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# Supermarkets struggle to stay in business in Uganda dampening the business climate.

## Executive Summary

*The Business Climate Index declined and remained well below potential by 22.12 percentage point to 70.93 during the current quarter (April – June 2017) from 93.05 in the preceding quarter (January – March 2017). This is the eighth consecutive quarter that the business climate index has indicated unfavourable business performance and is largely explained by low demand that has led to collapse of some retailers key among them Nakumatt Supermarket and poor performance of the agriculture sector due to persistent adverse effects armyworms invasion. This calls for monetary policy responses to improve aggregate demand and fiscal policy interventions to combat the effects of the armyworm. Nevertheless, the future outlook (July – September 2017) remains favourable driven by rising profits margin, new business opportunities and favourable input cost in the agricultural sector and increased capacity and reduced labour cost in the service and manufacturing sector.*

## Data and methods

The data used in computing the business climate index were collected from 179 business establishments sampled from the 450,000 businesses recorded in the Uganda Bureau of Statistics Census of Business Establishment 2011. Throughout the surveys

# The Uganda Business Climate Index



Photo: Nakumatt Supermarket in Katwe Closed  
 Source: Matooke Republic (2017)

we keep following the same businesses. This enables us to construct comparable indices through time.

The business climate index 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.

It is worth noting that 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, the business managers were asked to assess the general economic environment for the current quarter (April – June 2017) relative to a similar period a year earlier; and their expectations for the next quarter (July – September 2017). 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 business climate index 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 over the last quarter, by identifying which business constraints are more of a problem and less of a problem. The survey respondents were asked 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.

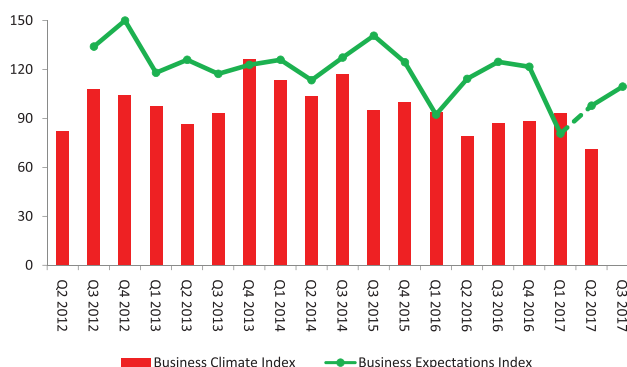
## Results

### Supermarkets struggle to stay in business dampening the business climate perceptions

Results indicate that the Business Climate Index deteriorated by 22 percentage points to 70.93, during the current quarter (April – June 2017), from 93.05 points during the preceding (January – March 2017) quarter. This suggests that conditions for doing business are in decline and remain well below potential. The decline in the perception on doing business in Uganda came in the face of the collapse of two large supermarkets, *Nakumatt* and *Tuskys*, and persistence of the effects of the army worm attack on Uganda’s agricultural sector posing a major threat to food security and agricultural trade. This is the eighth consecutive quarter where the business climate index has indicated unfavourable business performance (Figure 1) on the backdrop of low business activity, poor turnover, reduction in profit, absence of new business, capacity constraints and high input costs.

While business managers interviewed remain bullish about the future prospects of the economy (figure 1), driven by new business prospects, lower input costs, and affordable and skilled labour, *Nielsen Africa Prospects* report of May 2017<sup>1</sup> shows that reduced spending, rising cost of living and high interest rate regimes that exacerbate debt default are making it difficult for businesses, especially retailers to operate in Uganda. Despite the Bank of Uganda’s efforts to reduce the Central Bank Rate (CBR) from 11.50 in at the end of January – March 2017 quarter to 10 percent in the end of the April – June quarter, the prime lending rates remain high at 21.1 percent. This suggest that commercial banks have a significant risk perceptions of Uganda’s economy. Nevertheless, retailers need to improve suppliers’ credit management in the face of falling consumer demand. Particularly, retailers need to adjust to the risk aversion amongst consumers in Uganda, which has put pressure on the retailers’ revenues leading to default on debt and subsequent closure of some of the largest supermarkets in the country. More importantly, consumers are not basing their decisions on affordability alone, but also on familiarity, trust and brand loyalty.

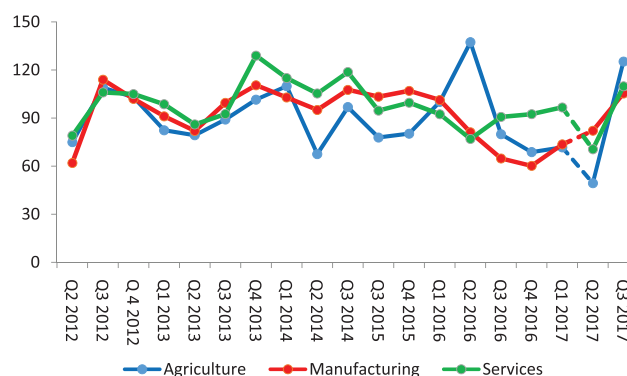
Figure 1: The Business Climate Assessment<sup>2</sup>



### The Business Climate Index by Sector

Business sentiments remained well below potential across all economic sectors, and declined significantly in agriculture and service sector. This drop in the agriculture sector mirrors the worsening of condition in the sector in same period of 2014 driven largely by a spike in product prices that constrained demand. For this quarter, however, the agriculture sector was largely devastated by the persistence of the adverse effect of the armyworm invasion (Figure 2) leading to low activity, turnover, and profits; postponement of new businesses; and capacity constraints. In this regard, business sentiment in the agriculture sector dropped by 22.34 points to 49.36 from 71.70 points in the last quarter. The Ministry of Agriculture, Animal Industry and Fisheries (MAAIF) estimates that the armyworm infestation affected 12 per cent of the produce such as millet, sorghum, rice and maize amongst others. In regard to maize, an estimate suggests that the armyworm destroyed 450,000 tonnes of maize worth \$192.8 million in the last crop season.

Figure 2: Business Climate Index by Sector<sup>3</sup>



In the services sector, business sentiment declined by 26.16 points to 70.51 from 96.66 on the backdrop of low activity and turnover; postponement of new businesses; and capacity constraints. Nevertheless, the manufacturing sector made marginal improvement in the conditions for doing business buoyed by improved activity and affordable skilled labour. The

<sup>1</sup> <http://www.nielsen.com/content/dam/nielsen/global/ssa/docs/reports/2017/nielsen-africa-prospects-report-edition-4.pdf>

<sup>2</sup> Please note that data was not collected from Q4 2014 to Q2 2015

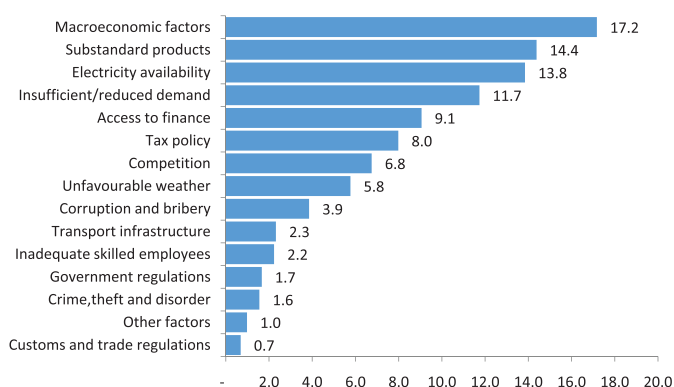
<sup>3</sup> Please note that data was not collected from Q4 2014 to Q2 2015

manufacturing sector sentiment increased by 8.58 points to 82.10 from 71.70. Despite the lower than potential performance in most indicators for doing business in Uganda, all sectors remain optimistic about future business prospects (figure 2).

### Challenges in doing business

Figure 3 shows that macroeconomic factors and the cost of electricity were the most important constraints in doing business for the current quarter but with reduced intensity in comparison to the last quarter. However, the intensity of access to finance increased from 6.2% to 9.1%. As earlier mentioned, the cost of credit has hardly reduced in the current quarter despite the reduction of the CBR by 1.5 percentage point. Also, the intensity of challenges of tax policy and competition from substandard products increased from 6.5% and 5.7% to 8.0 % and 14.4% respectively.

**Figure 3: Business Constraints, %**



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

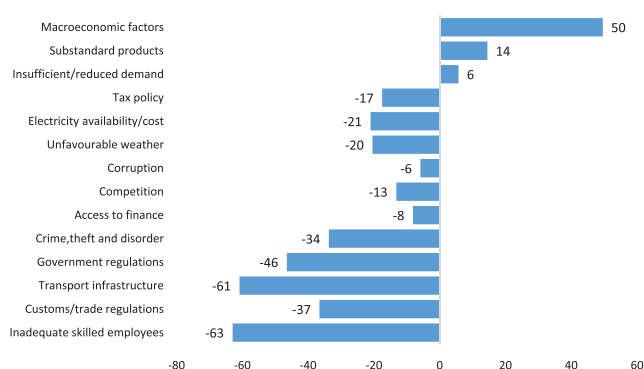
Similar to the last two quarters, challenges posed by the macroeconomic environment, competition from substandard products and insufficient demand are elevated in the current quarter. A further analysis reveals that the deteriorating macroeconomic environment affects the small and the medium firms most. Yet, micro firms suffer most from insufficient demand. While small firms were relatively more affected by competition from substandard goods.

Improvements in electricity availability is perceived positively, particularly by large firms. There is no indication that the benefits of electricity availability have trickled down to other firm sizes. Just as in the last quarter, the limited access could be linked to the high electricity tariffs. Tax policy is perceived to have improved for large and micro firms. This could be attributed to Uganda Revenue Authority (URA) continued efforts to improve tax administration through tax education. Unlike the last two quarter, most firm, except large ones, perceive the weather to have improved in the current quarter. This is consistent with improvement in rainfall in the current quarter. Uganda received an average of 112.0 mm more rain in the current quarter than the

111.3 mm received in January – March 2017 quarter. However, the amount of rain did not have much significance to the large agricultural firms in the sample that usually invest in irrigation technology.

Access to finances is perceived to be worsening in the current quarter for firms, regardless of size. As earlier mentioned, the cost of credit remains high despite adjustment in the CBR. This calls for reforms that aim at reducing the perceived risk. Particularly, the efficiency of the Credit Reference Bureau facility and the extent to which it is able to reduce Non Performing Loans (NPL) needs to be re examined. There is also a scope for deepening the financial market to increase competition.

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



### Future business outlook: July – September 2017

Similar to the last quarter, businesses are significantly more optimistic about the near term developments. The expected index for July – September 2017 is 109.47 (figure 1) and is 11.70 index points higher than the current quarter's expectation which was 97.77 points. The agricultural sector is expected to bounce back from two consecutive quarters of poor performance instigated by poor climatic conditions and the invasion of the armyworm. The agriculture sector is expected to improve by 53.30 percentage to 125.27 percentage from the below potential performance of 71.97 in the last quarter. Improvement in business conditions in the agriculture sector are expected to be anchored by expected lower input cost raising the profit margins.

Consistent with the last quarter, the expected improvement in overall business climate is expected to be supported by robust performance of the manufacturing and service sector. The expected indices are 105.33 for the former and 109.85 for the latter. The favourable future business environment in the manufacturing and service sector is perceived to be anchored on expected new business opportunities, favourable input cost, increased capacity and reduced labour cost.

## Question of the Quarter

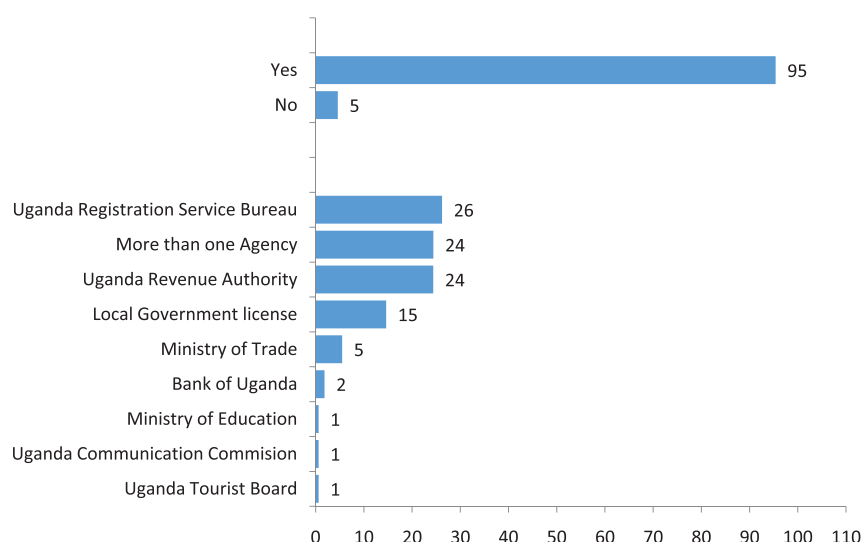
### Company Registration

In this quarter we sought to understand the authority by which businesses are registered in Uganda. We approached this by asking the kind of registration the business has. In particular, we asked:

#### *What kind of registration does this business have?*

Results in Figure 5 indicate that overall, 95% of businesses are registered. Most business are registered with the Uganda Registration Service Bureau (26%), 24 % of businesses have multiple registration, 24% of businesses are registered with the Uganda Revenue Authority, 15% of businesses are registered with a local government and 5% with the Ministry of Trade. The number of businesses registered by Bank of Uganda, Uganda Communication Commission, and Uganda Tourism Board is low (1%). This is anticipated given the fact that the nature of business they regulate is specific in nature.

**Figure 5: Agencies Registering businesses in Uganda, %**



## Conclusions

Perceptions about the business environment in Uganda worsened by 22 percentage point in this quarter and remained below potential. The service and agriculture sector drove much of the pessimistic sentiment of the business climate index, driven partially by collapse of businesses in the retail segment and persistent effects of armyworm invasion, respectively. This significant fall in the agriculture sector mirrors the worsening of condition in the sector in same period of 2014 driven largely by a spike in product prices that constrained demand. Nevertheless, businesses expect the business environment to recover in the next quarter on the backdrop of rising profit margins, new business opportunities and favourable input cost in the agricultural sector and increased capacity and reduced labour cost in service and manufacturing sector. As regard to business registration by different agencies, the percentage of business registered by the local governments is still low. There is a scope for synergies between Uganda Revenue Authority and the Uganda Registration Services Bureau to improve the number of businesses registered for improved service provision and domestic revenue mobilisation.

*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. It can be used to forecast turning points in economic activity and thus provides 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.

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