ECONOMIC POLICY RESEARCH CENTRE

Towards Sustainable Development

The Uganda Business Climate Index

Photo: Farmers in their flooded garden in Karusandara Sub-county, Kasese District

Source: The Daily Monitor, https://www.monitor.co.ug/News/National/Hunger-looms-aftermath-floods/688334-4634706-format-xhtml-6yef2f/index.html

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Above normal rainfall dampen business climate environment; future outlook remains subdued

Executive Summary

The Business Climate Index (BCI) slightly improved by four percentage points from 100.8 in the previous quarter (July-September 2019) to 104.9 in the current quarter (October-December 2019). The slight improvement was largely driven by improvement in business perceptions in the services sector. The favourable perceptions in the services sector are attributed to the rapid expansion of the banking service using the agent banking model across the country as well as entry of new players in Uganda's financial subsector. However, the positive perceptions in the services sector were offset by the deterioration in both the agriculture and manufacturing sectors. The large drop in the agriculture sector emanated from onset of prolonged above normal rainfall that caused flooding, while the continued closure of the Uganda-Rwanda border continues to dampen perceptions in the manufacturing sector. Business expectations for the next quarter (January – March 2020) remain subdued on the account of anticipated decline in sales turnover, profitability and new business establishments.

Data and methods

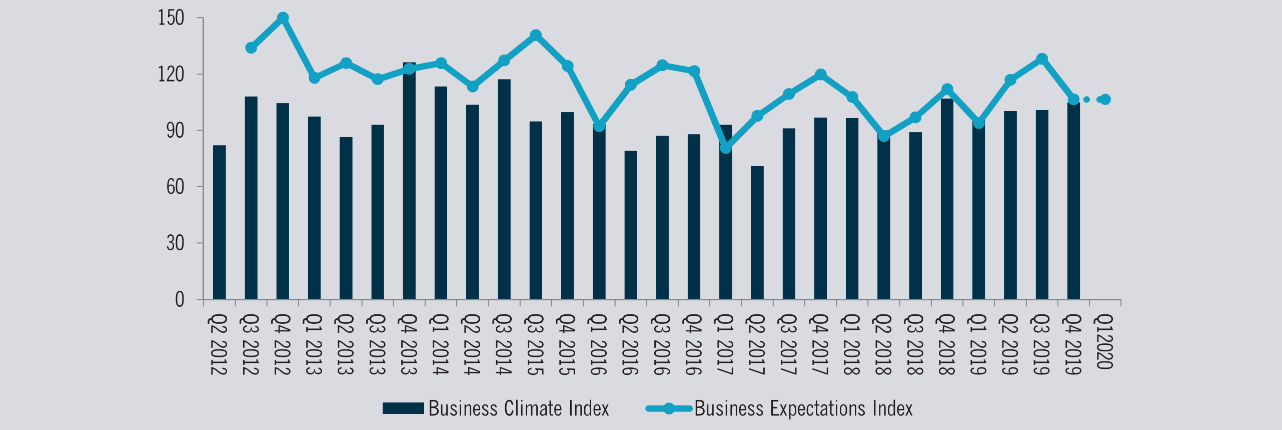
The data used in computing the Business Climate Index (BCI) is a panel of businesses based on the Uganda Bureau of Statistics Census of Business Establishment 2011, first tracked in 2012. This current quarterly bulletin covered 157 business establishments. The panel element has enabled us to track business environment in Uganda over time.

The BCI is computed based on the following business evaluation indicators: level of business activity, turnover, profitability, incoming new business, capacity utilisation, average costs of inputs, price of produced 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" or "more favourable", "unchanged", "less favourable". These responses are coded as 0, 1, and 2 respectively. In this case, 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 the business climate did not change and 2 if the business climate improved.

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, we ask business managers to assess the general economic environment for the current quarter relative to a similar period a year earlier; and their expectations for the next quarter. Based on the business evaluation indicators explained earlier, the business climate index is computed as the weighted arithmetic mean of indices of the individual business evaluation indicators. The indices range from 0 – 200. The interpretation of the BCI 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, a score of 100, points to unchanged business conditions.

In addition, the index analyses the evolution of challenges facing businesses during October-December 2019 by identifying which business constraints are more of a problem and less of a problem. We also ask business managers to indicate how each

Figure 1 The Business Climate Assessment[1]



1 Solid lines show period under review.

of the identified business constraints have evolved over the last full year. For each of the business constraints we asked if it was "more of a problem", "unchanged", or "less of a problem". The resultant weighted indices range from -100 to 100, with positive scores suggesting that a particular constraint is perceived to be more of a problem in the current quarter; negative scores imply that a constraint is less of a problem; and zero scores point to business constraint whose severity has remained unchanged.

Results

Business climate marginally improves, but perceptions about the future remain downcast.

Results indicate that the Business Climate Index improved by four percentage points to 104.9 during the current quarter (October-December 2019), from 100.8 points in the preceding quarter (July-September 2019). The slight improvement was on the backdrop of increased sales turnover, improved labour availability, increase business optimism, lower cost of labour and improvements in general business environment. The conditions for doing business remained upbeat with the onset of the Christmas season (Figure 1). In particular, credit to the private sector grew at an average of 3 percent per month in the current period compared to 1 percent in the preceding quarter (July to September 2019). Data from Bank of Uganda shows that the financial sector lent more than UGX. 400 billion between October and December 2019 compared to just over UGX 100 billion between July and September 2019. In addition, business managers experienced declining input costs in the current quarter. According to the Electricity Regulatory Authority end user tariff guide for the quarter, domestic users paid UGX 752 per unit, a 0.4 percent decrease from the tariff in the current quarter. Commercial users were charged UGX 666 per unit, a decrease of 0.4 percent. Large and extra-large industries were charged UGX 364 and 302 per unit respectively. This represents a 0.3 and 0.7 percent decline compared to the preceding quarter (July-September 2019).

Figure 1 indicates that while current business prospects remain favourable, business managers interviewed expect business perceptions to dampen in the coming quarter (January – March 2020). This sentiment is largely driven by anticipated reduction in profits due to a decline in sales turnover likely to reduce expansion of new businesses. Usually, the first quarter of the year (January – March) often records a slowdown in business activity as consumers prepare to pay school fees for the beginning of the first school term.

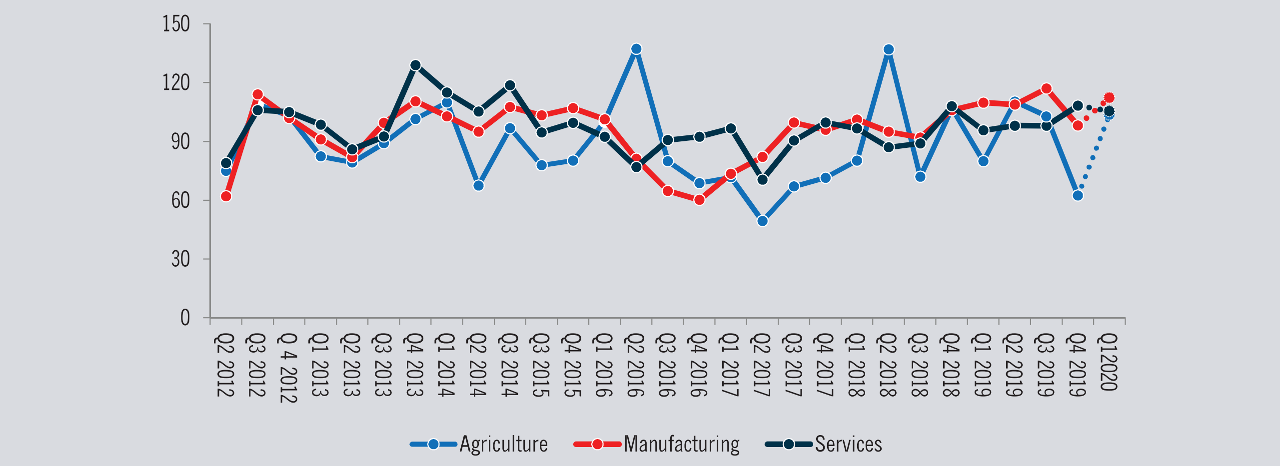
The Business Climate Index by Sector

During the current quarter, business sentiments declined in both the agriculture and manufacturing sectors compared to the previous quarter. Perceptions of business conditions in the agriculture sector made the most setbacks. The agriculture sector index registered a 40.3 points decline to 62.4 in the current quarter (October-December 2019) from 102.7 points during last quarter (July-September 2019) (Figure 2). The large deterioration in the agriculture sector was largely driven by a reduction in profits due to underutilisation of capacity emanating from declining business activity, sales turnover and rising input cost. During the current quarter, Uganda registered an onset of prolonged above normal rainfall across most parts of the country. According to FEWS NET report (2020)[1], the October to December 2019 rainfall season was ranked among the wettest rainfall season in the East Africa in the last 40 years. Across the region, floods affected 3.4 million people, causing more than 350 deaths, extensive damage to infrastructure (over 130,000 housing units), cropland (73,000 hectare of cropland), and animal losses (over 96,000 animal deaths). In Uganda, prolonged periods of water saturated soil ranging from 30 to 90 days above average contributed to the death of an estimated 38 people and displacement of 65,000 people across the country.

In the manufacturing sector, business sentiments declined by 18.42 percentage points to 98.13 in the current quarter from 116.55 in the previous quarter. The decline is on the basis of reduced capacity utilisation, business activity, declining sales turnover and increased input cost. Business perceptions in the manufacturing sector in Uganda continue to be affected by the closure of the Uganda-Rwanda border at Katuna. Indeed, data from Bank of Uganda indicates that Uganda's exports to Rwanda plummeted by 14 percent to US$ 2.12 million in the current quarter (October- December 2019) from US$ 2.47 million in the previous quarter (July- September 2019). The current export

1 https://fews.net/east-africa/special-report/january-29-2020

Figure 2 Business Climate Index by Sector



values are down by more than 90%--from US$ 60.6 million and US$ 51.9 million registered during the third and fourth quarter respectively in 2018 before the border closure. To date all efforts to re-open the border are yet to bear fruit.

Perception of business conditions in the services sector registered the largest improvement—a change of 9.98 points to 108.28 from 98.30 in the previous quarter. The improvement in the services sector came on the backdrop of improved sales turnover, optimism, establishment of new outlets, favourable product cost and improvement in the general business environment. The favourable perceptions in the services sector came with increased financial innovation as well as entry of new players in Uganda's financial subsector. During the quarter, Barclays Bank Uganda successfully transitioned to Absa Bank Uganda, a South African finance giant. In addition, data from Bank of Uganda indicates that the number of outlets for Agent banking expanded by 11 percent from 10,073 in the previous quarter to 11,161 in the current quarter. Finally, total private sector credit to the telecommunication subsector improved by 8 percent from UGX 292 billion to UGX 316 billion in the current quarter compared to a decline of 21 percent in the previous quarter (July- September 2019).

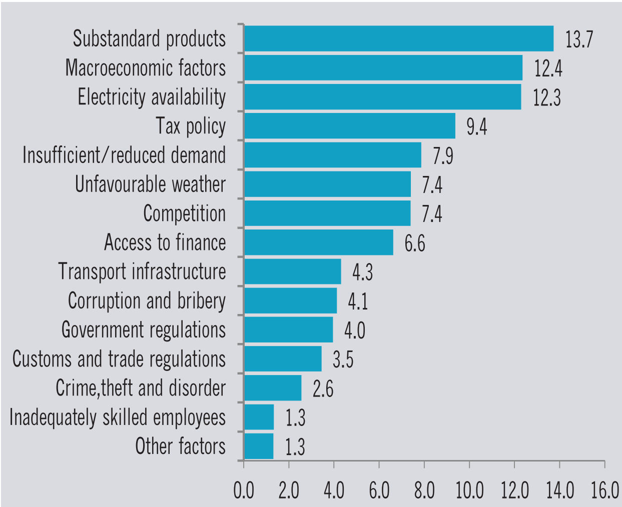
Challenges in doing business

Figure 3 shows that substandard products, macroeconomic factors and electricity unavailability were the most important constraints in doing business for the current quarter. According to the World Bank (2019) ease of doing business indicators, Uganda's electricity cost remain significantly high—the cost of getting electricity as share of income per capita is 7,508 percent. This is almost double the estimate for Sub- Saharan Africa (3,737 percent). With respect to the doing business index Uganda is also ranked 173rd, far below Kenya (ranked 71st), and Rwanda (ranked 119th). In addition, while Uganda has improved power generation, the country is still short on power distribution. Indeed by end of the current quarter, the Electricity Regulatory Authority was still short of the targeted 300,000 new connections as stipulated under the government's free Electricity Connections Policy (ECP). On the hand, unfavourable weather increased intensity in comparison to the last quarter.

How have the business constraints evolved over the last period?

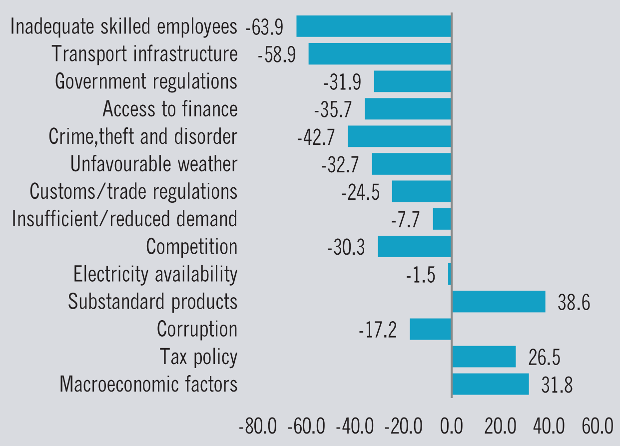
Unlike the previous quarter, where deteriorating macro-economic factors, unfavourable tax policy and increased bribery became more of a problem. Figure 4 reveals that in the current quarter,

Figure 3 Business Constraints, %



increased availability of substandard goods on the market become more of a business constraint in the current quarter compared to the previous quarter. The increased intensity of the substandard products on the market could have partly emanated from delayed implementation of the digital tax stamps, a measure to curb harmful and counterfeit products on the market. Digital tax stamps were introduced by government in October 2019, to help URA improve its revenue collection efficiency but also reduce the supply and entry of counterfeit products. However, installation of digital tax stamp equipment on local manufacturers' product lines has delayed due to objections by local manufacturers on who has to bear the cost of installing. Similar to the previous quarter, inadequate skilled employees, crime and theft and government regulation became less of a problem in the quarter under review.

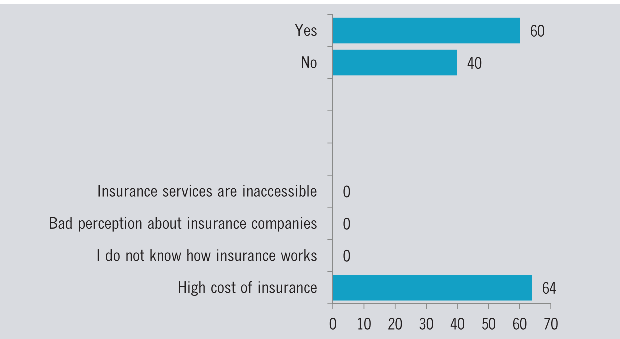
Figure 4 The evolution of business constraints (% of businesses)



Future business outlook: January – March 2020

Unlike the last quarter, businesses are more pessimistic about near term developments. The expected index for January–March 2020 is anticipated to be at 106.5, and this is 17 percentage points below the current quarter's expectation. The expected deterioration in the overall business climate is projected to be driven by the anticipated drop in the performance of the agriculture and services sectors. The agriculture sector is expected to decline by 4.75 points from 108.4 registered in the last quarter to 103.7 in the coming quarter. The services sector is expected to decline by 26.7 basis points from 132.3 reported in the last quarter to 105.5 in the coming quarter. The unfavourable business expectations in the agriculture and services sectors are largely anchored on anticipated reduction in profits, business expansion, sales turnover, increased input cost, lower product prices and increased labour cost.

Figure 5 Extent of Insurance uptake by businesses, %



Question of the Quarter

Insurance of the businesses against risks

In this quarter, we sought to understand if businesses were insured against risks such as theft, vandalism and fire listed. And if not, what are the constraint to insurance? We approached this by asking each business whether the business was insured against theft, vandalism and fire. In particular, we asked:

Is your business insured against threats such as theft, vandalism and fire? If no, why?

Results in Figure 5 indicate that overall, 60 percent of the businesses interviewed had ever insured against business risk. Among the businesses that had not taken up any insurance policy, 64 percent reported that high cost of insurance policies on the market was the key deterrent to uptake. As such, insurance providers in Uganda need to combine innovation in product and delivery to reduce the cost of this service. One such way would be introduction of micro insurance services for deep market penetration. The introduction of micro insurance schemes could be coupled with innovative distribution networks. This would entail using micro agents such as bank agents, mobile phones, popular motorbike outlets instead of sending agents on ground to sign up people for insurance policies. This would result in reduction of overhead costs of distribution of micro insurance by leveraging community structures.

Conclusions

Perceptions about the business environment in Uganda have slightly improved, rising from 100.8 in the previous quarter to 104.9 in the current quarter. The services sector registered the most gains largely explained by rapid expansion of the agent banking as well as entry of new players in Uganda's financial subsector. On the other hand, business perceptions in the agriculture sector registered the largest deterioration by 40.3 points, largely driven by a reduction in profits due to an onset of prolonged above normal rainfall across most parts of the country. In the manufacturing sectors, business perceptions remained subdued, escalated by continued closure of the Uganda-Rwanda border. The future outlook is pessimistic compared to the current quarter. The pessimism is projected to be driven largely by declines in perceptions in the services sector driven by an anticipated reduction in sales turnover, profitability and new business expansion. With regards to constraints, macro-economic factors, tax policy and existence of substandard goods on the market were perceived to have became more of a problem in the current quarter. The high cost of insurance policies in Uganda calls for innovation by insurance providers in both product and distributional channels to reduce overall cost.

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. The purpose of BCI is to forecast turning points in economic activity and thus provide 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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