ECONOMIC POLICY RESEARCH CENTRE

Towards Sustainable Development

The Uganda Business Climate Index

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Ugandan Manufacturing sector performance declines as future business outlook further dampens.

An abandoned sawing room in Kiyimbe, Kampala.

Source: Sserunjogi Brian EPRC

Executive Summary

The Business Climate Index (BCI) remained below potential for the fifth consecutive quarter since the first quarter of 2020. Nonetheless, business perceptions in the current quarter (January-March 2021) improved slightly by 19 basis points from 37 in the previous quarter (October-December 2020) to 56 in the current quarter. The meagre improvement in business sentiments was primarily driven by a slight improvement in business activity which improved capacity utilisation and product prices. In particular, a favourable general business environment aided by a return to normalcy during the post-election period improved the general business optimism, increased labour availability and reduced labour cost for doing business in the current quarter. Meanwhile, business perceptions in the manufacturing sector further dampened compared to the previous quarter. This was against the backdrop of less favourable business activity, turnover, reduced capacity utilisation, increased inability to establish and expand new business centres. Perceptions about business sentiments in the next quarter (April–June 2021) are pessimistic about the anticipated rise in input cost, reduced product cost, reduced business activity and inability to establish new businesses.

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 167 business establishments. The panel element has enabled us to track the business environment in Uganda over time.

The BCI is computed based on the following business evaluation indicators: the 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 the quarter", "normal for the quarter", below average for the quarter" or "more favourable", "unchanged", "less favourable". These responses are coded as 0, 1, and 2, respectively. If a respondent's perception of the business environment 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. The index is sensitive to the direction instead of 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 the previous quarter; 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 means 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.

Also, the index analyses the evolution of challenges facing businesses over the last quarter by identifying which business constraints became more of a problem and less of a problem. We also ask business managers to indicate how each specified business constraint has evolved during the quarter. 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. A positive score suggests 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 a business constraint whose severity has remained unchanged.

Results

Business Climate Perceptions slightly improves, but future sentiment further deteriorate.

Results indicate a slight improvement in the conditions for doing business in the current quarter (January – March 2021), having improved from a generally pessimistic trend over the previous four quarters— since quarter one of 2020, i.e. January- March 2020 (Figure 1). The business climate index is 56 and has slightly improved by 19 index points on a quarter-on-quarter basis from 37 during October –December 2020. Despite the slight improvement in the conditions for doing business in Uganda during the period under review, all sub-indices, namely capacity utilisation, turnover, activity, labour, salary, and profit, were below potential (below 100). This indicates that, like the previous quarter (October –December 2020), the economy is still operating at less than full potential.

The below potential improvement in the business environment was driven mainly by some persistent challenges in doing business and some new emerging ones. In particular, the post-election uncertainty came with increased government regulation to ensure political tranquillity and stability amidst disruptions caused by the COVID-19 pandemic, elevated the perceived risks for doing business in the current quarter. In addition, insufficient demand, increased difficulty in accessing reliable and cheap electricity, unfavourable tax policy and volatility in the macroeconomic environment continued to be binding constraints to business competitiveness and were reported to be more of a problem in the current period.

Indeed by the end of the current quarter (March 2021), the government, under its free Electricity Connections Policy, had only prioritised free power connections to only businesses that do not require an electricity pole. Besides, in April 2021, the government passed new taxes in an attempt to raise revenues. Notably, under the Excise Duty Amendment Bill, 2021, which Parliament endorsed, motorists were required to pay an additional UGX 100 tax per litre of petrol and diesel. In addition, the depreciation of the Uganda shilling against the leading world currencies has affected business, especially in the services and wholesale trade where a sizeable amount of stock and other materials are imported. The nominal exchange rate continued to depreciate by 0.2 percent during January – March 2021 on a year-on-year basis. The depreciation of the local currency further strengthened the inflationary outlook.

The Business Climate Index by Sector

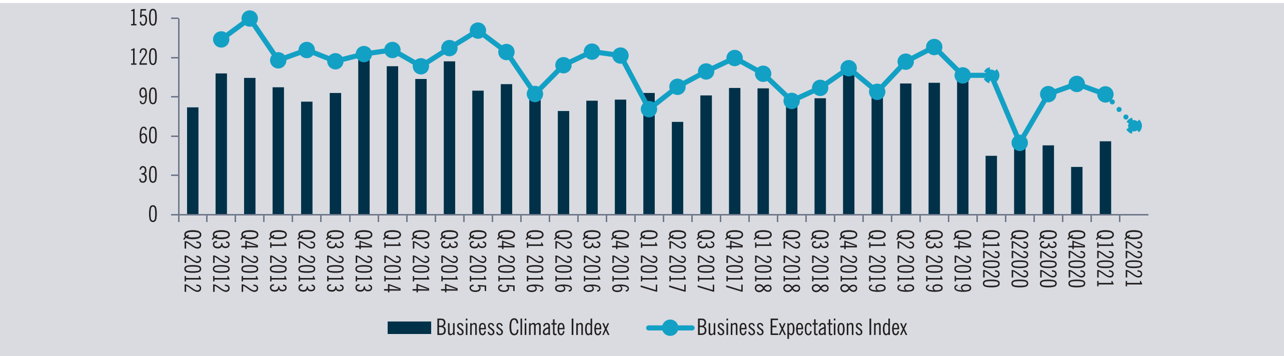
While perceptions in the agriculture and services sectors improved slightly, business perceptions in the manufacturing sector dampened further during the current quarter compared to the previous quarter (October-December 2020) (Figure 2). In this regard, the manufacturing sector further relapsed by 14.9 points to 31.5 from 46.4 points registered in the previous quarter. On the other hand, the services sector registered the most significant rebound, improving by 23.4 points to 57.8 from 34.4 points registered during the last quarter. Similarly, the agriculture sector further improved by 17.8 points to 64.8 from 46.9 points in the previous quarter (October-December 2020). The increased deterioration of business perceptions in the manufacturing sector in the current quarter was primarily attributed to the less favourable business activity, turnover, reduced capacity utilisation, increased inability to establish and expand new business centres that affected business profitability. These could have been amplified by the business uncertainty and anxiety due to a post-national election period.

On the contrary, the improvement in business sentiments in the services sector was on account of improved business activity, capacity utilisation, improved product prices, improved labour availability, lower labour cost, and general improvement in business optimism. Like developments in the services sector, business sentiment in the agriculture sector also improved compared to the previous quarter because of increased business activity, capacity utilisation, ability to expand business outlets and lower salaries due to improved labour supply.

Challenges in doing business

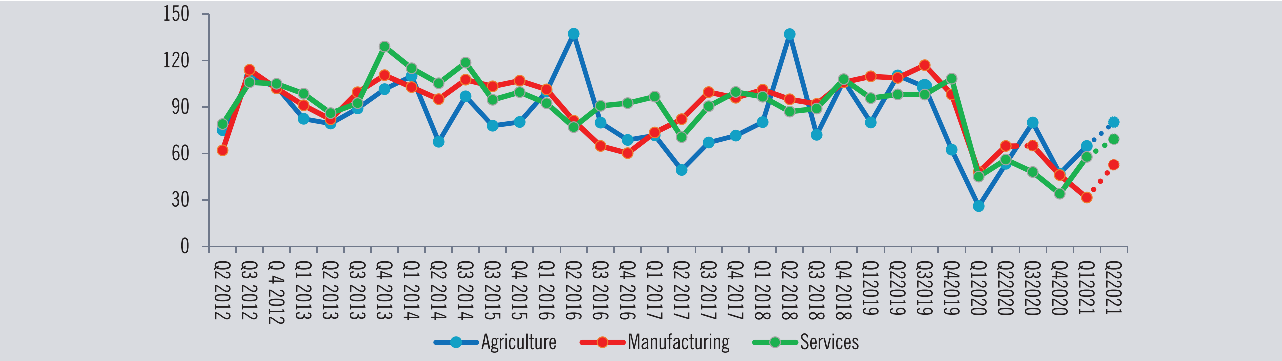
Unlike the previous quarter (October-December 2020), the top five most important constraints in doing business for the current quarter comprised increased government regulation and unreliable electricity supply. This was in addition to the persistent business challenges (insufficient demand, unfavourable tax policy and macroeconomic factors) that have not changed since last quarter. This suggests that

Figure 1 The Business Climate Assessment



Solid lines show period under review.
Source: EPRC Rapid Survey March 2021.

Figure 2 Business Climate Index by Sector



major policy and regulatory constraints facing Ugandan businesses are rather persistent. The increased government regulation in the current quarter could have emanated out of the need to adhere to the COVID-19 standard operating procedures to contain the further spread of the pandemic. In addition, macroeconomic factors, notably exchange rate volatility, continue to be the major business constraint in the current quarter. Challenges with electricity availability became more pronounced in the current quarter.

Just like in the previous quarter (October-December 2020), the persistent burden of insufficient demand emanated from the low purchasing power in the economy as a result of severe job losses caused by the COVID-19 pandemic and an increase in precautionary savings due to the rising uncertainties regarding income flows[1] in preparation for an uncertain post-presidential election period. Again, tax payment has continued to be burdensome on businesses since their capacity to meet tax obligations continues to be severely affected by the low business performance due to COVID-19 and its containment measures.

How have the business constraints evolved over the last period?

The results (Figure 4) indicate that some of the most critical challenges businesses had to deal with during the current quarter are those whose severity got worse over the current quarter. Unlike in the last quarter (October- December 2020), the severity of the challenges posed by increased government regulation and electricity unavailability were perceived to have been elevated during the current quarter. As already mentioned, tax policy was reported to be more of a problem in the current quarter as in the previous, due to a severe decline in the capacity of businesses to meet their tax obligations due to the subdued demand and sales turnover. Lastly, just like in the previous quarter, increased government regulation was serious concern within the business community in the current quarter, with high severity during the current quarter.

Future business outlook: April – June 2021

Like the previous quarter, businesses continue to be pessimistic about the near term developments. The expected index for April –

Figure 3 Business Constraints (%)

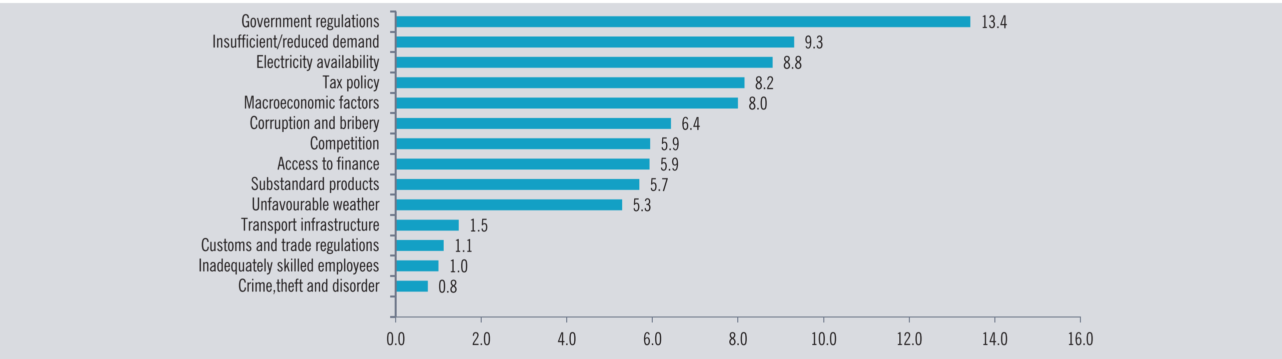
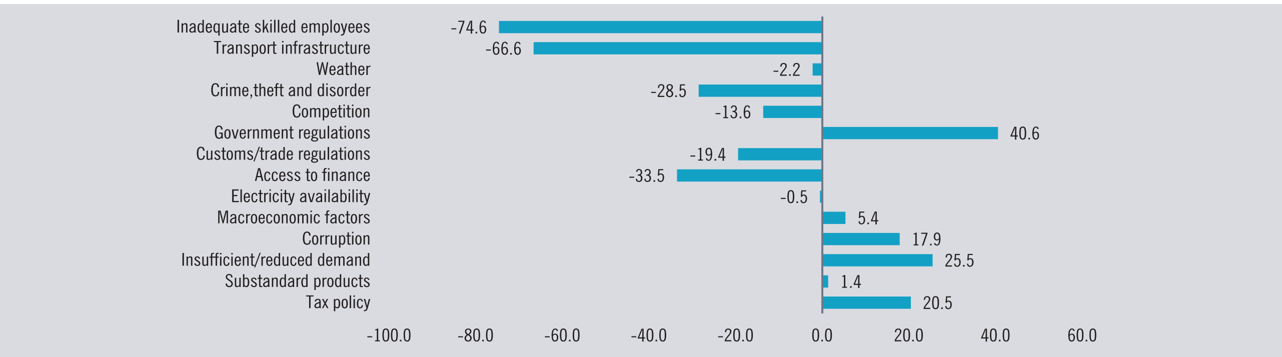


Figure 4 The evolution of business constraints (% of businesses)



1. https://www.bou.or.ug/bou/bouwebsite/bouwebsitecontent/publications/StateofEconomy/publications/StateOfEconomyReports/2020/Sep/State-of-the-Economy-September-2020.pdf

January 2021 is 67.9 (Figure 1) and is 24 index points lower than the current quarter's expectation which was 92 points. Further deterioration in business conditions is expected to relapse most from anticipated reduced business activity, turnover, profit, and increase labour scarcity, which is expected to limit business expansion, heightened by the disruptions due to the COVID-19 pandemic and the post-election uncertainty before swearing-in of the president.

Nonetheless, sectoral differences in the expected business environment exist. Lower business confidence is expected in the manufacturing and services sectors than in the agriculture sector. In particular, the manufacturing sector is anticipated to suffer more than the service sector, while the agricultural sector is expected to have rather a modest decline. The stock indices are 80.2, 52.7 and 69.2 for agriculture, manufacturing and services, respectively. The anticipated slightly favourable sentiments for doing business in the agriculture sector are attributable to the anticipated improvement in business activity, sales turnover, increased labour availability and reduced wages. On the contrary, the expected unfavourable business environment in manufacturing sectors is anchored around the anticipated deterioration of the general activity, turnover, reduction in capacity utilisation, and inability to expand new business operations, possibly signalling business risks associated with post-election uncertainty within the manufacturing sector.

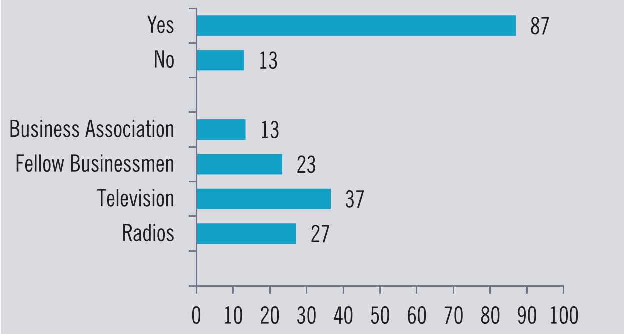
Question of the Quarter

Access to business development services

This quarter, we sought to understand if business owners had access to business development services (BDS) such as training, technology transfer, market assistance, corporate governance, mentoring, business advice, etc. In particular, we asked: a) "Does your business have access to business development services (such as training, technology transfer, markets assistance, corporate governance, mentoring, business advice etc.?" b) "If yes, What is the main source of business development services?"

Results (Figure 5) indicate that majority of businesses in our sample (87 percent) had access to BDS, such as business coaching, training, market intelligence, corporate governance, among others. However, among the firms with access to the BDS, about 37 percent accessed it through Television, 27 percent through radios, while 23 percent accessed it through fellow business people. In addition, the evidence presented in Figure 5 indicates that only 13 percent access BDS through business associations. These results reveal the need for government to strengthen BDS provision through multimedia channels. In light of the COVID-19 pandemic, the government could step up BDS by paying for more airplay on radios and Television sets, bringing on business experts, and ensuring that BDS provision is delivered in local dialects to ensure broader benefit of the entire business community.

Figure 5 Access to business development services



Conclusion

Perceptions about doing business in Uganda in the current quarter (January-March 2020) slightly improved compared to the previous quarter (October-December 2020). Despite the slight improvement in the conditions for doing business, all sub-indices, namely capacity utilisation, turnover, activity, labour, salary, and profit, were all below potential (below 100), reflecting heightened post-election uncertainty, amplified by disruptions caused by the COVID-19 pandemic.

Just like in the last quarter (October-December 2020), some business constraints persisted. In this regard, increased government regulation, unreliable electricity, unfavourable tax policy, insufficient demand and exchange rate volatility were critical binding constraints to business competitiveness in the current quarter. Considering future expectations, business sentiment for the next quarter (April-June 2021) further deteriorated across all sectors. The next quarter will see below-potential sentiments for the manufacturing, services and agriculture sectors due to anticipated unfavourable business activity, turnover, general environment and optimism.

Based on the findings, most business executives in Uganda have access to BDS and access these services via Television and radios stations. In this regard, it is vital to improve the duration of the airplay for these services as well as involve personnel with business knowledge and expertise to conduct these services in local dialects for the broader benefit of the entire business community. In addition to encouraging peer to peer learning and mentorship, the government needs to strengthen the provision of BDS through business associations across the country.

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. BCI aims to forecast turning points in economic activity and thus provide critical information for policymakers 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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