

Business climate deteriorates as the COVID-19 pandemic upsets enterprises and the future outlook remains downcast.

The Uganda Business Climate Index



Photo: Farmers in their flooded garden in Karusandara Sub-county, Kasese District

Source: New vision, 27th May 2020

Executive Summary

The Business Climate Index (BCI) sharply declined by about 59.7 basis points from 104.9 in the previous quarter (October-December 2019) to 45.2 in the current quarter (January-March 2020). The sharp decline was driven by a fall in business perceptions in all the sectors with services and manufacturing declining the most by 63 and 51 basis points respectively. The unfavourable perceptions in all the three sectors are attributed to the global COVID-19 pandemic and the measures implemented to contain its spread. The large drop in the service sector emanated from COVID-19 containment measures such as restrictions to movements which reduced physical interactions and reduction in working hours. Other measures such as the border closure continues to dampen perceptions in the manufacturing sector due to challenges in accessing imported inputs. Business expectations for the next quarter (April – June 2020) remain downcast on the account of anticipated decline in business activity, employment and the business environment.

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

The BCI 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.

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, we ask business managers to assess the general economic environment for the current quarter relative to a similar period a year earlier; 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 mean 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.

In addition, the index analyses the evolution of challenges facing businesses during January-March 2020 by identifying which business constraints are more of a problem and less of a problem. We also ask business managers 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

Business climate sharply deteriorates, with expectations of further decline in the subsequent quarter.

Results indicate that the Business Climate Index sharply deteriorated by 59.7 basis points to 45.2 during the current quarter (January–March 2020), from 104.9 in the preceding quarter (October–December 2019). The sharp decline was on the backdrop of unfavourable business environment, reduction in business optimism and sales turn over. The conditions for doing business remained downbeat with the onset of the global COVID-19 pandemic (Figure 1). In particular, closure of factories abroad and national borders to mitigate the spread of the virus disrupted supply chains leading to a reduction in both export of products and import of inputs.¹ Data from Bank of Uganda indicates that there was an 18 percent decline in exports from USD 386 million to USD 316 million between January and March 2020 compared to the 7 percent increase in the previous quarter (October–December 2019). In the same period, private sector imports decreased by 17 percent from USD 551 million to USD 460 million compared to 5 percent increase in imports that was registered during October–December 2019. The decline in importation of inputs affected operations of businesses especially in manufacturing sector.

On the other hand, the decline in exports led to a fall in demand for goods especially in agricultural sector leading to unprecedented losses. In addition, the suspension of operations of enterprises dealing in non-food in late march contributed to downcast of the perceptions. Furthermore, the institution of Standard Operation Procedures (SOPs) to mitigate the spread of COVID-19 e.g. provision of hand washing facilities and social distancing increased operating costs of businesses thus worsening their

perceptions of the business climate.

Figure 1 also indicates that while current business perceptions remain unfavourable, business managers interviewed expect business perceptions to dampen further in the coming quarter (April–June 2020). This sentiment is largely driven by anticipated reduction in business activity, number of employees, and an unfavourable business environment due to the continued spread of COVID-19 and consequent containment measures.

Changes in the Business Climate Index by Sector

During the current quarter, business sentiments sharply declined in all the three sectors. Perceptions of business conditions in the service sector made the most setbacks. The service sector index declined by 63 basis points to 45.3 in the current quarter (January–March 2020) from 108.3 points during last quarter (October–December 2019) (Figure 2). The deterioration of conditions for the service sector came on the backdrop of a worsening business environment, and low business optimism, sales turnover and profits which are highly attributed to the measures instituted to curb the spread of COVID-19 such as restriction on movement and interaction. More succinctly, businesses in services sector such as financial institutions reduced working hours from the usual 8 hours (between 9:00 am to 5:00 pm) to 6 hours (9:00 am to 3:00 pm) to reflect the reduction in customer traffic and create room for their staff members to abide with the 7:00 PM curfew regulation. The decline in cash flows for businesses in other sectors meant reduced debt repayment ability which further affected the banking sector, as the ratio of non-performing loans to total gross loans increased to 5.4 percent in the quarter ending March 2020 from 4.7 percent in the quarter ending December 2019.² Overall, sectoral analysis of businesses conducted by EPRC rapid assessment of the impact of COVID-19 on Ugandan businesses revealed slightly higher resilience among agricultural and manufacturing firms compared to service sector firms.

In the manufacturing sector, business sentiments declined by 50.6 basis points to 47.5 in the current quarter from 98.1 in the previous quarter. The fall is on the account of a decline in new manufacturing businesses, unfavourable business environment,

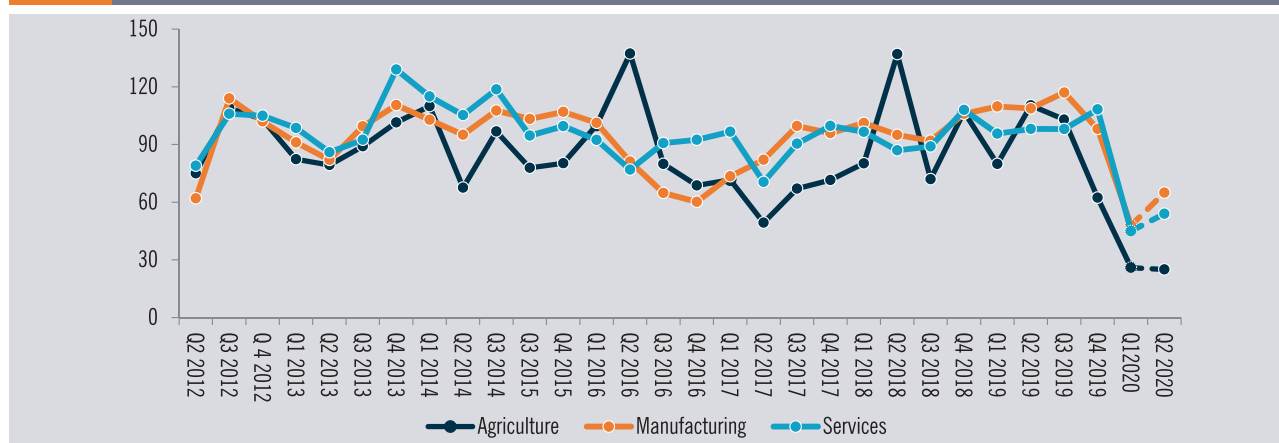
¹ <https://www.monitor.co.ug/News/National/fuel-tankers-Uganda-bound-trucks-Covid-19-Busia-border-held/688334-5504766-6umcc5/index.html>

² <https://www.bou.or.ug/bou/bouwebsite/Statistics/Statistics.html>

Figure 1 The Business Climate Assessment



Note: Solid lines show period under review.

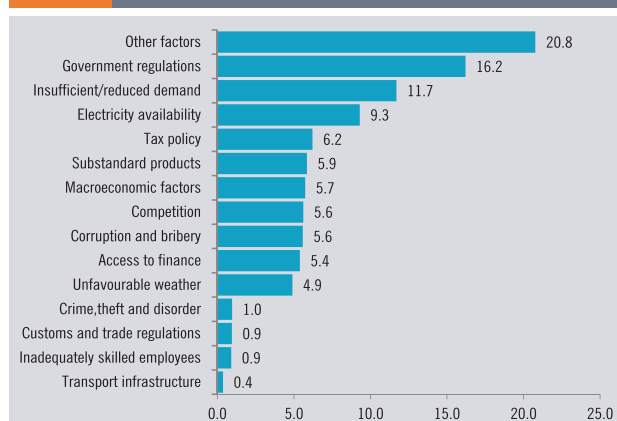
Figure 2 Business Climate Index by Sector

decrease in labor demand and the decrease in salaries. As earlier mentioned, business perceptions in the manufacturing sector were largely affected by disruptions in supply chains arising from closure of borders and factories in major suppliers such as China, making it difficult for firms to access inputs. To date, several borders are still closed which further increases the cost of accessing inputs. Worse still, depreciation of the Uganda shillings against the dollar made it even more expensive to import from alternative source that had not yet closed borders. For instance, Uganda shillings depreciated by 2.5 percent against the US dollar between January and March (from UGX 3,680 to UGX 3,773).³

Agriculture sector has been a bit resilient though performing below potential. Although the index for the sector declined by 36.3 basis points, the decline was not as much as that for services and manufacturing. In spite of the decline in demand for the products, production activities in agriculture sector continued with less interruption while those for other sectors were heavily interrupted by COVID-19 and containment.

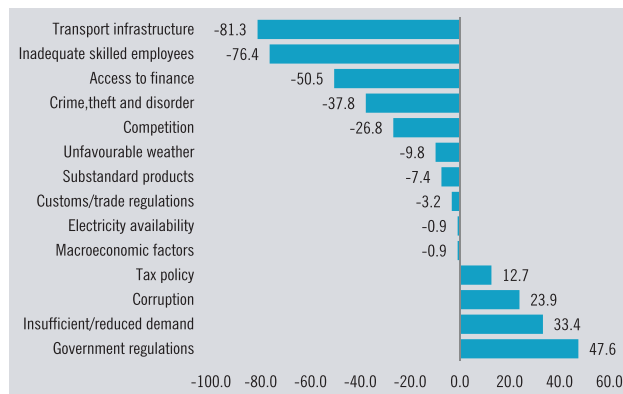
Challenges in doing business

Figure 3 shows that government regulations, insufficient demand and electricity availability were the most important constraints in doing business for the current quarter. In the same quarter, government regulations on conducting business such as the requirement by enterprises to observe SOPs generally increased the cost of operation. According to a rapid Business Climate Index survey conducted by EPRC in April 2020, 90 percent of the businesses surveyed reported having experienced an increase in operating cost, 38 percent of which reported a cost increase of over 25 percent. The rise in the cost of doing business is due to the demand by government for all businesses to put in place SOPs such as hand washing equipment and sanitizers which came at a time when businesses were already struggling. Regarding insufficient demand, the outbreak of the pandemic created panic and tension amongst citizens which suddenly led to a sharp decline in demand for both non-food and food items, only non-perishable dry foods were highly demanded, creating a temporary increase in their prices. For example, in March 2020 a packet of salt was sold at UGX 3,000, up from the normal UGX 700.⁴

Figure 3 Business Constraints (%)

How have the business constraints evolved over the last period?

Unlike the previous quarter, where increased availability of substandard goods on the market became more of a problem, Figure 4 reveals that in the current quarter, government regulations became more of a business constraint compared to the previous quarter. The increased intensity of constraints related to government regulation could have emanated from COVID-19 containment measures. For instance, during the current quarter, the government ordered the closure of all international borders and imposed restrictions on most forms of

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

³ <https://www.bou.or.ug/bou/bouwebsite/Statistics/Statistics.html>

⁴ <https://www.monitor.co.ug/News/National/Four-arrested-hiking-commodity-prices-coronavirus-Museveni/688334-5503284-49od0sz/index.html>

public transportation including commuter taxis and bodabodas. This resulted into a decline in both demand and supply due to difficulties in movements by customers and a rise in transport costs. As earlier indicated, the requirement by all businesses to implement SOPs raised the cost of doing business. Additionally, regulations on the working hours and the closure of businesses that deal in non-food items further brought business operations to a standstill.

Future business outlook: April – June 2020

Similar to the previous quarter, businesses are much more pessimistic about near term developments. The expected index for April to June 2020 is anticipated to be at 55, and this is 48 percentage points below the current quarter's expectation. The expected sharp deterioration in the overall business climate is projected to be driven by the anticipated drop in the performance of all the three sectors—agriculture, services and manufacturing. The agriculture sector is expected to decline by 79 points from last quarter's expectation of 103.7 to 24.7 in the coming quarter. The services sector is expected to decline by 51.5 basis points from last quarter's expectation of 105.5 to 54 points in the coming quarter. The unfavourable business expectations in all the sectors are largely anchored on anticipated reduction in business activity, lower employment, unfavourable business environment, increased labour costs and lower sales turn over owing to the continued spread of COVID-19.

Question of the Quarter

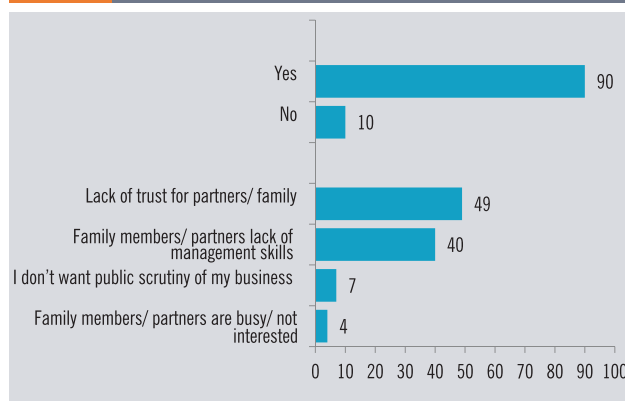
Opening up ones business to family, shareholders or partners for business continuity

In this quarter, we sought to understand if business owners opened up their businesses to trustees such as friends, relatives and business partners to ensure business continuity in the absence of the owner. And if not, what are the reasons for the failure to open up? We approached this by asking each business whether the business was opened up to a trusted family member, shareholders or other business partners for business continuity in the absence of the owner. In particular, we asked:

Have you opened up your business to a trusted family member, other shareholders or business partners for the purpose of business continuity in your absence? If no, why?

Results in Figure 5 indicate that overall, 90 percent of the businesses interviewed had their businesses open to trusted family members, shareholders and business partners. Among the businesses that had not opened up, 49 percent reported that the lack of trust for partners and family members was the key deterrent. As such, capacity building for business owners regarding succession management and business continuity

Figure 5 Opened up business to a trusted family member, other shareholders or business partners, %



plan beyond the owner's departure would be pertinent. This may entail training and sensitising business owners about business continuity.

Conclusions

Perceptions about the business environment in Uganda have sharply declined, lowering from 104.9 in the previous quarter to 45.2 in the current quarter. The services sector registered the biggest decline largely explained by low sales turnover, and low profits which are highly attributed to the measures to curb the spread of COVID-19 such as restrictions on movements and interactions. Business perceptions in the manufacturing and agriculture sectors too registered a sharp deterioration by 51 and 36 points respectively in the current quarter. The sharp decline in all the three sectors was escalated by the COVID-19 pandemic and the onset of containment measures during the current quarter. Worse still, the future outlook is much more pessimistic compared to the current quarter. The high pessimism is projected to be largely driven by declines in business activity, low employment, unfavourable business environment, increased labour costs and lower sales turn over. With regards to constraints, government regulations, insufficient demand and corruption were perceived to have become more of a problem in the current quarter. Based on the key findings, it's paramount to develop domestic supply chains in form of import substitutions to reduce reliance on imported inputs by the manufacturing sector, which is highly susceptible to global shocks such as COVID-19. In addition, it's important to streamline government resuscitation efforts to ensure that businesses that have been affected most by the pandemic receive the adequate support in form of subsidised credit. Sensitisation and training of business owners about business continuity and succession plans is key for those businesses that are not open to family members and partners due to trust issues.

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. The purpose of BCI is to forecast turning points in economic activity and thus provide 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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Acknowledgement

The Business Climate Survey team appreciates the support received from all participating business establishments across the country, our partners at the Uganda National Chamber of Commerce and Industry, Kampala City Traders Association and all persons who reviewed and edited this publication.

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