The Uganda Business Climate Index

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Consumer demand, export markets help maintain favourable business climate

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1. Executive Summary

The Uganda business climate has continued to improve for the second successive quarter. This implies that the conditions for doing business in Uganda are getting better. The current (January - March 2014) index is 113.4 points and is 16.4 percentage points higher when compared to the corresponding period last year (January - March 2013) when the index was 97.4 points. The annual improvement in the business climate was sustained by a stronger than expected consumer demand, stable macroeconomic environment characterized by low and falling inflation, stable exchange rates, and lower interest rates. In addition, the business environment was aided by stronger export demand for Ugandan products in both regional and international markets. However, perceptions and expectations for next quarter (April – June 2014) are downcast. Overall, results suggest that the business climate improved modestly but maintained a favourable sentiment. In addition, the business climate index indicates some modest improvements in job creation in the current quarter.

The Business Climate Index Indicates Modest Recovery in Employment Prospects

2. Data

The data used in computing the business climate index are collected from 150 business establishments sampled from the 450,000 businesses recorded in the 2011 Uganda Bureau of Statistics business register. The probability proportional to size sampling technique was used to select businesses into the sample. The different business sub-sectors were treated as sampling strata. The largest two firms in each stratum were automatically selected to ensure that influential business players are included in our sample. The rest of the businesses were selected using simple random sampling within each stratum. Sample weights were used in the computation of the results. The respondents were business managers. We keep following the same businesses every quarter. The distribution of the sampled businesses is presented in Table 1.

Table 1: Distribution of the sampled business, %

Business					
Size[a]	%	Sub sector	%	Location	%
Micro	10.06	Agriculture and agro processing	17.22	Kampala	45.56
Small	32.54	Hotels, recreation and tourism	19.44	Central	21.30
Medium	31.95	Manufacturing and industry	16.11	West	11.24
Large	24.44	Mechanical services	11.11	East	11.83
		Retail and wholesale trade	16.11	North	10.06
		Finance, IT and other services	10.56		
		Social Services	9.44		
Total	100		100		100

Notes: [a] The classification of businesses by size was guided by the World Bank Enterprise Surveys that classify a business as Micro if it employs no greater than 4 people; Small if it employs 5-19; Medium if it employs 20-99; and large if it employs more than 100 people.

3. Evaluation Methods

The business climate index is computed based on the following business evaluation indicators: level of business activity, turnover, profitability, incoming new business, capacity utilisation, average costs for inputs, price of produced goods, new orders for goods, business optimism, number of employees, and average monthly salary. For each of the evaluation indicators, respondents are asked to express their perceptions on a Likert scale as follows: "improved", "did not change", "declined" or "above normal for quarter", "normal for quarter", below normal for quarter". These responses are coded as 0, 1, and 2 respectively. For example, if a respondent's perception of the business environment is that it deteriorated, such a response would be coded 0, it would be coded 1 if business climate did not change and 2 if business climate improved. Notice that the index does not consider the magnitude of change in the data but considers the general direction of movement in the key indicators. As such, the index is sensitive to the direction as opposed to the magnitude of the change in business conditions.

During the data collection process, the business managers were asked to assess the general economic environment for the current (January - March 2014) quarter relative to the previous (October - December 2014) quarter; and their expectations for the next quarter (April - June 2014). Based on the business evaluation indicators explained earlier, the business climate index is then computed as the weighted arithmetic and seasonally adjusted mean of individual business evaluation indicators' indices. The indices range from 0 – 200. The interpretation of the Index is such that scores above 100 point to an improving business climate; scores below 100 imply that the general business conditions are getting worse.; and scores of 100 indicate that business conditions are unchanged.

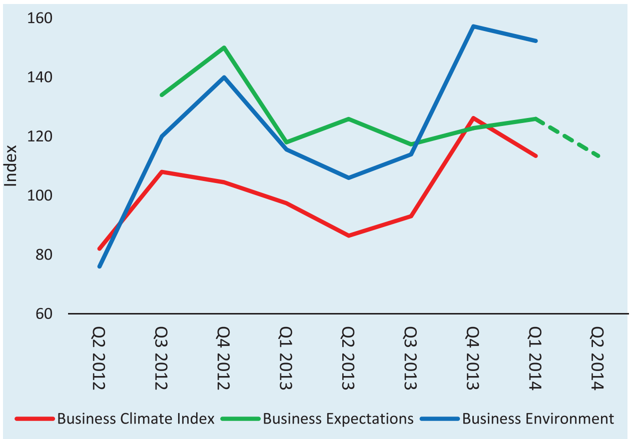
4. Results

Business Climate Remains Favourable in the Current Quarter

Results indicate that the overall perceptions about the business environment have remained favourable in the current quarter (January – March 2014). The business climate index is 113.4 and is 16.4 percentage points (16 index points) higher than during the corresponding period last year (January - March 2013) when it was 97.4 points. However, on a quarterly basis the index declined by 10 percentage points from 126.2 points in the previous quarter (October - December 2014).

The annual improvement in the business climate was sustained by a stronger than expected consumer demand, stable macroeconomic environment characterized by low and falling inflation, stable exchange rates, and lower interest rates. In addition, the business environment was aided by stronger demand for Ugandan products in the regional and international market. This is the second successive quarter that the index score is above the 100 mark, signifying that business conditions are getting better.

Figure 1: The Business Climate Assessment

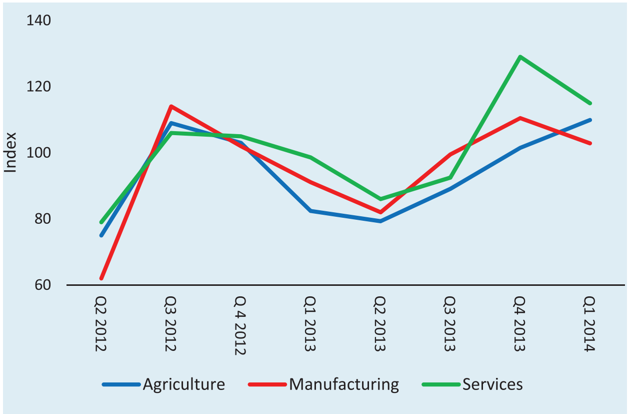


The Business Climate Index by Sector

Overall, business climate has improved across all sectors (Figure 2) albeit with different degree. The services sector recorded the highest index of 114.99 points, followed by the Agricultural Sector with 109.92 and the Manufacturing sector which realised a business climate index of 102.86. However, on an annual basis the agricultural sector realised the biggest improvement in the business climate index having recorded an index of 109.94 in January – March 2014). This was a 33.46 percent change from (82.36) that of a similar period (January – March 2013) last year. In addition, the services sector recorded a 16.60 percent increment while the manufacturing sector recorded a 12.90 increment.

The improved performance across all sectors was supported by improved turnover and favourable product and input prices. These results highlight the importance of effective demand and macroeconomic stability for business growth.

Figure 2: Business Climate Index by Sector

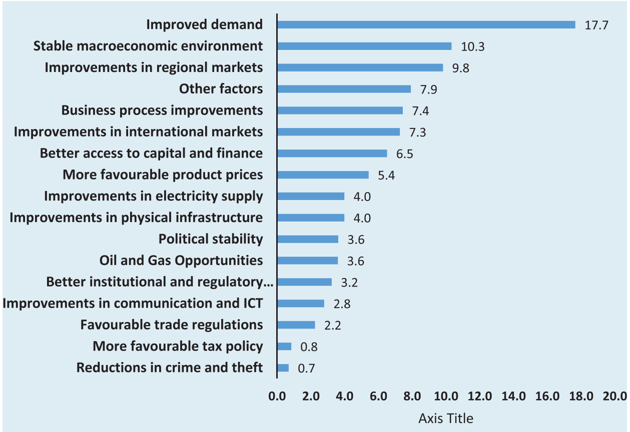


Despite the strong business sentiment across all business sectors, perceptions about capacity utilisation have remained below potential across all sectors. In addition, perceptions about incoming new business are below potential in the manufacturing sector. Indeed, capacity utilisation indices were below potential across all sectors. Capacity indices stood at 80.15, 73.72 and 73.09 points for agriculture, industry and services respectively. This implies that businesses are operating below capacity and have the potential to improve production without requiring additional resources such as labour, machinery and/or operating for longer hours. As a result, business have realised modest improvements in jobs created. Indeed, the percentage of businesses that reported improvements in jobs created during the quarter under review were only 5 percent in agriculture, 12 percent in manufacturing and 13 percent in services sector. A majority of businesses reported no changes in employment. These results suggest that despite improvements in the business environment, employment creation in Uganda's business sector has been modest.

What explains the favourable business climate assessment?

The Uganda business climate has maintained favourable business sentiment in the current quarter (January – March 2014) despite posting a weaker quarterly performance compared to the previous quarter (October – December 2013). The favourable business sentiment was on account of strong consumer demand (17.65 percent), stable macroeconomic environment (10.33 percent), higher regional export demand (9.82 percent), improvement in business processes (7.44 percent), higher international export demand (7.27 percent), better access to financing (6.51 percent), and more favourable product prices (5.42 percent), among others. In the discussion that follows, we explain the three reasons for an improving business environment.

Figure 3: Reasons for an improving business climate, %



i) Improved demand

Improved consumer demand (17.7 percent) continues to be the major driver of business climate improvement. Our results show that the indices for sales turnover (103.18), business activity (104.99), and incoming new business (105.02) are all above the 100 mark implying that there were improvements in relation to the previous quarter. These results suggest favourable sentiment with regards to business activities and consumer demand. It is likely that these indices are linked to the reported improved demand for products and services.

ii) Macroeconomic Stability

The macroeconomic environment (10.3 percent), characterised by stable inflation and exchange rates coupled with the gradually declining interest rates has continued to positively influence sentiment with regards to the business environment in Uganda in the current quarter. During the period under review, inflationary pressure continued to ease. During the October – December 2013 quarter, inflation averaged 7.19% while it eased to an average of 6.97% in the January – March 2014 quarter. At the same time, exchange rates were stable and the lending interest rates declined from an average of 22.31 percent per annum during the October - December 2013 period to averages of 21.40 percent in the January – March 2014 period.

iii) Regional and international market dynamics

Business managers indicated that the Uganda business environment benefitted from improved demand from export destinations both in the region and internationally. In the previous quarter (October – December 2013) issue of the business climate, there was improved trade especially with Kenya (Uganda is a net exporter of maize to Kenya) and other COMESA countries. The improved external demand indicates stronger than expected recovery in the regional and global economic conditions.

Future business outlook: January – March 2014

The business climate is expected to continue improving in the next quarter albeit weakly. The expected index for April – June 2014 is 113.41 (figure 1) and is 10 percentage points lower than what was expected for both the corresponding period last year (April – June 2013) and that of the past quarter (October - December 2013). In addition, the expected index is not significantly different from the current realised index of 113. This implies that business managers expect the business environment to continue improving but at a slower pace.

However, the expected business index climate index of 113.41 is the lowest projection of the business climate index since April – June 2012. It is likely that the expected decline in the index points to a possible turning point where economic conditions are expected to start deteriorating. However, given that the expected index is still above 100 points, we do not think that this should be a big problem; business conditions will continue improving but at a slower pace. The risks to the business environment in the next quarter are likely to emanate domestically from unfavourable input prices, particularly in the agricultural and service sectors. This result points to the possible elevated inflationary risks arising out of expected high input prices.

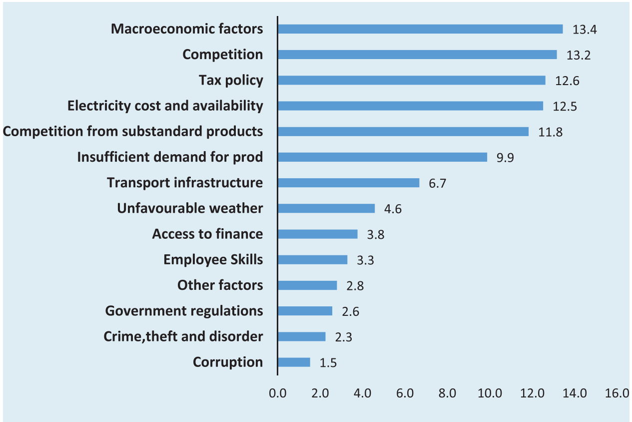
The expected decline in the business climate will most probably be driven by unfavourable perceptions particularly in the agricultural sector. The expected index of the agriculture sector falls by 35 percentage points from 93.2 to 60.7 points. However, the service and manufacturing sector are expected to record a positive index of 115 and 120 points respectively. These results suggest that attention should be directed to supporting the agricultural sector.

Challenges in doing business

The top five constraints in doing business for the current quarter include: macroeconomic factors (13.4 percent), competition (13.2 percent), tax policy (12.6 percent), the cost and reliability of electricity supply (12.5 percent), and competition from substandard products (11.8 percent).
Compared to the last quarter (October –December 2013), there have been changes in the top obstacles to doing business in Uganda indicating a shift in business perception about the most pressing challenges in the current quarter. Specifically, macroeconomic challenges, that ranked number 5 in the previous quarter, have emerged as the top challenges in the current quarter. This is surprising considering that inflation and interest rates were stable and slowly dropping during the current quarter. However, it is likely that the high and sticky interest rates in this quarter (January – March 2014) constrained access of credit by businesses. In this case, interest rates did not come down as fast as business would have wished in response to a falling central bank rate.

The greatest improvements were recorded in infrastructure constraints that include bottlenecks in electricity and transport. Although electricity retained its position among the top five challenges, perceptions about its severity have dropped from number 1 in the previous quarter to number 4 in the current quarter. Likewise, the ranking of transport infrastructure has dropped from number 4 in the previous quarter to number seven in the current quarter.

Figure 4: Binding Business Constraints, %

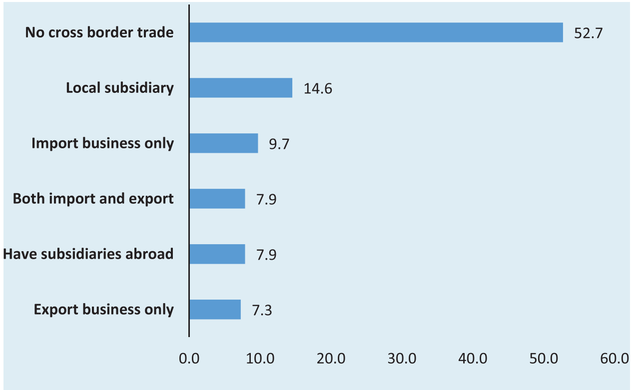


Other business constraints include: weather variability (4.6 percent), access to finance (3.8 percent), unskilled labour (3.3 percent), crime and theft (2.3 percent) and corruption (1.5 percent). The finding that corruption is the least troublesome challenge could be due to the fact that it is profitable for businesses in Uganda especially in an environment of intense bureaucratic red tape. If paying bribes helps firms circumvent cumbersome government regulations and procedures, and thus profitable, then businesses are less likely to report it as a business obstacle. Moreover, it could be that people are accustomed to a culture of corruption that they do not view it as an obstacle. In this case corruption is viewed as a way of life. However, the interpretation of business constraints results should be done with caution. Changes in the ranking of "challenges in doing business" should not imply that a specific element is improving or deteriorating. Such changes only reflect the elements that are currently deemed more relevant to firms.

5. Question of the Quarter

In this quarter we sought to understand the extent to which Ugandan businesses are integrated into regional and international trade. Specifically, firm managers were asked the following question "Do you do business across borders (import-export) or does your business have a subsidiary abroad, or is your business a subsidiary of a parent firm abroad?" Figure 6 provides an overview of the extent to which firms engage in international trade either as importers, exporters or representatives of bigger subsidiaries abroad. Results indicate 52.7 percent of Ugandan businesses do not engage in any form of cross-border trade; 14.6 percent operate as local subsidiaries for larger firms abroad, 9.7 percent engage in import trade only, 7.9 percent engage in both import and export trade, 7.9 percent have subsidiaries abroad, and 7.3 percent engage in export trade. The businesses that engage in cross-border trade tend to be larger, engage in agriculture and agro processing, manufacturing, and trade, and are mostly located in Kampala.

Figure 6: Extent of cross-border trade by Uganda businesses, %



6. Conclusions

Perceptions about the business environment in Uganda have continued to improve over the last two quarters. This has been on account of strong consumer demand, stability in the macroeconomic environment, and a rebound in export demand. Equally important, the business environment is expected to continue on this upward trajectory in the medium term, albeit weakly, on account of uncertainty in the global environment.

The Economic Policy Research Centre (EPRC) has been producing the Business Climate Index (BCI) for Uganda since June 2012. The BCI reflects the perceptions of Ugandan business managers on the current and near future (expected three months ahead) business conditions. The BCI is a perceptions indicator of economic activity and the general business environment in which businesses operate. It can be used to forecast turning points in economic activity and thus provides critical information for policy makers both in Government and the Private Sector.

About EPRC

The Economic Policy Research Centre (EPRC) is an autonomous not-for-profit organization established in 1993 with a mission to foster sustainable growth and development in Uganda through advancement of research –based knowledge and policy analysis.

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