ECONOMIC POLICY RESEARCH CENTRE

*Towards Sustainable Development*

# The Uganda Business Climate Index

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*Rehema Kahunde, Nathan Sunday, Corti Paul Lakuma and Brian Sserunjogi*

# Recovery in the manufacturing sector improves the business climate; but future outlook remains downcast

**Workers assembling phones at the newly commissioned Mobile-phone factory in Namanve**
*Source: The independent, November 22, 2019*

## Executive Summary

*The Business Climate Index (BCI) slightly improved from 100.3 in the previous quarter (April-June 2019) to 100.8 in the current quarter (July-September 2019). The slight improvement was largely driven by improvement in business perceptions in the manufacturing sector. Favourable business perceptions in the manufacturing sector are attributed to the reduction in the power tariffs for industrial consumers and stable power supply owing to provision of independent power lines for each industrial park. In addition, the appreciation of the shilling could be another reason for the good performance of the manufacturing sector given its reliance on imported inputs. Business perceptions in the manufacturing sector were also bolstered by higher profitability, labour availability, lower cost of labour and improvements in general business environment during the quarter. However, the positive perceptions were counteracted by the deterioration in the performance of the agriculture sector hence the marginal improvement in the overall BCI. Business perceptions and expectations for the next quarter (October – December 2019) remain subdued on the account of anticipation by firms regarding reduction in sales turnover, inadequate labour, and generally lower business optimism.*

## 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 178 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 July-September 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 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 improved slightly, but perceptions about the future remain pessimistic.

Results indicate that the Business Climate Index improved slightly by one half of percentage points to 100.8 during the current quarter (July-September 2019), from 100.3 points in the preceding quarter (April-June 2019). The slight improvement was against the backdrop of higher profitability, labour availability, lower cost of labour and improvements in general business environment. Figure 1 shows that the conditions for doing business as captured by the BCI index improved slightly. The improvement was driven by the rise in business perceptions for the manufacturing sector. As earlier mentioned, the good performance in the manufacturing is largely attributed to the reduction in the power tariffs for industrial consumers and adequate power supply to small, medium and large-scale industries owing to provision of independent power lines for each industrial park. According to statistics from Electricity Regulatory Authority (ERA), power tariffs for medium, large and extra-large industrial consumers reduced from UGX 605 to UGX 599, UGX 371 to UGX 366, and UGX 308 to UGX 305 per kilowatt-hour from the previous quarter to the current quarter respectively. This, together with the depreciation in shilling reduced the sector's cost of doing business. According to Bank of Uganda statistics, there was a 1.5 percent appreciation in the shilling from an average of UGX 3744 per USD recorded in the last quarter to an average of UGX 3689 per USD in the quarter under review which made the sector's imported inputs cheaper.

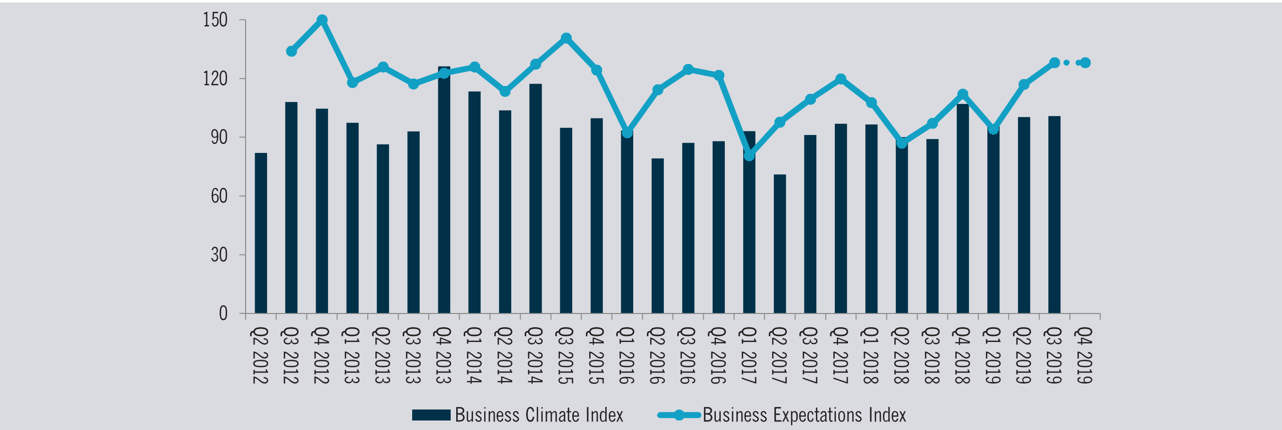
Figure 1 also indicates that business managers interviewed expect the business environment to worsen in the coming quarter (October–December 2019). This sentiment is largely driven by anticipated decrease in sales turnover, reduced labour availability, reduced product prices, lower profitability and general business pessimism.

### The Business Climate Index by Sector

During the current quarter, business sentiments improved in the manufacturing sector compared to the previous quarter. Indeed, changes in the perceptions of business conditions in the manufacturing sector improved more than perceptions in the service sector. The manufacturing sector index posted a 7.8 points increase to 116.6 from 108.8 points in the last quarter (Figure 2). As earlier mentioned, improvement in the manufacturing sector was largely driven by the lower electricity tariffs for industrial consumers. In addition, provision of independent power lines for each industrial park ensured the availability of reliable and adequate power to small, medium and large-scale industries. The positive sentiments in the manufacturing sector were favoured by: improvement in general business environment, reduction in input costs, increase in new businesses and better product prices during the quarter. Only business optimism, labour availability and sales turnover slightly deteriorated by 5.0, 2.6 and 1 percentage points respectively.

Perception of business conditions in the services sector registered the second best improvement though the changes were very minimal —a rise by 0.2 points to 98.3 from 98.1 in the previous quarter. Improvement in the services sector were registered against a backdrop of increase in labour availability which resulted into lower cost of labour, higher profitability, higher capacity utilization and better product prices. This minimal improvement could be attributed to positive development in the financial sector such as the granting of new commercial bank licenses to Afriland First Bank Uganda Limited and Opportunity bank Uganda Limited during the quarter. In addition, the improvement in the profitability in the banking sector which

**Figure 1** The Business Climate Assessment[1]




1 Solid lines show period under review.

**Figure 2** **Business Climate Index by Sector**

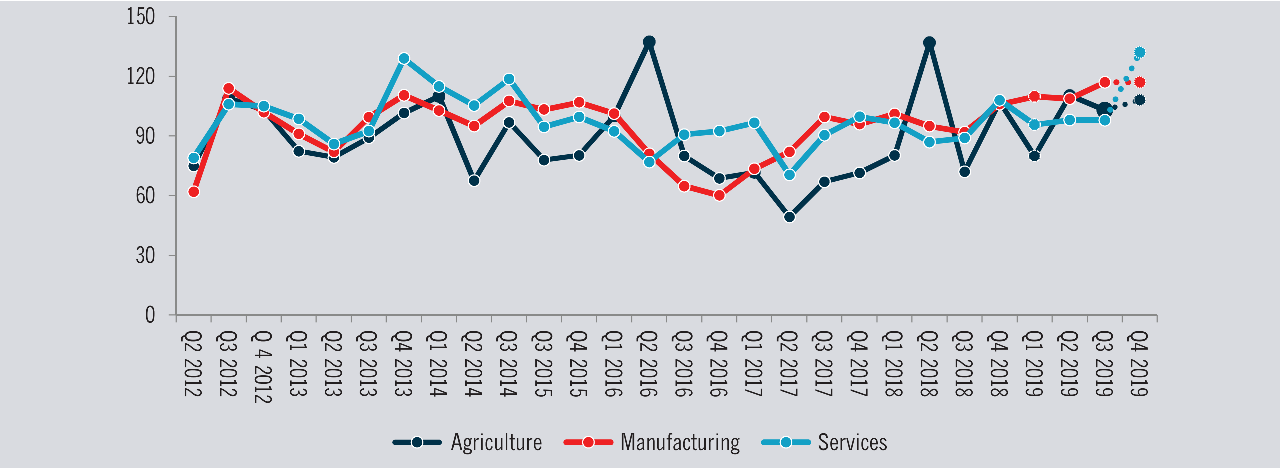
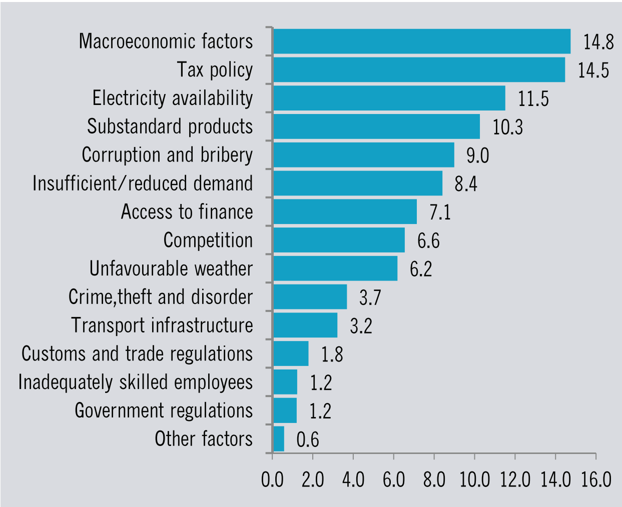



**Figure 3** **Business Constraints, %**




was driven by the 10 percent growth in deposits from UGX 3.75 trillion to UGX 4.1 trillion reported by largest commercial bank in Uganda—Stanbic Bank— in the 2019 half-year results could partly explain the slight improvement in the service sector.

In the agriculture sector, business sentiments declined by 7.7 points to 102.7 in the current quarter from 110.4 in the previous quarter. The decline was occasioned by lower business optimism, reduction in the sales turnover, absence of new businesses, and low profitability. The unfavourable sentiments in the agriculture sector can partly be explained by the decline in global food prices in August which were driven by the sharp falls in the prices of staple cereals as reported by FAO[1], resulting into a reduction in volumes of agricultural exports. For instance, Bank of Uganda statistics show that monthly exports of maize reduced from 41,785 tons in July to 40,197 tons in September. Monthly exports of simsim also reduced from 4,221 tons to 2060 tons between July and September.

## Challenges in doing business

The top three most important constraints (Figure 3) for doing business for the current quarter were perceived to be: macroeconomic factors, tax policy and electricity unavailability. The worsening in the macroeconomic environment is explained by a relative increase in lending rates, which increased the cost of credit. Data from Bank of Uganda indicate that commercial bank lending rates increased by 1.0 percent from an average of 19.5 percent in the previous quarter to 20.5 percent in the quarter under review.

## How have the business constraints evolved over the last period?

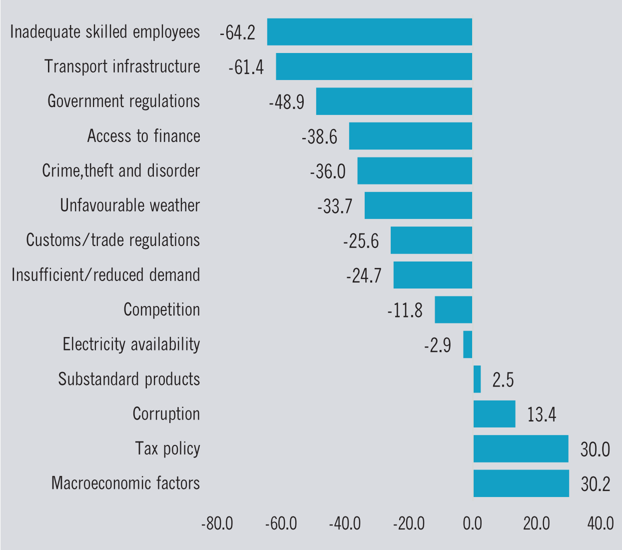
Unlike the previous quarter, where perceived electricity unavailability and unfavourable macroeconomic environment, and corruption and bribery were the most frequently cited problems, in this quarter, macro-economic factors, tax policy and corruption and bribery became more of a problem. Parliament's rejection of the 1 percent tax cut for beverage firms in July 2019 partly explains why tax policy could have become more of a problem. Similar to the previous quarter, inadequate skilled employees and poor transport infrastructure and government regulation became less of a problem in the quarter under review. Indeed, according to the World Bank's annual Country Policy and Institutional Assessment report 2019, Uganda scored above average in terms of raising the quality of the institutions and policies posting a score of 3.7.

## Future business outlook: October – December 2019

Unlike the last quarter, businesses are pessimistic about near term developments. The expected index for October–December 2019 is anticipated to be at 128.1, and this is 0.1 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 manufacturing sectors. The agriculture sector is expected to decline by 20.6 points from 130 registered in the last quarter to 108.4 in the coming quarter. The manufacturing sector is expected to decline by 6 basis points from 123.3 reported in the last quarter to 117.3 in the coming quarter. On the other hand, the service sector is expected to increase slightly by 3 points from 129.3 reported in the last quarter to 132.3 points in the fourth

1 http://www.fao.org/news/story/en/item/1207098/icode/

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



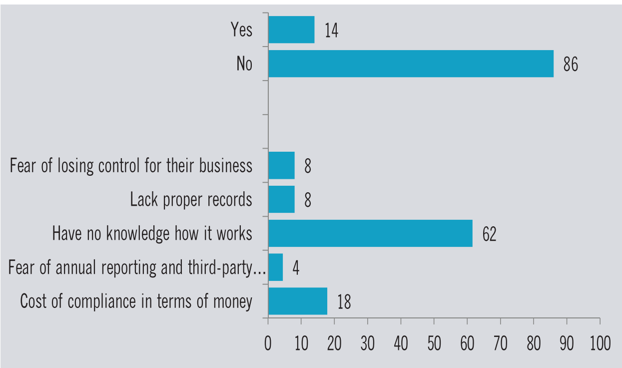

quarter of 2019. The unfavourable business expectations in the agriculture and manufacturing sectors are largely anchored on anticipated reduction in sales turnover, lower availability of labour, lower product prices and less business optimism.

## Question of the Quarter

### Listing shares on the stock market

In this quarter, we sought to understand if these businesses were listed on the stock market. And if not, what are the constraint

**Figure 5 Why businesses are not listed on the stock market, %**




to listing? We approached this by asking each business whether it has ever listed any shares on the stock market as a way of raising capital. We also sought to understand the constraints to listing. In particular, we asked:

***Have you ever listed your shares on the stock market as a way of raising capital? If no, why?***

Results in Figure 5 indicate that overall, only 14 percent of the businesses that were interviewed had ever listed shares on the stock market as a way of raising capital. The remaining 86 percent had never listed shares on the stock market. About 62 percent of the businesses reported having no knowledge of how the stock market works. There is hence a need by the Uganda Securities Exchange to intensify business education and mass awareness about the operation and benefits of businesses listing on the bourse.

## Conclusions

Perceptions about the business environment in Uganda have slightly improved, rising from 100.3 in the previous quarter to 100.8 in the current quarter. The manufacturing sector registered the highest improvement largely explained by the lower power tariffs. The appreciation of the shilling also partly explains the good performance of the manufacturing sector as it made the sector's inputs cheaper. The performance of the service sector also marginally improved and this was driven by the newly licensed commercial banks and the reported increase in profitability. On the other hand, business climate in the agriculture sector deteriorated by 7.7 points, largely driven by lower business optimism, reduction in the sales turnover, absence of new businesses, and low profitability. The future outlook is pessimistic compared to the current quarter. The pessimism is projected to be driven by declines in perceptions across the agriculture and manufacturing sectors driven by an anticipated reduction in sales turnover, lower availability of labour, lower product prices and less business optimism. With regards to constraints, macro-economic factors, tax policy and corruption and bribery became more of a problem in the current quarter. The failure of majority businesses to list shares on the stock market calls for measures to increase sensitisation about the working of the stock market in Uganda.

*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.

**Address**
Economic Policy Research Centre
Plot 51, Pool Road, Makerere University Campus
P.O. Box 7841, Kampala, Uganda
Tel: +256-414-541023/4
Fax: +256-414-541022
Email: eprc@eprcug.org

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