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## Business Perceptions Indicate Slow Recovery in Economic Conditions

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Truck awaits inspection at Malaba Border Post

### Executive Summary

In July – September 2012 the business climate index remained weak at score of 8, having improved from a score of -18 in the April-June quarter. This implies that the general business conditions have improved over the last quarter. Expectations for the next quarter (October-December 2012) are that the business climate will continue to improve on account of a more stable macroeconomic environment, improved reliability of electricity supply and better than expected rains in the July – September quarter.

### Background

The Economic Policy Research Centre (EPRC) initiated the quarterly Business Climate Index (BCI) for Uganda, starting with the April – June 2012 issue. The BCI reflects the perceptions of Ugandan business executives on the current and expected business economic conditions with regard to their business. The BCI is intended to be a perceptions indicator of economic activity, to supplement official statistics.

The major advantage of the BCI over other measures is that it is compiled more frequently and therefore contains recent and up to date information. More importantly the BCI can be used to forecast turning points in economic activity, with a view of informing policy makers both in Government and business.

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 can take scores in the range -100 to +100 and is interpreted as follows: a negative score indicates deterioration and a positive score indicates improvement in the general business conditions.

### Data

The data used in computing the business climate index was collected from 150 business establishments sampled from the 450,000 businesses 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, while 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 the business managers. We followed up the same businesses as in the April – June quarter and we intend to keep tracking the same businesses over time. The distribution of the sampled businesses is presented in Table 1.

Table 1: Distribution of the sampled business, %

Business					
Size <sup>a</sup>	%	Type	%	Location	%
Micro	8	Agriculture and agro processing	19	Kampala	52
Small	34	Hotels, recreation and tourism	17	Central	16
Medium	30	Manufacturing and industry	14	East	13
Large	28	Mechanical services	13	North	7
		Retail and wholesale trade	18	West	12
		Professional and other services	19		
Total	100		100		100

Notes: <sup>a</sup> 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 100 or more people.

## 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 utilization, average costs for inputs, price of produced goods, new orders for goods, business optimism, number of employees, 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”. These responses were coded as -1, 0, and 1 respectively. For example, if a respondent’s perception of the business environment is that it deteriorated, such a response would be coded -1, it would be coded 0 if business climate did not change and 1 if business climate improved.

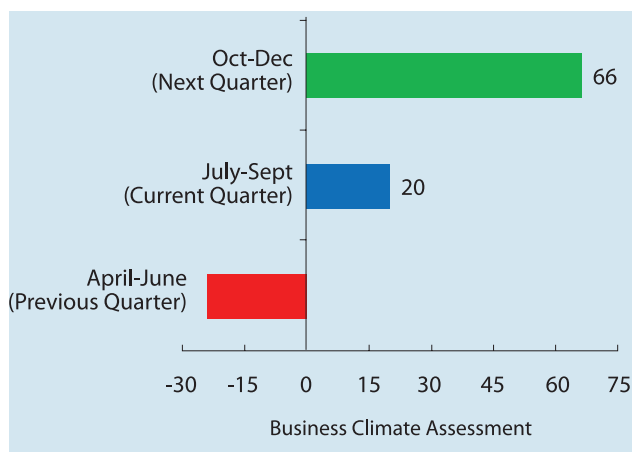
The balance score of a business evaluation indicator is the difference in percentage shares of the responses “improved” and “declined”. The business climate index is computed as the weighted arithmetic mean of the balances based on the business indicators described above. The interpretation of the Index is such that any positive scores point to an improving business climate, while negative scores would imply that general business conditions are getting worse.

## Results

### The Business Environment Assessment

The business executives were asked to assess the general economic environment for the July-September quarter relative to the precious quarter (April-June); and their expectations for the next quarter (October – December 2012).The findings show that the overall perception of the business environment in Uganda improved for the July-September 2012 quarter. For example, 43.5 percent of all business executives cited improvement, decline was cited by 23.6 percent and 32.9 percent cited no change. Thus the balances score for the July – September quarter business environment stood at 20 percentage points as illustrated in Figure 1. This result implies that the perceived business conditions have improved compared to the April-June quarter when the balances score stood at -24 percentage points.

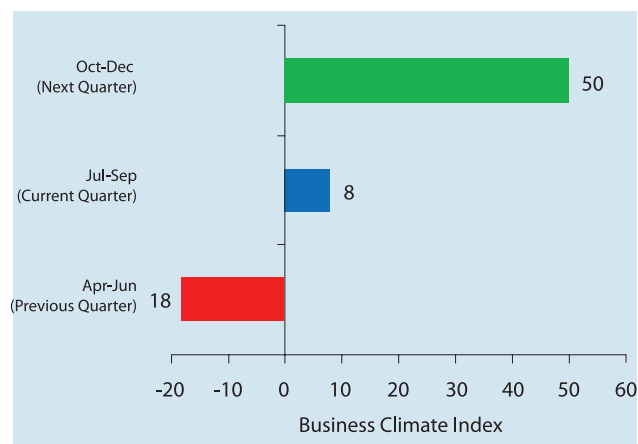
Figure 1: The Business Environment Assessment



### The Business Climate Index

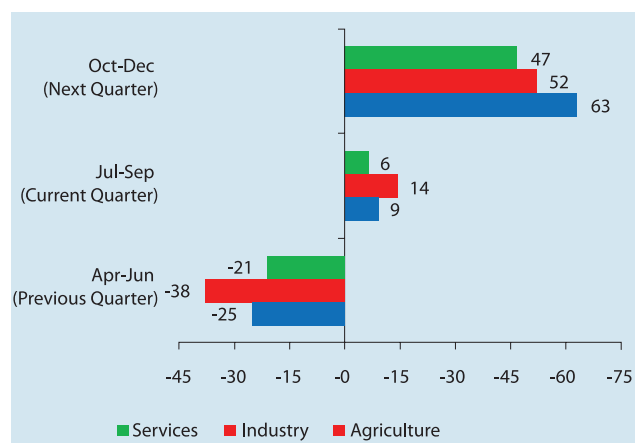
Consistent with the business environment assessment, the results in Figure 2 confirm that the business climate improved for the July-September quarter. The business climate index, computed at 8, is still weak but depicts a more positive perception about the business conditions in Uganda, compared to the April – June quarter when business executives expressed a downcast assessment of the business climate.

Figure 2: The Business Climate Index



At disaggregated level, Figure 3 reveals that overall improvement across all the sectors of the economy with the industry sector (index score of 14) recording the greatest improvement followed with agriculture (index score of 9).

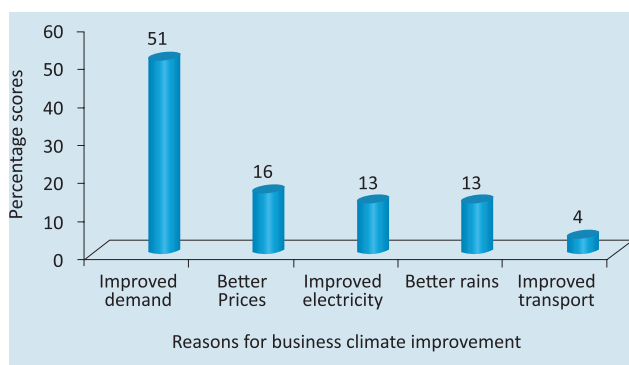
Figure 3: Business Climate Index by Sector



### What explains the observed improvement in the business climate?

For the July-September quarter the business climate improved, albeit weakly, on account of improved demand for products and services particularly for the retail and whole sale trade sector; better than expected rains that might have boosted agriculture production; improved electricity availability that favoured mostly industry and agro processing; and better international market prices especially for sugar and tea (Figure 4). The business sector also benefitted from a more stable macroeconomic environment as the inflation levels were steadily declining and the exchange rates more stable.

Figure 4: Reasons for an improving business climate, %



### ***i) Improving macroeconomic environment***

The macroeconomic environment that was particularly hostile in the first half of the year continued to stabilize with inflation rates, as measured by the Consumer Price Index, easing from 18 percent in June to 5.4 percent at the end of September. Following gains in bringing down inflation, and a disinflationary trajectory in the near future, the central bank continued to ease the monetary stance, reducing the Central Bank Rate (CBR) by 5 percentage points from 20 percent in June to 15 percent in September 2012. The move to reduce Central Bank Rate (CBR) was aimed at stimulating the economy following a slowdown in real economic growth due to subdued domestic demand. According to statistics available from the Uganda Bureau of Statistics, real GDP growth has slowed to 0.6 percent in the April- June Quarter of 2012, but improved to 1.8 in the July – September Quarter of 2012.

Despite these reductions in the CBR, the commercial banks' weighted average lending rates have been slow to adjust downwards. The weighted Uganda shillings denominated lending rates reduced from 27.0 percent in June to 25.7 percent in September 2012. The persistently high interest rates resulted into slower growth in private sector credit, whose annual growth decelerated from 10.8 percent in June to 3.9 percent in September 2012. Specifically credit to agriculture, trade and personal loans decelerated to negative growth rates at about -7 percent, -6 percent and -13.7 percent, respectively. This implies that nominal credit to the above sectors declined during July-September quarter.

### ***ii) Improved electricity supply***

The business environment has improved owing to increased supply in electricity. This follows the completion and commissioning of the 250MW Bujagali hydro electricity project in June 2012 and the 3.5MW Nyagak plant in September 2012. These positive developments in the electricity sector notwithstanding, business executives still report that the price per unit of electricity is high. It should be remembered that in January 2012 the Government decided to scale down on subsidies to the electricity sector, choosing to focus on increased investments that will ensure improved electricity supply to match the growing demand. The aim is to adopt marginal cost reflective tariffs that will be adjusted monthly for inflation, fuel prices

and exchange rate movements.

At sub-regional levels, challenges still remain and require policy attention. The gains due to improved electricity supply are not equally enjoyed across the country. For example, in the West Nile Region, business executives agree that the Nyagak dam has provided some relief, but there are still challenges with reliability of electricity supply, possibly owing to the dilapidated distribution network that needs to be upgraded. In the South western part of the country, some businesses continued to report frequent electricity blackouts leading to massive loss of revenue.

### ***iii) Other factors***

Other factors that have led to an improved business climate include improved rains that were reported as above normal for the season that resulted in better yields, especially for perennial crops such as tea and sugar. In addition exporters for agro processed products for the same category of crops (tea and sugar) reported an above normal price for their exports that resulted into a better business environment.

### ***Future outlook – October-December quarter***

Notwithstanding the structural constraints to improving business environment, most business executives are fairly optimistic about the future business developments. Nearly, 72 percent of the business executives were optimistic of improved business environment in the next quarter, while 6 percent believe that it will get worse. Thus the balances score for the October-December quarter business environment index stood at 66 percentage points (see Figure 1). The future business climate index based on the simple arithmetic average of the business indicators is 50 (Figure 2).

The business activity is expected to rebound across all sectors, with greatest improvements expected in the agriculture sector (index score of 63) followed by the industry sector (index score of 52). This is expected to result in improved incoming new business, turnover, profitability, capacity utilisation, and employment. Business executives do not expect significant further reductions in the inflation as the current and expected balances scores for the product and input prices are not significantly different. Overall, they expect the business environment to continue improving in the next quarter. However, future expectations for the October-December quarter do seem to suggest that the greatest improvement will be in the agricultural sector (at an aggregate score of 63) followed by the industry sector (at an aggregate score of 52) (see Figure 2).

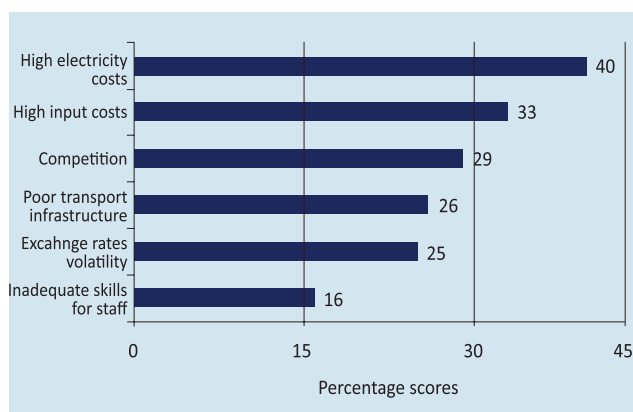
The strong optimism about the near future outlook is premised on expected better electricity supply, and the improving macroeconomic environment characterised by reducing inflation, a more stable exchange rate and expected reductions in the commercial bank interest rates. This optimism provides some hope regarding the performance of the economy.



### Challenges in doing business

The Business Executives were also asked about the most pressing challenges they face in doing business that require urgent Government policy interventions. Despite the improved electricity supply, the results in Figure 5 suggest that businesses executives still perceive the cost of electricity (40 percent) as the single most burdensome challenge in doing business. Businesses are also struggling to recover from the recent inflationary pressures (33 percent) that resulted into the persistently high commodity prices. These high prices probably explain the observed slower recovery of effective demand for products and services. The other most cited challenge was increased competition (29 percent) - this partly confirms the business fears arising from the East African Common Market and unregulated imports of rather low quality products from China. Figure 5 also depicts other challenges that include: poor transport infrastructure, exchange rate fluctuations, inadequate skills for technical and managerial staff and financial constraints and inadequate capital, among others.

Figure 5: Challenges to doing business, %



### Conclusions

Using perceptions data collected from 150 firms, we set out to assess the current and expected business economic conditions. We achieved this by constructing a business climate index, computed as the weighted arithmetic mean of the balances scores based on the business indicators. We show that compared to the previous quarter (April – June 2012), conditions for doing in Uganda have improved slightly in the current quarter (July – September 2012). The business climate index improved from -18 to 8 signifying recovery in the business activity. The perceived improvement was due to the stabilising macroeconomic environment and better than expected rains that boosted agricultural production. The business sector also benefited from improved electricity supply.

However, recovery in the economic activity during July-September quarter has been slower than anticipated. This has been on account of low domestic demand for goods and services, and some persistent constraints in doing business. Notwithstanding improvements in the supply and availability of electricity, businesses still rank the cost of electricity as the single most important challenge in doing business followed by the high cost of inputs.

It is important to note that despite a weak assessment of the current business environment, most business executives are optimistic about the future (October-December quarter) business climate trends. This optimism is premised on Government's continued focus on the key drivers of business growth and competitiveness. Such drivers include a stable macroeconomic environment and infrastructure development particularly in transport and energy sectors.

#### 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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