

## Perceptions of Ugandan Business Executives on the Current and Expected Business Economic Conditions

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### Introduction

The Economic Policy Research Centre (EPRC) in carrying out its mandate of advancement of research-based knowledge and applied policy analysis has initiated the Business Climate Index (BCI) for Uganda. The BCI reflects the perceptions of Ugandan business executives on the current and expected business economic conditions. The BCI is intended to be an indicator of economic activity, to supplement official statistics.

The major advantage of the BCI over other measures is that it will be compiled more frequently and more easily available. More importantly the BCI will be used to forecast turning points in economic activity, with a view of informing policy makers both in Government and business. The EPRC will prepare the BCI report on a quarterly basis, starting with this issue for quarter II, 2012.

The BCI is a composite perception index based on the following indicators: level of business activity, turnover, profitability, incoming new business, capacity utilization, average costs for inputs, prices of

produced goods, new orders for goods, business optimism, and number of employees. The Index is interpreted as follows: a negative value indicates deterioration and a positive value indicates improvement in the general business conditions.

Our results show that the business climate index is -18. This implies that the general business conditions have deteriorated over the last quarter. However, businesses perceive this poor business climate as temporary as the expected business climate index for the next quarter is expected to rise to 34, suggesting that general business conditions are expected to get better.

### Enterprise Distribution

The results presented here were computed from 96 business establishments selected randomly from across the country<sup>1</sup>. The detailed distribution of the businesses is shown in table 1 below. The classification of businesses by size was guided by the draft Micro Small and Medium Enterprises (MSME) policy (2011) that classifies a business as micro if it employs no greater than 4 people; small if it employs 5-50; medium if it employs 51-400 people and large if it employs more than 400 people.

**Table 1: Business distribution in Uganda, %**

Business Size	Business Type		Business Location		
Micro	7	Agriculture	4	Kampala	67
Small	48	Manufacturing	14	North	14
Medium	34	Services	82	East	19
Large	11				
Totals	100		100		100

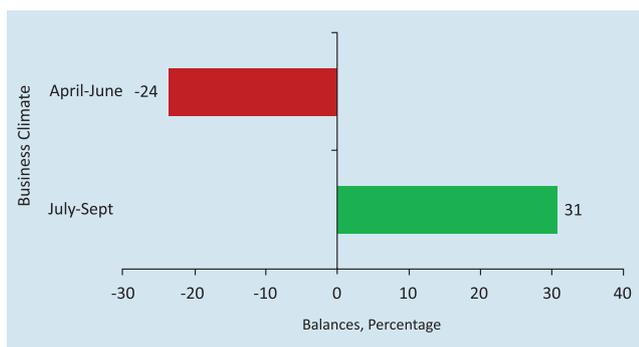
<sup>1</sup> The initial survey round did not include businesses in Western and Central Uganda

## The Business Environment Assessment

Generally, the business executives were asked to assess the current business environment (the general economic environment) by comparing the current quarter (April – June 2012) to the previous (Jan – March 2012). In addition, they were asked to give their expectations for the next quarter (July – September 2012). The respondents were asked to express their perceptions on a Likert scale as follows: – declined, – did not change, – improved. These responses were coded as -1, 0, and 1 respectively. For example if a respondent’s perception about the business environment is such that it declined, such a response would be coded -1, it would be coded 0 if business climate did not change and 1 if business climate improved. The index therefore is calculated as the balances or difference in the percentage of respondents who reported improvements to those who reported decline.

The findings show that the overall perception about the business environment in Uganda has deteriorated for the period under review. For example, 52 percent of all business executives indicated that the business climate declined, and 28 percent of the business executives indicated that business climate improved. Thus the balances score of the current (April – June) business environment is at -24 percentage points (Figure 1) implying that business climate deteriorated.

**Figure 1: The Business Climate Assessment**

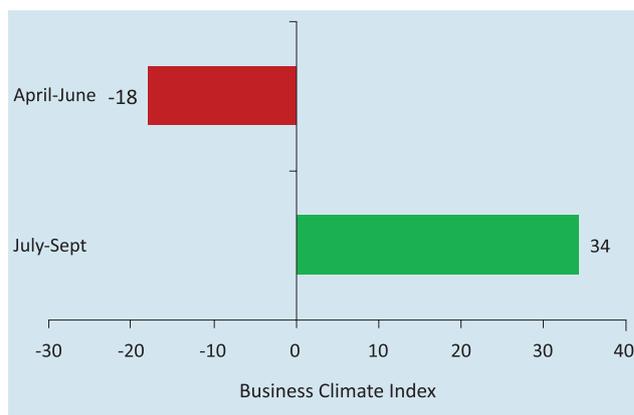


## The Business Climate Index

The business climate index is computed as a simple arithmetic average based on the following business indicators: level of business activity, turnover, profitability, incoming new business, capacity utilization, average costs for inputs, price of produced goods, new orders for goods, business optimism, number of employees, average monthly salary. The interpreta-

tion of the BCI is such that any positive scores point to an improving business climate, while negative scores would imply that general business conditions are getting worse. Consistent with the business environment assessment, our results (Figure 2) show that the business climate index, at -18, has deteriorated over the last quarter. However, businesses perceive this poor business climate as temporary as the expected business climate for the next quarter, at 34, suggests that general business conditions are expected to get better.

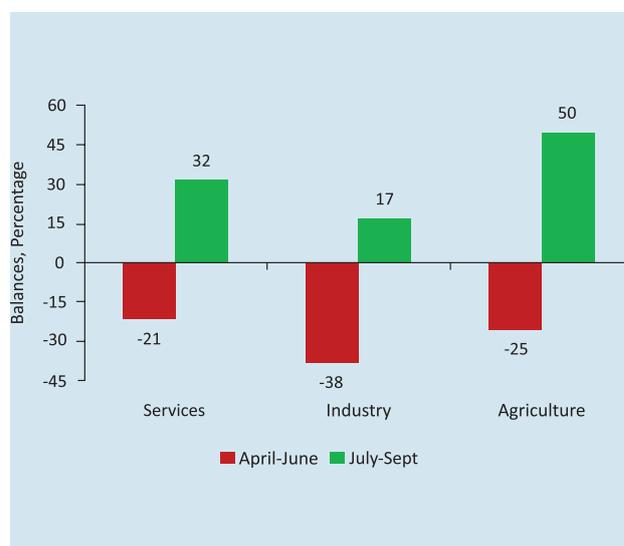
**Figure 2: The Business Climate Index**



## Business Climate Index by Sector

Overall, the business climate deteriorated across all the sectors of the economy (Figure 3). The industrial sector, with balances score of -38, was the worst hit by the deteriorating business climate. This was mainly on account of limited electricity supply, increased input and product prices and reduced capacity utilisation.

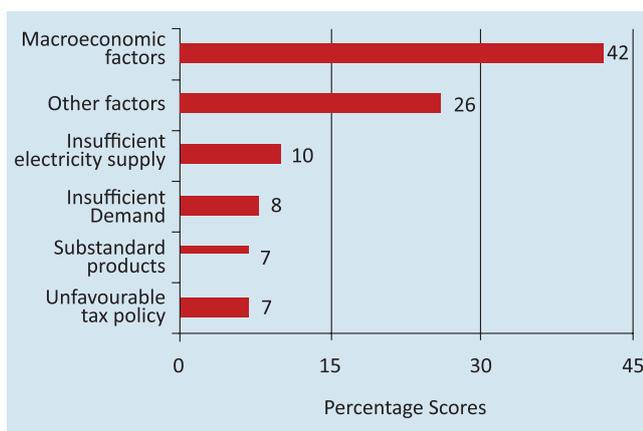
**Figure 3: Business Climate by Sector**



## Reasons for a declining business climate

For the period under review, the business climate declined on account of poor macroeconomic environment, inadequate electricity supply, insufficient demand and competition from substandard products especially in the local manufacturing industry (Figure 4). It should be remembered that the macroeconomic environment was particularly hostile at the beginning of 2012 exacerbated by the volatile exchange rates, inflation and high interest rates.

**Figure 4: Reasons for a declining business climate**



The central bank continued to pursue a tight monetary policy stance to stabilise the economy following the strong inflationary pressures that ravaged the economy in the last half of 2011 and the first quarter (Jan – March) of 2012. Bank of Uganda introduced the central bank rate (CBR) in July 2011 as a new rate that would be used to signal the bank monetary policy stance. Since its introduction, the CBR rose from 13 percentage points in July 2011 and reached its peak of 23 percentage points by November 2011 through January 2012, later reducing to 21 percentage points by March 2011. In the same time period, the commercial banks’ weighted average lending rates rose from 19.94 to 27.6 percentage points and annual private sector credit growth slowed from 40.9 to 21.7 percentage points.

The continued tight monetary policy stance owed to the persistence of the inflationary pressures for which the exchange rate, global commodity prices and food prices were the reported main causes. The tight monetary policy stance was also aimed at strengthening the local currency.

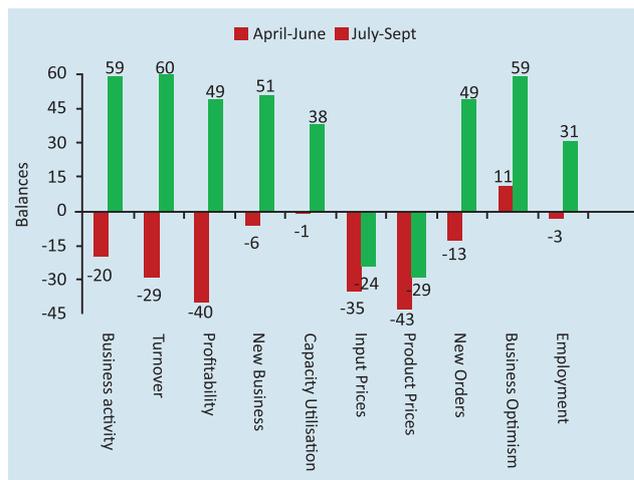
In addition to the turbulent macroeconomic environment, the business environment was bruised by limited electricity supply that crippled many businesses

while threatening to arouse public unrest. Businesses also suffered owing to politically motivated protests and strikes by traders, teachers and health workers, among others.

The external environment, shaped by both regional and global developments has not been conducive for business in Uganda. The political tensions in Uganda’s major regional export markets of Southern Sudan and the Democratic Republic of Congo, coupled with the economic crises in some of the European markets and slower growth in the United States have not augured well for a conducive business environment.

The business indicators (Figure 5) seem to suggest that overall business climate declined on account of the high input and product prices and subdued demand. In turn, these factors could have affected the levels of business activity, turnover, incoming new business and capacity utilisation.

**Figure 5: Business Indicators**



## Future outlook

Despite the poor prevailing business environment, most business executives are fairly optimistic about the future business developments. For instance, 48 percent of the business executives believe that the business environment will improve in the next quarter, while 17 percent believe that it will get worse. Thus the balances score for the future (July – Sept) business environment index is at 31 percentage points (Figure 1). The future business climate index based on the simple arithmetic average of the business indicators is 34 (Figure 2). This firm optimism implies that businesses perceive the current economic shocks as temporary.

In the next quarter, business activity is expected to rebound across all sectors. This is expected to result into improved incoming new business, turnover, profitability, and capacity utilisation. Inflationary pressures are expected to ease as is evidenced in the expected lower input and product prices. Businesses expect to create more jobs in the next quarter. Overall, business executives expect the business environment to ease next quarter.

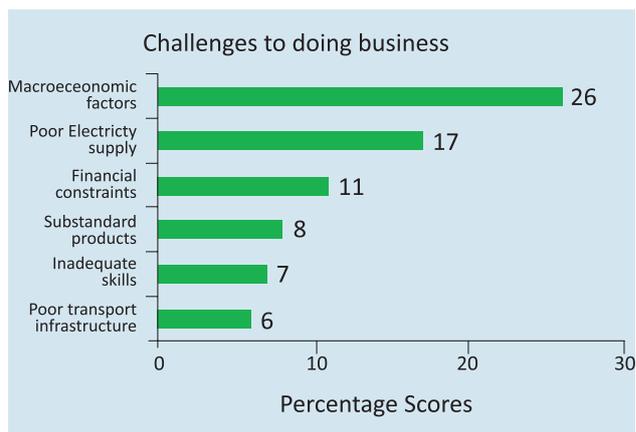
Recovery is expected to be highest in the agricultural sector, followed by services and much slower in industry as demonstrated earlier in figure 2. The positive future outlook is premised on expected better electricity supply, and the improving macroeconomic environment shaped by reducing inflation, a more stable exchange rate and better interest rates.

### Challenges in doing Business

Respondents were also asked about the challenges to doing business and the possible areas for Government policy interventions. Specifically, respondents were asked to evaluate the most significant challenges that would require Government intervention. Our results (Figure 6) suggest that businesses struggled to cope with the volatile macroeconomic environment that prevailed over the last three quarters. In particular, businesses cited the high interest rates, exchange rate risk and the high commodity prices as the biggest challenges.

In addition to the volatile macroeconomic environment, businesses were affected by the unreliable electricity supply (17 percent), financial constraints and inadequate capital (11 percent), competition from cheaper substandard products (8 percent) and inadequate skills for technical staff (7 percent). Other challenges that affected businesses over the last quarter include climate change and a tax system that is perceived as inelastic and unfair.

**Figure 6: Challenges to doing business**



### Conclusions

Most business executives are optimistic about the future business climate and trends, despite a downcast assessment of the current business environment. Recovery is expected to be highest in the agricultural sector, followed by services and much slower in industry.

The deterioration of the business climate over the last quarter has been on account of some macroeconomic factors (inflation, interest rates and exchange rate volatility), institutional factors (for example failure of the Uganda National Bureau of Standards and the Ministry of Trade Industry and Cooperatives to curb the infiltration of substandard products) and infrastructural challenges (such as transport and electricity). This in turn resulted into reduced business activity, turnover, profitability and employment.

Therefore, addressing the key challenges in doing business will be instrumental in revamping Uganda's business growth and employment creation.

#### 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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