 5 percent level.

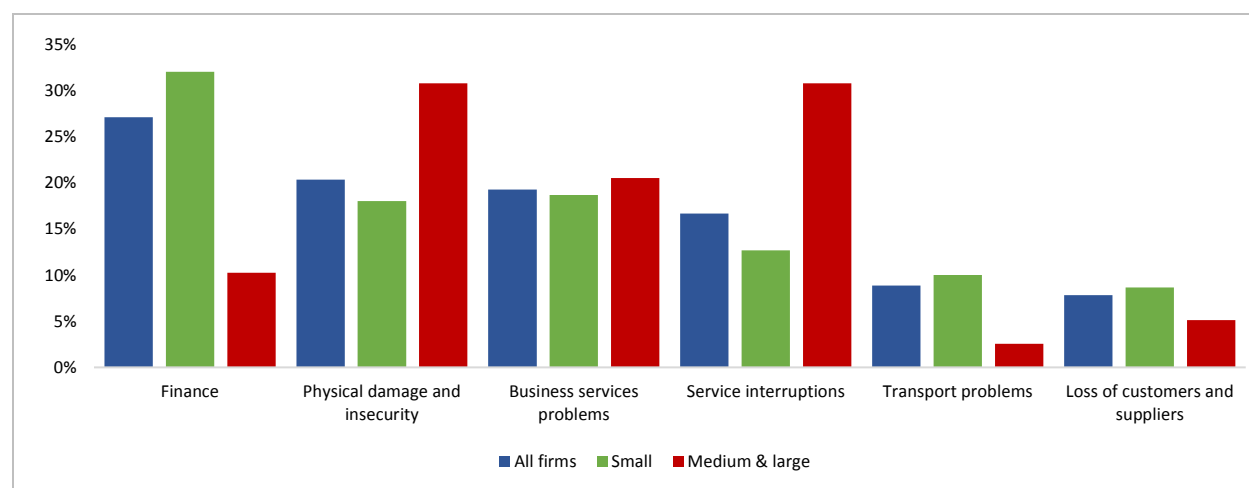
⁴² Construction Assessment

unregistered, illegal, and counterfeit companies compete successfully with legitimate businesses in obtaining government contracts.

f. Overall most important constraint

Access to finance and physical damage are the main challenges identified by all firms. Some constraints are more significantly impacting small firms. Figure 15 illustrates the importance of different constraints in the business environment by firm size. Finance was identified by 27 percent of firms as a most important constraint, while 20 percent identified physical damage and insecurity. For small firms the top constraint was reported to be access to finance (32 percent)⁴³. While medium and large firms report that service interruption (30 percent)⁴⁴ and physical damage and insecurity (30 percent)⁴⁵ were their top most significant constraints. Readers will note that when firms were asked to provide information about the frequency of insecurity in the last month most of them answered never, however when firms were asked about the “most important problem” physical damage and insecurity was among the top constraints. This might be because the first question referred to the past month, whereas the latter represents the overall impact of physical damage and insecurity since the conflict.

Figure 15: Most important constraints by firm size



Source: RES 2018.

Note: Share of firms that reply the survey with positive values: 77 percent of the sample.

VI. Coping mechanisms used by firms to overcome the conflict

The impact of prolonged conflict is particularly pervasive on the formal private sector, leading firms to adopt coping strategies to stay afloat. Once foreign and local investors have fled, taking with them the skills, the jobs, and technology, the surviving firms are left to struggle with disruptions in their supplies and an environment that is increasingly corrupt. Some coping mechanisms adopted by firms in Iraq are the following:

⁴³ Statistically significant differences at the 1% level.

⁴⁴ Statistically significant differences at the 1% level.

⁴⁵ Statistically significant differences at the 10% level.