

An Overview of financial macro business environment in East Africa

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Business environment affects the decisions, strategies, processes and performance of the business. There are two types of business environment: micro business environment consisting of different types of stakeholders such as customers, employees and suppliers; and macro business environment consisting of all exogenous factors that influence decision making on resource use and performance of any business. The main objective of this paper was to analyze the level of financial micro business environment across five countries of Burundi, Kenya, Rwanda, Tanzania and Uganda, using the World Bank's Enterprise Survey Data. Two- way analysis of variance was used to compare the level of financial macro business environments that affect small and medium enterprise across the five Eastern Africa countries. Except for Kenya which has relatively better financial macro business environment, major indicators related to availability of financial capital were relatively similar across the other four countries. Very few firms utilized formal financial institutions to acquire business capital in Burundi, Rwanda, Tanzania and Uganda. It is therefore important for these countries to join forces in developing joint macroeconomic policies that are conducive to availability of microfinance derivatives to small and medium enterprises. Improved financial macro business environment will expand available capital and attract external support for small and medium enterprises in East Africa.

INTRODUCTION

An environment can be defined as anything which surrounds a system. Therefore, the business environment is anything which surrounds the business organization. Business environment affects the decisions, strategies, processes and performance of the business. There are two types of business environment: micro and macro. The micro environment consists of different types of stakeholders such as customers, employees, suppliers, board of directors and creditors. The macro environment consists of factors which are beyond the control of the business such as social, political, economic, regulatory, tax, cultural, legal, and technological environments. The macro business environment includes all exogenous factors that influence decision making on resource use and performance of any business. Competitiveness of small and medium enterprises (SMEs) would therefore depend on the micro business environment existing within the country and the capability of management to adapt to these variables in a way that the profit flow generated guarantees the long term operation of the business (Chikan, 2005; OECD 1998).

While changes in the micro environment will directly affect the firm's activities, changes in the macro environment will indirectly affect the business costs and therefore its aggregate performance. Parente and Prescott (1994) argue that macro business environment increase the cost of technology adoption and

hence reduce long-term economic growth at the country level. Macro business environments have also been found to influence availability of credit (Aghion et. al., 2005), contract enforceability (Acemoglu et. al. 2007), investor protection (Rui et al., 2004) and business entry costs (Aghion et. al., 2006). An accommodating macro business environment is one that encourages firms to operate efficiently. Such conditions strengthen incentives for firms to be innovative and to increase productivity, a key factors for sustainable development. A more productive private sector, in turn, expands employment and contributes taxes necessary for public investment in health, education, and other services. In contrast, a poor macro business environment increases the obstacles to conducting business activities and decreases a country's prospects for reaching its potential in terms of employment, production, and welfare.

Access to, and costs of finance are reported to be a severe problem for SMEs in Africa. Availability of microfinance derivatives have been viewed as a critical element for the development of SMEs. Levy (1993) highlighted the consequences of limited access to financial resources by SMEs. Typically, SMEs face higher transactions costs than larger enterprises in obtaining credit (Saito and Villanueva, 1981) and availability of funds to finance working capital (Peel and Wilson, 1996). In addition, information asymmetries associated with lending to small scale borrowers have continued to restrict the flow of finance to SMEs.

Empirical investigation to determine the level of financial macro business environment can proceed at both firm and country levels. The underlying assumption is that countries and firms facing better financial macro business Environments perform better. In this paper we use the World Bank's Enterprise Survey Data to compare the level of financial macro business environment facing business enterprises in the five East Africa countries (i.e., Burundi, Rwanda, Kenya, Tanzania, and Uganda). The five countries belong to the East Africa Community with a long term objective of forming a federation. The specific objectives are to test if the financial macro business environments affecting the availability of financial resources to SMEs are similar across countries; and suggest policies to improve availability of financial resources to SMEs in East Africa. We use both cross tabular analysis and multivariate analysis of variance to achieve the study objectives. The rest of the paper is organized as follows.

SOURCE OF DATA

The data source is the Enterprise Surveys database maintained by World Bank and freely available at www.enterprisesurveys.org. The sample is consistently defined in all countries and includes the entire manufacturing sector, the services sector, and the transportation and construction sectors. Public utilities, government services, health care, and financial services sectors are not included in the sample. The surveys collect a wide array of qualitative and quantitative information through face-to-face interviews with firm managers and owners regarding the business environment in their countries and the productivity of their firms.

Several topics are covered during the survey and include: the obstacles to doing business; infrastructure; finance; labor; corruption, regulation, law and order, innovation and technology, trade, and firm productivity. The qualitative and quantitative data collected through the surveys connect a country's business environment characteristics with firm productivity and performance. We use the 2006 available data for Burundi, Rwanda, Tanzania and Uganda and 2007 data and for Kenya. The definition of indicators can be found on the database website. The sample constitutes 137 firms from Burundi, 781 firms from Kenya, 128 firms from Rwanda, 65 firms from Tanzania, and 100 firms from Uganda.

DATA ANALYSIS

Non parametric techniques and one one-way analysis of variance (ANOVA) were used to compare the level of financial macro business environment across the five countries. The objective is to determine if financial macro business environment are statistically similar or different across. Non-parametric methods are widely used for studying variables that take on a ranked order. In particular, the use of non-parametric

methods is necessary when data has a ranking but no clear numerical interpretation. One-way ANOVA is a technique used to compare means of two or more samples (using the F distribution). This technique can be used only for numerical data. The ANOVA produces an F statistic, the ratio of the variance among the means to the variance within the samples. This allows a comparison of the variance amongst the different groups to the variance amongst all the individuals within those groups. A higher ratio implies significant differences between the groups. For details on both procedures see Huberty and Olejnik (2006).

RESULTS AND DISCUSSION

The summary statistics of variables that represent financial macroeconomic environment are presented in Table 1. From the table, the important thing to notice is that there are negligible uses of financial services in East Africa. Also notice that that personal finance was a major source of both investment and working capital. In addition, few SMEs used formal financial institutions as source of investment and working capital. More than 45% of the respondents indicated that availability of financial capital was a major constraint. To borrow, all SMEs needed collateral valued between 123% and 266% of the requested loans. The average annual interest rate for the loan was 15%; Burundi recording the highest at about 20%.

The results in Table 2 indicate that financial macroeconomic environment differs across countries. For example, Kenya's SMEs response on availability of over-draft differs from all other four countries. The annual interest rate was similar between Rwanda and Burundi but statistically different from Tanzania and Uganda. Other results in the Table have analogous interpretations and great variability in financial business environment which needs harmonization across the five countries to allow flow of resources among countries.

Table 1: Summary Statistics on the financial macro environment across countries

Variable	Country					Average
	Burundi	Kenya	Rwanda	Tanzania	Uganda	
	Percent					
Firms with line of credit or loans from financial Institutions	35.26	25.41	37.58	16.25	M	28.63
Firms With a Checking or Savings Account	90.54	89.07	82.72	86.17	M	87.13
Firms using banks to finance investments	12.25	22.92	15.90	6.79	14.33	14.44
Internal finance for investment	62.90	78.42	74.10	84.60	71.41	74.29
Credit from suppliers	0.06	3.76	2.06	1.15	0.48	1.50
New equity shares	0.00	0.10	0.00	0.20	1.96	0.45
Other financing for investment	21.50	2.22	5.65	6.25	12.61	9.65
Firms using banks to finance operation and management	25.51	26.00	32.50	17.33	17.00	23.67
Working capital internal financing	69.31	73.24	64.87	71.13	79.95	71.70
Working capital bank financing	8.84	6.90	15.53	6.24	6.98	8.90
Working capital from suppliers or customers	8.81	16.97	14.86	13.81	5.31	11.95
Working capital other financing	13.04	2.89	4.73	8.82	7.76	7.45
Loans requiring collateral	97.35	86.11	96.66	92.55	93.22	93.18
Value of collateral needed for a Loan (% of the loan amount)	266.54	120.81	160.44	124.05	123.10	158.99
Firms identifying access to finance as a major constraint	50.94	41.80	35.95	40.63	45.04	42.87
Annual interest rate	19.50	11.60	15.50	13.55	13.31	14.69

Table 2 Semi-parametric analysis and one way analysis of variance results

	Country	Country	Std. Error	Sig.
Does your establishment have an overdraft facility?	Kenya	Burundi	0.04	0.01
		Rwanda	0.04	0.01
		Tanzania	0.05	0.01
		Uganda	0.04	0.01
If yes, what is the average annual interest rate?	Rwanda	Tanzania	3.66	0.05
		Uganda	3.21	0.01
		Kenya	2.29	0.01
Borrowed from Private commercial banks	Burundi	Rwanda	4.39	0.05
		Kenya	3.31	0.01
Borrowed from state-owned banks and/or government agency	Rwanda	Burundi	1.08	0.00
		Uganda	1.17	0.01
Borrowed from state-owned banks and/or government agency	Burundi	Rwanda	2.88	0.01
		Kenya	2.17	0.01
Borrowed from non-bank financial institutions	Burundi	Rwanda	1.23	0.01
		Uganda	1.33	0.01
		Kenya	0.95	0.01
Borrowed from non-bank financial institutions	Kenya	Burundi	2.30	0.01
		Rwanda	2.37	0.02
		Tanzania	3.20	0.01
		Uganda	2.64	0.01

POLICY IMPLICATIONS

Although Small and Medium Enterprises (SMEs) constitute a significant part of total employment in many East Africa, their contribution to economic growth is minimal because they face greater growth obstacles. As indicated to this study, the East Africa SMEs are more constrained by limited access to finance. Results reported elsewhere so far show a strong positive economic effect of microfinance finance institution on SMEs' growth. But what are the policies that drive SME-friendly financial and institutional development? What can policy makers do, both in the short- and in medium- to long-term, to ease SMEs' financing constraints and improve their access to external financing, thus leveling the playing field in East Africa? Financial availability to SMEs depends on the infrastructure that supports financial transactions, including the legal system and the information environment.

Furthermore, the absence of well developed financial markets makes it difficult for SMEs to grow to their optimal size since outside and cannot attract external or capital from formal financial institutions. This is important for SME promotion strategies. It may be optimal for SMEs to stay small when the financial business environment is weak. Government policies that stimulate growth (e.g., tax breaks and low interest loans) may be effective in promoting SMEs growth. Steps towards improving the microfinance institutions that serves SMEs and the overall business environment are probably the most effective way of enhancing growth constraints SMEs face. However, microfinance institution building is a long term

process. While interim innovative lending technologies holds promise to provide market friendly ways of relaxing the constraints SMEs face, the East African countries need to work jointly to improve microfinance institutions in their countries. Joint actions will improve efficiency through increased economies of scale and easy flow of capital among the five countries.

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