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The business climate in Uganda: implications for job creation

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Executive Statement

This brief is a summary of the findings of four business climate surveys conducted in the four quarters between April 2012 and March 2013. The purpose is to highlight the evolution of Uganda's business climate and its implications for business expansion and employment creation. For each of the surveys we followed up and interviewed the same business establishments. Our results show that the business climate has been weak and declining in the last four quarters. In addition results show that businesses are operating below capacity and that under the current business conditions they are not likely to create new employment opportunities. Moreover, businesses have expressed dissatisfaction with the available labour force describing it as unproductive due to its perceived inadequate education, poor work ethic and insufficient capacity to innovate. We therefore make the recommendation that any measures geared towards creating employment opportunities should also consider ameliorating the business environment and equipping the labour force with the necessary skills to improve productivity.

Introduction

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 near-future (expected) business conditions. The BCI is a perceptions indicator of economic activity that is intended to supplement official statistics. In this regard the BCI gives a feel of the economy from the perspective of the business managers. The major advantage of the BCI over other measures such as the Gross Domestic Product (GDP) 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 providing timely information to policy makers and decision makers both in Government and the private sector.

The scope

The data used in computing the business climate indices are collected from 150 business establishments sampled from the 450,000 businesses in the 2011 Uganda Bureau of Statistics business register. The businesses are spread across 25 districts covering all regions and sectors. The surveys target business managers as the respondents. We keep following the same businesses every quarter. The distribution of the sampled businesses is presented in Table 1.

Table 1: Distribution of the sampled businesses, %

Business					
Size[a]	%	Sub sector	%	Location	%
Micro	10.29	Agriculture and agro processing	22.29	Kampala	42.86
Small	24.57	Hotels, recreation and tourism	22.29	Central	21.14
Medium	38.86	Manufacturing and industry	10.29	West	13.14
Large	26.29	Mechanical services	11.43	East	12.57
		Retail and wholesale trade	13.71	North	10.29
		Finance, IT and other services	12.57		
		Social Services	7.43		
Total	100		100		100

Notes: [a] 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 more than 100 people.

How do we evaluate the business climate?

The business climate index is computed as the arithmetic and seasonally adjusted average of indicators that include: level of business activity, turnover, profitability, incoming new business, capacity utilisation, average costs for inputs, price of produced goods, new orders for goods, business optimism, number of employees, and average monthly salary.

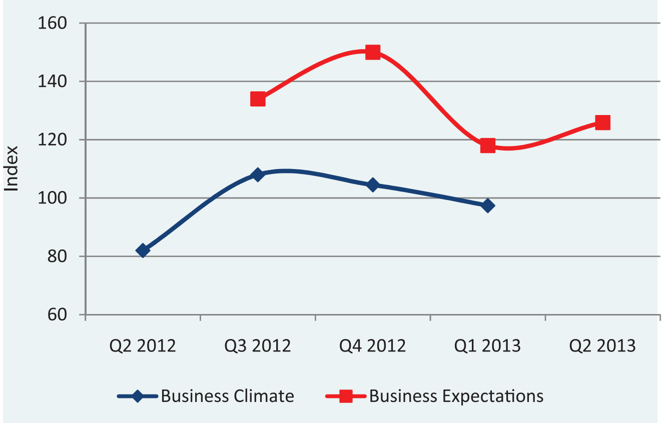
For each of the evaluation indicators, respondents are asked to express their perceptions on a Likert scale as follows: "improved", "did not change", "declined" or "above normal for quarter", "normal for quarter", below normal for quarter" or "less favourable", "did not change", "more favourable". The responses are coded as 0, 1, and 2 respectively. For example, 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 business climate did not change and 2 if business climate improved. As such the index is sensitive to the slightest changes in business sentiment since it does not consider the magnitude of the change in business conditions.

The index of a business evaluation indicator is the average difference in percentage shares of the responses "improved" and "declined" or "above normal for quarter" and "below normal for quarter". The business climate index is computed as the weighted arithmetic and seasonally adjusted mean of the individual component indices based on the business indicators described above and takes the range 0 – 200. The interpretation of the Index is such that scores above 100 point to an improving business climate, while scores below 100 imply that general business conditions are getting worse.

The business climate is weak

The results from the initial four rounds of the business climate survey show that Uganda's business climate is weak and has been declining since the second quarter in the annual year 2012. However, the business climate is expected to recover in the near future owing to an expected recovery in economic conditions. The recovery in business perceptions will be supported by the expected continuity in macroeconomic stability and an upturn in the global economic outlook that is expected to boost export demand.

Figure 1: The Business Climate in Uganda



What explains the weak business climate?

The business climate is weak due to the perceived persistence of some binding constraints in doing business. Such constraints include; the cost of inputs, constraints in electricity reliability and cost; difficulty in accessing capital; proliferation of substandard products on the Ugandan market; inadequately skilled labour; poor transport network; increased competition, high taxes and inadequate demand. It is important to note that when there are changes in the percentage of firms reporting a certain challenge it should not be interpreted that a specific element is improving or deteriorating. Changes in the most important challenges in doing business should only be interpreted as changes in what factor is currently most relevant to firms.

Table 2: Challenges in doing business

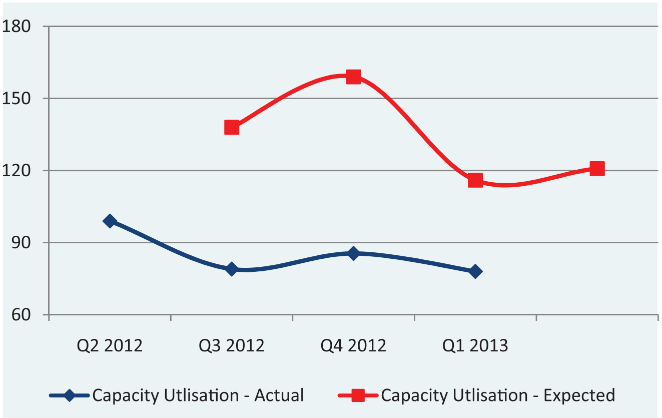
Challenge	Percentage of firms reporting a challenge			
	Q1 2012	Q2 2012	Q3 2012	Q1 2013
Cost of inputs	26	33	23	20
Electricity constraints	17	40	16	12
Financial constraints	11	-	7	16
Proliferation of substandard products	8	-	7	4
Inadequately skilled labour	7	16	10	7
Poor transport infrastructure	6	26	13	13
Competition	-	29	14	13
Exchange rate uncertainty	-	25	-	-
Inadequate demand for products	-		10	5
High taxes	-	-	-	11

Currently, the biggest challenges include the cost of inputs, infrastructure constraints – including in the electricity, roads sectors and access to financing and an inadequately skilled labour force.

Businesses are operating below capacity

Our data shows that Ugandan businesses are operating below capacity. The capacity utilisation index averaged 85.3 signifying limited business expansion and idle factor resources. The low level of capacity utilisation also points to the state of the economy. Between 2012 and 2013 national economic growth slowed down significantly. GDP growth slowed from 6.7 percent in 2011/2012 to 3.4 percent in 2012/2013. The major causes of reduced economic growth were a fall in the prices of commodity exports, high fuel prices, bad weather and turbulences in the global economy.

Figure 2: Capacity utilisations is below potential



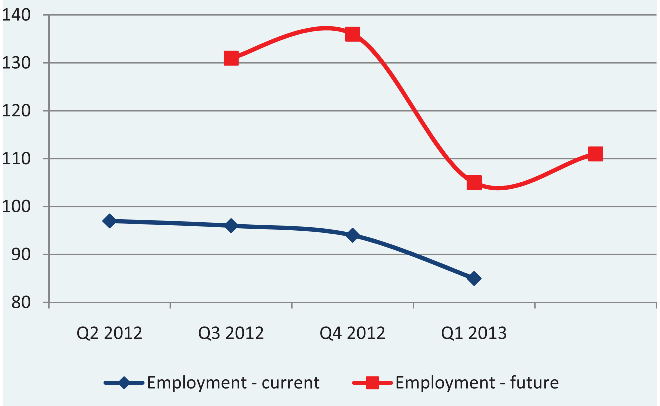
Subsequent developments in the local economy that included the withdrawal of donor financing exacerbated the problem. The donor aid cuts resulted into slowed project implementation by the Government which led in reduced economic activity, and thus affected doing business in Uganda. When capacity utilisation is low, businesses cannot expand and possibly create jobs. In addition falling consumer demand and increased competition that eats up market share did not auger well for business expansion.

Businesses are struggling to create jobs

All the factors explained above have resulted into limited opportunities for business to expand and create jobs. The ability of businesses to employ additional labour is weak and as shown in the graph below it has been declining over time.

As explained earlier, one of the binding constraints to business growth and competitiveness is the challenge of an unskilled and unproductive labour force, and it

Figure 3: Jobs are not forthcoming

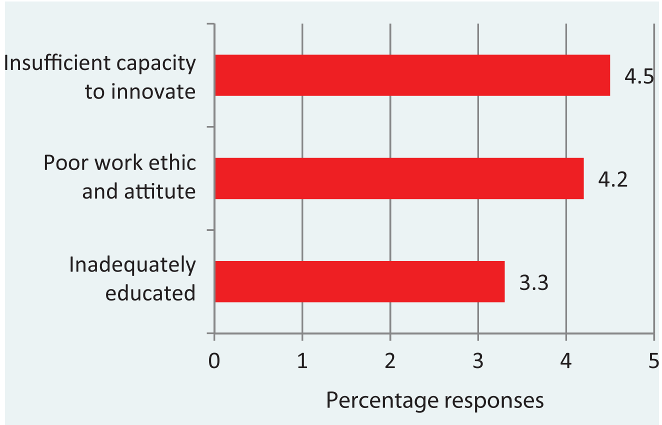


is one of the top constraints that have been reported by firms as greatly affecting the business climate. Obviously the inability for businesses to be able to easily identify adequately motivated and qualified work force has implications for firm survival and job creation.

Why is the Ugandan labour force perceived to be unproductive?

The Africa competitiveness report 2013 that is jointly published by the World Bank, the African Development Bank and the World Economic Forum provides comprehensive insights into the challenges facing the labour force in Uganda: they are not adequately trained; have a poor work ethic and have insufficient capacity to innovate.

Figure 4: The challenges with the Ugandan Labour Force



Notes: Respondents were asked to name the most problematic factors and rank them between 1 (most problematic) and 5

Source of data: The Africa Competitiveness report 2013

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About the Author

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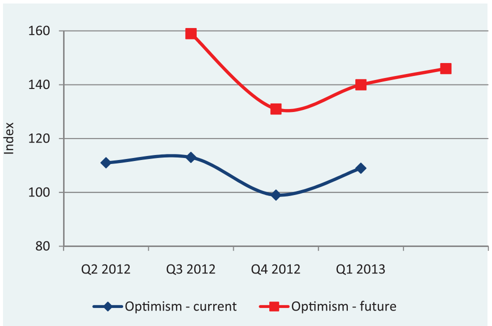
Optimism is high

Despite the poor business climate and its associated effects on capacity utilisation and employment creation, business people are fairly optimistic that things will get better. It is this optimism that keeps firms in operation, otherwise they close shop. The average optimism score for the last four quarters was 104 and has been on an upward trend since the last quarter of 2012. The optimism is premised on expected continuity of the macroeconomic stability characterised by stable product and input prices (low inflation), a more stable exchange rate and expected reductions in the commercial bank interest rates. Overall, business executives expect the business environment to improve in the near future. This optimism is likely to result into business expansion. But first policy makers must try to address the identified challenges that constrain business growth.

Figure 5: Optimism is high among firms



Conclusions:

The business climate in Uganda is weak and this has had negative implications for business expansion and job creation. The weak business climate is on account of some binding constraints to business growth that include the poor state of Uganda's infrastructure, high cost of inputs and external shocks due to a weak global economy. Other factors include the perceived increased competition, falling consumer demand and the withdrawal of donor funding that affected government project implementation. Of particular concern, businesses continue to report that they are constrained by a work force that is inadequately skilled coupled with a poor work ethic and limited capacity to innovate. These challenges notwithstanding the future outlook points to promising environment for businesses to thrive, expand and create jobs.

References:

World Bank, African Development Bank, and World Economic Forum, (2013), The Africa competitiveness Report

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