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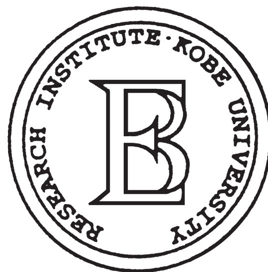

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INBOUND M&A TO JAPAN: CHERRY PICKING VERSUS RESCUE MISSION?

RALF BEBENROTH **Kobe University**

Abstract:

This paper investigates differences in targets overtaken by cross-border bidders versus domestic ones. The literature from the selection theory argues that there is "cherry picking." Put simply, cross-border bidders overtake the comparably better performing targets. In contrast, domestic bidders acquire weaker targets what can be termed as "rescue mission." Targets in the study were investigated to see if this statement holds true.

The results show that cross-border targets did not perform better but performed worse than domestic ones. According to my sample, I have to conclude that there is no "cherry picking" of cross-border acquisitions. This lends support to the idea that foreign bidders probably come to the acquisition target at a later stage. To put it differently, Japanese firms were being overtaken by foreign bidders in cases where no domestic firm was interested in overtaking the target. Reasons are discussed.

JEL Classification: G34, O53
Keywords: Inbound M&A, cross-border bidders, Japan

1. Introduction

Cross border M&A has been historically seen as a means for firms from developed countries to enter less developed ones (Wilson, 1980). Nowadays, this has changed, as cross-border M&A also appear to target companies in developed countries (Shimizu et al., 2004). In contrast to domestic acquisitions, cross-border acquisitions face additional challenges of evaluating, negotiating and integrating targets (Shimizu et al., 2004). Uncertainty and information asymmetry in foreign markets lead firms to difficulties in adjusting and learning both in the local market and the target firm (Kogut and Singh, 1988; Zaheer, 1995).

Corresponding Address:
Ralf Bebenroth
Research Institute for Economics and Business Administration (RIEB), Kobe University
2-1 Rokkodai-cho Nada-ku, Kobe 657-8501 Japan
E-mail: rbeben@rieb.kobe-u.ac.jp

There has been much research done in the international field (Goehlich 2009), concerning investigative post-acquisition performance with positive short term results for acquirers (Barnes, 1984; Gregory, 1997, Meshi and Metais, 2006). In the long run, however, acquirers are considered to have negative financial performance and there are mixed results for acquired target firms (King et al, 2004). These results are supported by recent studies, where acquisitions were researched in a longitudinal study framework (Barkema and Shijven, 2008). Also when investigated in life cycles of M&A booms, with early mover advantages for acquisitions at the beginning of a boom, the performance of the bidder companies in the long run was generally negative (McNamara et al, 2008).

The M&A area has been thoroughly researched. Using patent data on pharmaceutical M&A, Ornaghi finds that mergers are more likely to be signed between firms with relatively similar technologies and drug portfolios and that performance implications depend on the similarity of bidder and target (Ornaghi, 2009). Rhodes-Kropf and Robinson (2008) show that financial indices of bidders and targets can be quite similar. Bidders with a high market-to-book-ratio acquire targets with a similar pattern. There is also research available about the post-merger effects of target enterprises (Olatunji O. R. and Uwuigbe U. 2009). The predominant target-oriented M&A research starts one year before the acquisitions occur (Eero and Boeckerman, 2008; Munoz-Bullon, 2008). An understudied topic, however, is target performance and employment effects in the years before the acquisitions take place.

This research aims to shed light on the pre-acquisition period of targets by comparing two groups of Japanese target firms taken over either by a foreign (non-Japanese) bidder or by a domestic one. This is of importance, as employee downsizing activities, as well as the M&A market in general, have recently been more active in countries like Japan (Lee, 1997; Fukao and Murakami, 2005). The wave of M&A nowadays clearly includes Japan and not only Japanese investments abroad – which were previously described as undertaking investments predominantly through Greenfield ventures but only to a lesser extent through M&A (Bebenroth, R. 2007; Hebert et al, 2005). Since this phenomenon was relatively unknown in Japan, it served as the bases for this investigation.

The literature states that cross-border bidders "cherry pick" targets, choosing comparably better performing targets against domestic acquisitions (Bandick and Karpaty, 2007). In the case of Japan, Paprzyki and Fukao (2008) state: "…on a closer inspection, it turns out that foreign firm's superior performance partly owes to the fact that they acquire Japanese firms that already perform better than the average local firms." (p. 7.) This "cherry picking" argument can also be found at Fukao et al. 2005 stating: "…we found that foreign firms acquire Japanese firms with higher TFP levels and higher profit rates. In contrast, in-in M&As ('domestic') [remark by the author] seem to have the characteristics of rescue missions. Small firms with a higher total liability/total asset ratio tend to be chosen as targets of in-in M&As" (p. 298).

I wanted to challenge this view by asking two questions: 1. Do foreign bidders "cherry pick"

in the sense that they choose financially better performing targets compared to domestic bidders? 2. Does the downsizing pattern of targets differ between foreign and domestic acquisitions? For this, I looked into the target companies on a yearly basis, starting seven years before the acquisitions took place and ending with the target's last financial statement before the acquisition event.

In the next two chapters theoretical arguments for cross-border acquisitions and downsizing effects in the Japanese M&A context are described. Chapter 4 presents hypotheses. Then data and results are empirically examined and presented. Chapter 7 ends with a discussion and conclusion of the results.

2. Theoretical arguments for cross border acquisitions and downsizing effects

The theoretical framework of this study is based on the theory of multinational firms. This research is separated from the "inefficient management hypothesis" that states that targets were poorly managed and were replaced by bidder firms (Mandelker, 1974).

According to this basic understanding, M&A might enhance creating value if companies put their expertise and know-how into an acquired firm (Buckley and Casson, 1976; Rugman, 1981). Departing from this inefficient management hypothesis, a theoretical construct can be provided, describing why headquarters undertake acquisitions. The "learning theory" states that a target will benefit from a bidder through financial help and advances in technology. Therefore, through expertise from the foreign headquarters in financial, technical or other areas, a target will benefit from being acquired. Beyond domestic transactions and cross-border transactions, there is a "selection theory" which states that a foreign bidder will overtake a better performing target. The reasoning behind this is that a cross-border bidder has more at stake and higher costs than a comparable domestic one. Therefore, transactions will only be undertaken in cases where a target is especially lucrative.

M&A has to be seen as much more than just financial transactions. Rather, it is a process which significantly affects all employees in a given target company (Cartwright and Cooper, 1996). It is well documented in the literature that downsizing can leave employees suffering from stress, fear and anxiety about their careers (McBain, 1999; Griffith, 2000). This naturally reduces the productivity of the target company and leads to an increase of absenteeism and low job satisfaction. Also, negative behavior of target employees against the bidder company has been reported (Nikandrou et al., 2000). This situation is also described as "merger syndrome" (Marks, 1997). Even years before the acquisition occurs, the handling of employees is considered to be of great significance for successful integration (McBain, 1999). In this sense, a systematic effort has to be made to create an internal climate of fairness between the target employees and the bidder company (Fairfield, 1992). In other words, there is evidence that the communication program is a vital tool for the success of the M&A (Bryson, 2003; Smith and Hershman, 1999; Gall, 1991).

Cross-border acquisitions face even more severe problems than domestic ones (Very et al.

1996). Executives of acquired cross-border firms are more likely to quit their jobs than executives of acquired domestic firms. (Krug and Hegarty, 2001). In this sense, cross-border targets, as the theory suggests, are more challenging to handle than domestic targets. Light will be shed on the differences of both kinds of transactions for investigating the targets' performance and to examine the downsizing behavior of the targets to see whether foreign bidders "cherry picking" their targets (Bandick and Karpaty, 2007) can be proved or disproved.

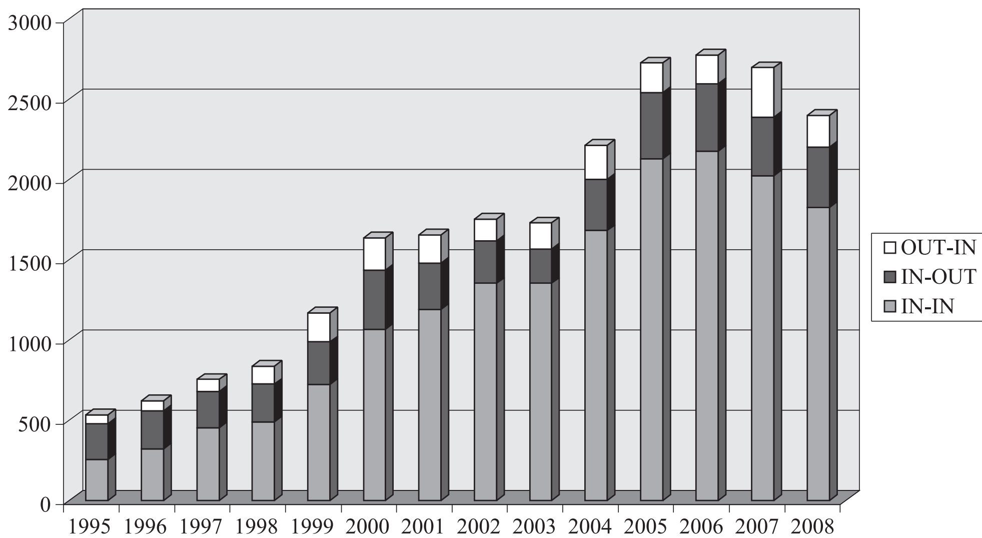
3. Japanese M&A

Potential economic benefits of inward foreign direct investments (inward FDI) are highly appreciated by all countries' governments. A reason for this is that, through inward FDI, competition between local companies increases, leading to lower prices for consumers and job-creation in the local economy (Fleming and Johnson 2008). Also, Japanese officials highly welcome foreign direct investment to Japan. The Japanese government has launched a number of political measures to promote inward FDI. Former Prime Minister Junichiro Koizumi promised several years ago in his general policy speech to the Diet in 2003 to double the cumulative amount of inward FDI until 2008 (Fukao et al, 2005). The largest part of this inward FDI has been realized through M&As (Schaede 2008, p. 117). However, the inward FDI to Japan is not yet seen as high enough. Japan had only 2.5% inward FDI compared to GDP in 2006 and, therefore, the lowest inward FDI ratio of the world's leading economies (Nagashima et al., 2008).

The Ministry of Economy, Trade and Industry (METI) proposed amendments in 2007. Several changes were implemented, e.g. harmonizing Japanese regulations to other leading countries' for improved inward FDI to Japan. Some of the amendments are fostering inward FDI, while others seem to be counterproductive. One example is regulatory changes. Before the amendments were made, companies were regulated according to industries and subsequently, according to products. Some companies then became more severely regulated after the amendments in cases where they produced goods sold to defense forces (Nagashima et al. 2008).

On May 20th 2008, the Expert Committee on FDI Promotion, an advisory group to the Minister of State on Economic and Fiscal Policy, presented five recommendations to the Council on Economic and Fiscal Policy to increase foreign inward FDI to Japan (WIP Japan, 2009). In spite of relatively small Japanese inward FDI, the number of transactions in the Japanese M&A market has recently been on the increase. This trend has been visible since 2000 (see the figure 1). In this terminology, in-in refers to domestic transactions, in-out to acquisitions of Japanese firms abroad and out-in transactions to foreign firms overtaking Japanese firms. In 2007 more than 2700 M&As were undertaken, out of which 308 were foreign (non-Japanese; out-in) bidders overtaking Japanese target companies (MARR, Febr. 2008). In 2008, there were still 2400 M&As undertaken with 198 by foreign bidders (MARR, Febr. 2009).

Figure 1: History of M&As in Japan



Source: MARR issues 1995 - Febr. 2009

Foreign bidders overtaking Japanese companies is a relatively new phenomenon and it has not yet been researched to a satisfying extent. Until now, Japanese research mainly covered domestic transactions, where a decline in productivity, ROE and ROA was found in the acquirer (Yeh and Hoshino, 2001). Also, some long term studies of domestic acquisitions are available where employment was positively related to post-merger performance (Kruse et al, 2007).

Available in Japanese, there is research on M&A and foreign direct investments to Japan (e.g. Fukao and Amano, 2004). The English literature, however, provides only few investigations in this area, e.g. Paprzycki and Fukao (2008) and Fukao et al. (2005). In their valuable contribution, they show evidence that cross-border acquisitions with a Japanese target differ from domestic ones.

In the case of Japan, there is some evidence suggesting "cherry picking" of cross-border target firms (Fukao et al, 2005). Fukao and Murakami find that cross-border target companies show a 10% higher TFP as well as higher earnings and a higher return on capital compared to domestically-acquired targets (2005). The profit/sales ratio is 1.5% higher at foreign companies compared to local companies. They also find significantly higher capital/labor ratio which leads to a higher labor productivity at foreign-owned firms. Finally, Return on Capital and the annual wages of employees were comparably higher among foreign firms.

4. Hypotheses

The structure of the targets for the financial performances and for downsizing was investigated. In each area I came up with one hypothesis comparing target enterprises of cross-border acquisitions to domestic ones.

In general, sources of the financial performance of targets as well as arguments for downsizing have much in common. Foreign investors face challenges, such as "liability of foreignness" (Zaheer, 1995) and a so called "double-layered acculturation" (Barkema et al., 1996). In this case, that would suggest that cross-border bidders pay a higher price for their targets and have cultural disadvantages versus domestic bidders. This is supported by Lin et al., who find evidence in the banking sector that shows that bank acquisitions in the same state in the US have a higher performance than out–of–state acquisitions (2006).

Foreign bidders have comparably higher costs. This starts with receiving information about the target. At the negotiation stage, costs for traveling to the target, translation services and costs for consulting expertise will be much higher than for a domestic acquirer. Also, the target's management should have a better negotiating position on foreign bids as foreign bidders are not as familiar with the Japanese market as domestic competitors are. All these facts lead to higher costs for cross-border bidders. Foreign buyers pay higher premiums in acquiring targets than domestic ones (Shimizu et al., 2004). Interestingly, Dewenter (1995) found some evidence that the level of premiums paid between foreign and domestic bidders differ according to whether the acquisition is hostile or not. However, only in cases of hostile takeovers, will foreign bidders pay a higher premium than rival bidders. Otherwise their premium would be even lower. The arguments lead to the conclusion that foreign bidders should be compensated with more financially attractive Japanese targets.

In my understanding of an acquisition, however, a potential Japanese target company suffered economically for some time before it was finally taken over by a domestic company. Apart from cost factors, it is to suggest that, in regards to information exchange, Japanese companies are closer to each other than foreign companies are to Japanese ones. In case of financial difficulties, therefore, potential domestic bidders are able to realize the chance of making an acquisition earlier than foreign bidders. Therefore, it is to state the following: Only in cases when no domestic company is interested in acquiring a suffering company whatsoever will foreign bidders have a chance of being able to make a bid on a Japanese target company.

Therefore, I assumed that the performance of the cross-border targets in this study is not better compared to domestic ones. That is to say, targets of cross-border acquisitions might outperform domestic acquisitions in the time after the acquisition has taken place. However, the reason is not that they are the potentially better companies, but that they start from a lower base. In other words, targets overtaken by foreign firms suffer for a longer time. As foreign bidders come to the target relatively late in the process, target performance is already very weak and the chances of surviving become more and more questionable. After an acquisition is accomplished, a turnaround would offer more chances for recovery compared to domestic acquisitions. Therefore, in contrast to existing research results in this field, I did not assume that there is "cherry picking" in the case of Japan, but rather to question the critical stage where the target company went in before being acquired. The hypothesis is stated as:

H.1. Foreign bidders come to the target in a later stage. Therefore, the financial performance of the target in the time period before the acquisition will be lower compared to targets at domestic acquisitions.

The second area of interest consists of target downsizing before the acquisition. Management literature deals with downsizing since the 1980s, where organizations used it as a tool to cut costs or to improve profitability and productivity (Iverson and Pullman, 2003). There is clear evidence that target companies in M&A reduce the number of employees after the acquisition event (McGuckin and Nguyen, 2001, Lichtenberg and Spiegel, 1990). In Europe, unions are relatively strongly organized and powerful in protecting their employees against the management. M&A could be seen as a way for some firms to "legally" downsize their workforce. It was less surprising that Gugler and Yurtoglu found European companies downsizing by 10% when involved at M&A (2004).

For the post-acquisition period, some scientific evidence reports that target-downsizing will be more severe in cross-border acquisitions than in domestic ones (Kurg and Hegarty, 2001). A reason for this could be that cross-border acquisitions are more costly. Therefore, to balance out these high costs and to make a success out of the target acquisition, a foreign bidder would need a stronger focus on the core business that results in higher synergy effects. One obvious way to receive this synergy effect would be possible through heavier downsizing of the target. Another explanation for higher downsizing of cross-border targets would be that foreign acquirers are less committed to countries like Japan so that acquisitions could lead to comparably more job losses in the acquired firms than in domestically acquired ones.

Post-acquisition downsizing could also be seen from a different perspective however. A domestic bidder is already supposed to be present in the market (at least in cases of horizontal M&As) and does not only provide production facilities but also services and distribution. This could result in even higher synergy effects through employee downsizing. Also Fukao and Murakami did not find evidence in Japan for foreign investors reducing employment significantly more than domestic bidders (2005). In summation, a domestic bidder may be even more likely to consolidate target activity and downsize employees.

In contrast to conventional studies, in this research downsizing activities of the targets is investigated in the time before the acquisition takes place. Assuming that the foreign bidder company comes to the target at a later stage, target employees should have been downsized to a greater extent before the acquisition compared to targets of domestic acquisitions. The hypothesis is:

H.2 Foreign bidders come to a target in a later stage. Therefore, the downsizing of the target's employees in the time period before the acquisition will be higher in cross-border acquisitions compared to targets in domestic acquisitions.

5. Data and Method

For the year 2007, 2022 domestic acquisitions and 308 inbound M&A could be identified, where the latter cases are when a non-Japanese bidder overtook a Japanese target in the form of a cross-border acquisition. To collect the data, Recof data from the monthly printed issues of Japanese Merger Acquisition Research Report were used (MARR, Febr. 2008 issue).

In the next step, all stock-listed target firms were collected from the sampling as non-listed firms where data could not be retrieved. Also all cases of business transfers were eliminated because in that particular case, a target firm separates only an entity to an acquirer. After these two processes were done, 241 stock-listed firms were left which underwent acquisitions, with capital participations as well as capital increases. Then data for these firms were retrieved from the electronic database of NEEDS financial request. All of these forms count as M&A according to Recof and were collectively used in this research as M&A targets. Finally five holding companies, five regional banks, three city banks and two security targets were dropped from the sample, as their financial accounting was different from the sample. In the end, I was left with 226 target firms. Split into two groups, there were 158 domestic targets and 68 cross-border targets.

The companies were investigated starting from the year 2001 to the last annual financial statements in 2007. Most of the companies have their annual financial statements report at the end of March with an acquisition thereafter. However, in two minor cases, exceptions needed to be made. Some companies had their annual financial statements reporting after March, e.g. in September.

As variables for financial performance, revenue, operating profit, profit per share and ROE as well as ROA was used (Yeh and Hoshino, 2001). To investigate other variables, such as downsizing developments, the number of employees, labor productivity, director salary and bonuses and the labor equipment ratio were also investigated. Also the foreigner share ratio of the targets was investigated[1].

For the method, a descriptive approach of investigation was used and data for all companies each year collected by dividing them into domestic and cross-border acquisitions. Data for financial performances and downsizing developments was retrieved. As a second step, three logistic regression analyses with dependent variables in the range of domestic to cross-border acquisition were employed. These models relate to the probability of having a foreign investor overtaking a Japanese firm to performance and with downsizing variables X. The regression analyses include return on assets (ROA), labor productivity (LP) and return on equity (ROE). Industry segmentation serves as control variable.

$$Prob\ (cross\ border\ ac=1)= Exp(\alpha+\beta X_i)/(1+exp(\alpha+\beta_i X_i)$$

1 I am thankful to Dr. Hiep Nguyen, a former post-doctorate at Kobe University for his help in data collecting process of the 243 companies.

6. Results

The aim of this research was to shed light on whether cross-border and domestic bidders differ in picking their target. I explicitly wanted to investigate if cross-border bidders really "cherry pick" Japanese targets.

The two samples differ tremendously in their company sizes, in revenue and in number of employees. The domestic sample of target firms in this research was about double in size compared to cross-border acquisition targets. This is clearly different when compared to the results of Fukao et al. (2005). The operating profit was therefore understandably also higher at the domestic acquisition targets (table 1). However, while the operating profit for the cross-border targets decreased, at least in the last annual financial statement before the acquisition, the domestic targets showed an increase of operating profit for the last three years.

Both samples had a positive ROA for cross-border targets all seven years before the acquisition, ranging from 6.9% in the year 2005 to only 3.3% in 2007. Looking at ROE data, there were negative values for domestic targets with only two positive years in 2004 and 2007, the last year before the acquisition occurred. Cross-border acquisitions, on the other hand, had a more positive development at the beginning of the observations, starting in the first years from 2001 until 2004 with positive values and then turning into negative values the last three years, with even a negative of 19.9% in 2007. These descriptive results for ROE clearly showed that the cross-border targets took a turn for the worse the last three years before the acquisitions occurred.

The ROE as well as ROA data in this research showed significantly lower values for cross-border targets in the year 2007. That is statistically significant (table 5 and 6). Looking at the number of employees, there is evidence that both groups downsized their workforce (table 3 and 4). Domestic targets downsized from 2203 employees in 2001 to 1907 in 2007. Cross-border targets downsized from 1435 employees in 2001 to 1171 in 2007. Labor productivity increased in both groups with statistically significant lower results for cross-border targets in the year 2007. Director and salary bonuses as well as the labor equipment ratio did not show any differences between groups (not stated in table). Looking at the ratio of shares held by foreigners, one sees that the level in both groups was very low. What is surprising here is that until the year 2001, only three cross-border targets were foreign-owned and that increased to only six targets by 2007.

The hypothesis about financial performance received preliminary support as well as the hypothesis about downsizing at least in the area for labor productivity. Other downsizing variables, e.g. no. of employees did not receive any significant result. However, I also did not find evidence for stronger downsizing at cross-border firms, as is stated in the literature. Cross-border targets find themselves in weaker shape compared to domestic targets. This leads to the idea that the cross-border bidders come to the target at a later stage.

The industry classification shows that only in the service industry (no. 6 in the industry classification at the tables 5, 6 and 7) has significant impact for takeovers. However, all other

industries do not significantly impact the results in this study.

7. Discussion and closing

I would not call the acquisitions by foreign bidders “cherry picking” but find evidence from my data that both groups varied in size considerably, with the smaller firms being the cross-border targets.

According to the data used in this study, cross-border targets were not the better performing firms in the years before the acquisition event but generally weaker than domestic targets. That means cross-border acquisitions in Japan do not occur because the foreign bidder merely invests its money for a lucrative investment. My understanding is that potential Japanese targets were left over, not getting taken over by any domestic firm. These Japanese companies in financial trouble then had to look to get overtaken by a non-Japanese firm. That fits well with some post-acquisition target performance research using total factor productivity as a measure for performance (Fukao et al., 2005). My idea is that cross-border targets might bounce back to positive financial performance earlier and stronger, as they were in worse financial shape before they got acquired.

Bandick and Karpaty find for their Swedish sample, positive employment effects in firms which were taken over by foreign bidders (2007). Girma and Goerg divide employment into skilled and less skilled labor and find for their electronics industry sample that only unskilled labor decreased in cross-border acquisition targets. However, no results of higher downsizing was found for skilled labor (Girma Goerg, 2004).

It is still questionable to the author however, how reliable the results are when measuring the post-acquisition performance of target companies. In the case of an acquisition, the target company’s name regularly disappears. For example, after Panasonic overtook Sanyo Denki in 2008, no longer can be any reliable information on Sanyo Denki received, as not only their name disappeared at some factories but also several departments of the old Sanyo Denki. Other departments got restructured, mixed with previous Matsushita departments or even sold in the form of a business transfer. It is to argue, therefore, that jobs which were eliminated by Panasonic were those of previous employees of Sanyo Denki.

This research has focused on strategic acquisitions, i.e. acquisitions by companies which had strategic interest in the target companies. In contrast to strategic investors, there are financial investors, so called “vulture” funds. These funds are often times described in Japan as reaping quick profits by taking advantage of troubled target companies (Fukao et al. 2005). To extend this research, it would be promising to compare acquisitions looking at whether the bidder has financial or strategic interests. Another future avenue of research would be to investigate if Japanese financial investors differ in their behavior toward non-Japanese cross-border financial investors. This research is limited to the pre-acquisition period, as the target names regularly disappear. It would be interesting to apply a case study format for investigating changes after the acquisition

in target firms with regards to financial performance and downsizing behavior.

This study is not without its limitations. It is to admit that it might not be enough to divide the sample into only two groups, but it does matter where foreign bidders come from. According to Rosenkopf and Almeida, knowledge stock will increase when a geographic similarity is available (2003). That means a Japanese target acquisition by a Korean bidder, for example, might differ from a German bidder. Another shortcoming might be the fact that Japanese targets could not get classified as keiretsu-grouped companies. Some evidence would suggest that Japanese targets which belong to any keiretsu group might get overtaken by a domestic company more easily.

In spite of its limitations, this work shows alternative explanations for cross-border target acquisitions. I have evidence that foreign companies do not "cherry pick" Japanese targets. There is more of a "recovery" from almost ground zero visible. That means, cross border targets are in a more severe situation than their domestically acquired counterparts. This might lend to better performing entities of cross-border targets in the years after the acquisition event.[2]

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2 I am indebted to Thomas James Michener, my previous student at Konan University, now at University of Hawaii for his careful proofreading of this paper.

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Attachments

Table 1: Japanese In-In-acquisitions: Financial performances

Year	Revenue	Operating profit	Profit per Share	ROE	ROA
2001	215907.8	8112.1	193.7	-0.9	4.7
2002	199691.5	5274.6	1787.5	-9.5	3.7
2003	201072.1	7508.4	1865.5	-0.5	4.4
2004	196573.9	8652.3	1741.8	3.4	5.0
2005	204598.0	11023.2	1981.8	-6.4	5.3
2006	218286.5	12912.1	698.3	-0.3	5.4
2007	225274.1	12358.2	743.3	4.6*	4.9*
Obs.	**154-158**	**154-158**	**149-156**	**149**	**152-158**

Table 2: Japanese Out-In-acquisitions: Financial performances

Year	Revenue	Operating profit	Profit per Share	ROE	ROA
2001	88685.9	5401.1	23514.5	2.5	5.2
2002	83426.9	3412.3	13308.2	0.6	4.4
2003	80555.8	3512.2	8381.7	1.8	6.1
2004	77020.8	4376.9	3404.5	5.3	6.0
2005	78902.6	6188.9	1824.4	-6.0	6.9
2006	81576.8	6191.1	1218.4	-0.2	5.3
2007	82529.5	4387.9	719.3	-19.9*	3.3*
Obs.	**62**	**66-68**	**64-67**	**64**	**64-67**

Table 3: Japanese In-In-acquisitions: Downsizing developments

Year	No. of Employees	Lab. Productivity	Director Sal.& and Bonuses	Labor equipment Ratio	Foreigners Shares Ratio
2001	2203.8	1874.3	197.7	3442.2	0.0014
2002	2129.9	1859.2	193.9	3708.8	0.0017
2003	2077.7	1920.4	183.8	4061.1	0.0025
2004	2014.2	2113.7	178.1	4336.4	0.0037
2005	1948.8	2366.8	210.5	4563.7	0.0036
2006	1898.6	2567.2	202.3	4833.4	0.0033
2007	1907.5	2657.8*	209.6	4686.0	0.0040
Obs.	**154-158**	**152-158**	**142-146**	**152-158**	**2-20**

Table 4: Cross border (Out-in) acquisitions: Downsizing developments

Year	No. of Employees	Lab. Productivity	Director Sal.& and Bonuses	Labor equipment Ratio	Foreigners Shares Ratio
2001	1435.5	1977.9	178.2	4276.1	0.0037
2002	1341.5	2099.4	164.5	4437.9	0.0096
2003	1225.3	2223.1	166.7	5012.1	0.0105
2004	1192.5	2313.0	167.2	5127.3	0.0101
2005	1171.3	2482.6	170.5	5054.4	0.0094
2006	1163.1	2797.9	177.7	5178.9	0.0174
2007	1171.7	2108.9*	209.6	5327.4	0.0243
Obs.	**65**	**65-68**	**59-63**	**64-66**	**3-6**

Regression analyses:

Logistic regression analyses of return on assets (ROA), labor productivity (LP) and return on equity (ROE).

Table 5: ROA Logistic regression

Dependant variable: out-in
Independent variable: Return on assets (ROA) on a yearly basis
Control variable: Industry

Logistic regression — Number of obs = 216; LR chi2(14) = 22.41; Prob>chi2 = 0.0706; Pseudo R2 = 0.0854

Log likelihood = -120.05633

outin	Coef.	Std. Err.	Z	P>|Z|	[95% Conf. Interval]	
roa2001	.0104016	.016274	0.64	0.523	-.0214948	.042298
roa2002	-.0566827	.0349957	-1.62	0.105	-.125273	.0119075
roa2003	.0636541	.0477433	1.33	0.182	-.0299211	.1572293
roa2004	.0373782	.0587914	0.64	0.525	-.0778509	.1526073
roa2005	-.0540291	.0549394	-0.98	0.325	-.1617084	.0536503
roa2006	.1186608	.0631024	1.88	0.060	-.0050175	.2423392
roa2007	-.1434196	.0486543	-2.95	0.003	-.2387803	-.0480589
_Inewindus~1	.1617972	.6548689	0.25	0.805	-1.121722	1.445317
_Inewindus~2	.8036952	.5512647	1.46	0.145	-.2767637	1.884154
_Inewindus~3	.4394132	.6483585	0.68	0.498	-.8313461	1.710172
_Inewindus~4	-.2001597	.5704188	-0.35	0.726	-1.31816	.9178407
_Inewindus~5	.680235	.7464327	0.91	0.362	-.7827461	2.143216
_Inewindus~6	1.525188	.7391125	2.06	0.039	.0765543	2.973822
_Inewindus~7	.2806921	.6307517	0.45	0.656	-.9555585	1.516943
_cons	-1.303647	.4298841	-3.03	0.002	-2.146205	-.4610901

Table 6: LP Logistic regression

Dependant variable: out-in
Independent variable: Labor productivity (LP) on a yearly basis
Control variable: Industry

Logistic regression — Number of obs = 217; LR chi2(14) = 21.06; Prob>chi2 = 0.1000; Pseudo R2 = 0.0795

Log likelihood = -121.94118

outin	Coef.	Std. Err.	Z	P>|Z|	[95% Conf. Interval]	
lp2001	-.000264	.0002547	-1.04	0.300	-.0007632	.0002352
lp2002	-.0003615	.0004326	-0.84	0.403	-.0012094	.0004865
lp2003	.0005465	.0005795	0.94	0.346	-.0005893	.0016823
lp2004	.0002381	.0004223	0.56	0.573	-.0005895	.0010657
lp2005	-.0001249	.0002889	-0.43	0.666	-.0006912	.0004414
lp2006	.0004826	.0002658	1.82	0.069	-.0000383	.0010036
lp2007	-.0005792	.0002926	-1.98	0.048	-.0011526	-5.73e-06
_Inewindus~1	-.0310596	.6662479	-0.05	0.963	-1.336882	1.274762
_Inewindus~2	.6558625	.5406332	1.21	0.225	-.4037591	1.715484
_Inewindus~3	.2332117	.6442017	0.36	0.717	-1.0294	1.495824
_Inewindus~4	-.3363298	.5795439	-0.58	0.562	-1.472215	.7995555
_Inewindus~5	1.076581	.809458	1.33	0.184	-.5099279	2.663089
_Inewindus~6	1.845458	.7908882	2.33	0.020	.2953457	3.395571
_Inewindus~7	.3570563	.5785203	0.62	0.537	-.7768227	1.490935
_cons	-1.118339	.4306857	-2.60	0.009	-1.962468	-.274211

Table 7: ROE Logistic regression

Dependant variable: out-in
Independent variable: Return on equity (ROE) on a yearly basis
Control variable: Industry

Logistic regression — Number of obs = 210; LR chi2(14) = 31.30; Prob>chi2 = 0.0050; Pseudo R2 = 0.1212

Log likelihood = -113.46729

outin	Coef.	Std. Err.	Z	P>|Z|	[95% Conf. Interval]	
roe2001	.0017557	.0061434	0.29	0.775	-.0102852	.0137966
roe2002	.0065618	.0100653	0.65	0.514	-.0131658	.0262894
roe2003	.0079875	.0092367	0.86	0.387	-.0101161	.0260912
roe2004	.0008954	.0088719	0.10	0.920	-.0164933	.018284
roe2005	-.0113949	.0057877	-1.97	0.049	-.0227385	-.0000512
roe2006	.0226563	.0169044	1.34	0.180	-.0104758	.0557883
roe2007	-.0306429	.0118073	-2.60	0.009	-.0537847	-.007501
_Inewindus~1	.2034105	.6365443	0.32	0.749	-1.044193	1.451014
_Inewindus~2	.7886594	.5449584	1.45	0.148	-.2794394	1.856758
_Inewindus~3	.3318029	.6441136	0.52	0.606	-.9306365	1.594242
_Inewindus~4	-.1862955	.6024623	-0.31	0.757	-1.3671	.994509
_Inewindus~5	.3819355	.7763567	0.49	0.623	-1.139696	1.903567
_Inewindus~6	1.742378	.7667434	2.27	0.023	.2395885	3.245167
_Inewindus~7	.153894	.6106311	0.25	0.801	-1.042921	1.350709
_cons	-1.25168	.4083607	-3.07	0.002	-2.052052	-.4513074

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A LAND-LOCKED AFRICA'S GROWTH STRATEGY: EXPORTS OF KNOWLEDGE-BASED SERVICES

MATSUO WATANABE University of Niigata Prefecture
HIROYUKI HINO Kobe University

Abstract

This paper argues for promoting exports of knowledge-based services, including skilled labour, in Uganda as an effective growth strategy for the land-locked Africa. For sustained growth at faster rate to be realised, the international development discourse finds a renewed interest in industrial policy, reflecting individual economies' diverse conditions in political economy and geography, among others—as opposed to the 'one-size-fits-all' prescriptions by donors in the past. Land-locked countries require a geography neutral strategy. To neutralise the disadvantages associated with its land-lockedness (i.e., high transport cost to sea), those countries may want to focus more on exporting skilled labour and ICT-related businesses, e.g. business process outsourcing, rather than on following the traditional export-oriented industrialisation in labour-intensive manufacturing.

JEL classification: O14, O25, O55
Keywords: Uganda, Africa, service, sustained growth, industrial policy, BPO

1. Introduction

Recent years have seen increasing attention to sustained growth acceleration in the international development discourse, e.g. Commission on Growth and Development (2008), following the emphasis on poverty reduction in the last decade. The economies of Sub-Saharan Africa (hereinafter Africa) have shown a good performance in the recent years. However, the income level of the continent as a whole is still behind other developing regions, and the growth pattern is subject to world commodity prices despite the considerable aid inflows over the last three decades. In

Corresponding Address:
Matsuo Watanabe
Faculty of International Studies and Regional Development, University of Niigata Prefecture
471 Ebigase, Higashi-ku, Niigata City, 950-8680 Japan
Hiroyuki Hino
Research Institute for Economics and Business Administration (RIEB), Kobe University
2-1 Rokkodai-cho Nada-ku, Kobe 657-8501 Japan

addition, while the negative effects of the current global financial crisis from 2008 on African economies appears to be smaller than expected at least for short-term period, the implications of the crisis to the international political economy (such as the possible changes in the global demand structure) may involve a substantial revision of the traditional development strategy—namely, the export-oriented industrialisation—for Africa.

The recent international development discourse also saw a renewed interest in industrial policy (for example, Rodrik 2004, 2006, and 2007; Stiglitz 2008; World Bank 2009), calling for a broader policy space given to the governments in developing countries, and for the respect to the diverse national contexts in designing development policies as a criticism to the 'one-size-fits-all' best practices policies under the guidance of international development community. Individual developing countries face different situations and times—exogenous and indigenous political and economic conditions, and geographies (e.g. costal versus land-locked), among others—which deserve different development paths. These arguments are reflected in the conclusion of the Tokyo International Conference on African Development (TICAD IV 2008; JICA/JBIC 2008; and Watanabe 2008).

This paper is intended to explore the rationale of service sector development and export thereof for Uganda's development strategy, based on a policy proposal submitted to the Ministry of Finance, Uganda, by the authors (Watanabe, Hino and Owa 2008). The proposal, drawing on experiences in Asia as a benchmark for consideration, i) identifies Uganda's educated workforce, rich farm land, and central location in Central East Africa as sources of comparative advantage; ii) targets knowledge intensive services, biofuels and associated green power generation, and regional logistical services as industries leading economic development; and iii) sets out some elements of the policy framework. Services, the focus of this paper, no longer mean provision of manual labour. High-end service is the provision of knowledge embodied in human capital. Given its historically high level of higher education, Uganda seems to have comparative advantages in knowledge-based industries in Africa. The globalisation, the cross-border expansion of communications network connections, and the advance of transportation technology have vastly expanded opportunities for trade of services, including outsourcing, tourism, financial products and transport hub, among others. Trade in services are not bound by the geographical location—Uganda's land-locked nature cannot be a disadvantage for the growth of services.

The plan of this paper is as follows: Section 2 presents a summary of the existing development policies/plans of the Ugandan Government and the donor documents on Uganda and Africa, namely the World Bank and Japan International Cooperation Agency. Section 3 demonstrates the importance of services for economic growth in the global economy. Then, taking a Philippines' case, it shows how the service export could contribute to economic growth. Section 4 examines Uganda's potentials of knowledge intensive services and exports, with particular emphasis on overseas employment and business process outsourcing (BPO). Section 5 discusses the issues in promoting the sector as a conclusion of this paper.

2. Review of past growth strategies: constraints and opportunities for a land-locked Africa

2.1 Ugandan Government's target areas

A number of development strategies for Uganda (and Africa at large) have been proposed by donors, and were planned by the Ugandan Government itself such as the Poverty Eradication Action Plan (PEAP), Competitiveness and Investment Climate Strategy (CICS) as well as annual Budget Speeches annual budget speeches. The country's current development strategy is based on the *2004 PEAP* which has five priority areas, namely 1) economic management, 2) enhancing production, competitiveness and incomes, 3) security, conflict resolution and disaster management, 4) good governance, and 5) human development (Republic of Uganda 2004). The *CICS 2006-2010*, an "operational pillar of the PEAP" finds Uganda's competitiveness in high-value agro-based products (while it also looks to service and industry as potentiality) (CICS 2006).

The *Budget Speeches 2005/06* afterwards put stress more on economic growth than poverty reduction. The *2007/08 Speech* prioritises i) investments in energy infrastructure, ii) development and maintenance of transportation infrastructure and iii) information communication technology (ICT), science, technology and industrial development. Also the speech finds growth potentialities in cash crop production, manufacturing, construction, transport and communications. The *2008/09 Speech* follows the priorities and adds financial policy measures to facilitate those sectors' effort to increase productivity. A distinction of the *2008/09 Speech* is that the government recognises the contribution of remittance to the economy (e.g. in macroeconomic stability and private investment[1]),while maintaining the importance to develop service export through ICT (e.g. offshoring)[2].

2.2 Donor side's views on Uganda's growth

The World Bank's *Country Economic Memorandum* (CEM) (World Bank 2007a, 2007b) finds Uganda's competitive advantage in those products which are based on domestically produced inputs and raw materials as well as in fish and cut flowers which have high value-weight ratios in the international markets. The memorandum points out that infrastructure, especially in transport and energy sector, as the major constraints for accelerating economic growth. Uganda's

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1 Remittances increasingly account for a major source of foreign exchange earnings for Uganda. The 2007/08 fiscal year saw USD 1,392 million inflows up from USD 646 in the previous year.

2 The development of offshoring has drawn increasing attentions in the last decade as a new type of international business operations. According to a survey conducted in 2007 by O'Sullivan (2008a, 2008b), 57 percent of the responding companies outsource ICT functions offshore–which is twice as many as in 2004. 49 percent of the companies with annual revenues of $1 billion or more are accounted for by offshore service providers. The market size of offshore IT and business process outsourcing is estimated to grow double or triple between 2006 and 2011. The types of offshoring are also expected to be more diverse from call-centre and routine tasks (e.g. accounts payable/ receivable and payroll processing) to legal research. In addition, the locations of provider are also differentiated. While India has been a major host of offshore service, the recent wage hike in India makes the clients to shift their finance and accounting outsourcing to Latin America and Eastern Europe.

high population growth rate (3.3 percent per annum) cannot sustain high per capita income growth rates. And as the workforce sets to double in the coming 15 years, the major challenge for Uganda is to facilitate private investments beyond agriculture for employment creation.[3] The memorandum provides scenarios of long term growth of the country, simulating the impact of total factor productivity (TFP) growth on agriculture, industry or transportation services. It finds that agriculture sector benefits most by TFP increase. It also indicates that government spending more on infrastructure will support GDP growth and private demand (i.e. consumption and investment) than on human development (e.g. primary education, health and water). However, no paths of TFP growth are provided in the memorandum.

Several approaches in development strategies have been suggested for Africa in the recent literature. Collier (2007) suggests that landlocked countries in Africa focus on regional markets (rather than global markets) and facilitate thereof through regional integration, infrastructure development and improving economic policies. It appears that such strategies imply cases of manufacturing development. In fact Collier does argue that development in other sectors beyond agriculture is needed for African countries to catch up middle income countries. However, the relevance for Uganda is indistinct. First, industrial sector may not necessarily dominate the indisputable position as the engine of growth for Uganda. The TFP of industrial sector inevitably relies on the development of neighbouring countries' infrastructure and institutions (e.g. border control and customs clearance). This poses uncertainty on Uganda's industrial sector to increase competitiveness. In addition, Asian counties, in the 1980s afterwards, have already developed market-oriented approach and established industrial agglomeration. Collier (ibid.) in fact admits that the chances of newly creating such agglomeration left for Africa might be slim. Dasgupta and Singh (2005, 2006) add that the dizzy changes in world consumption trend and production technologies make rapid industrial development a tough task for many developing countries. Second, Collier appears to disdain the global market as the destination of Ugandan products. To realise sustainable growth acceleration, however, it is questionable that domestic and the low-income regional economies provide enough and stable market. Third, while Collier does mention telecommunication (e.g. call centres) and remittance as possible help for landlocked African countries, he sees no strategic value in service sector. As seen in the subsequent section, services have been the engine for growth in most of the emerging economies. The recent world economic trend shows that GDP growth is closely associated with the development of service sector (see Section 3.1). Both high and low income countries have seen faster growth in service—such as ICTs, business service and financial—than in industrial sector.

The Japan International Cooperation Agency (JICA/JBIC 2008) looks to more active roles of governments with broader policy space to realise sustained growth acceleration in Africa. Given

3 Not surprisingly, the 'official' stance of the memorandum maintains sceptical view on broadening role of government. It stress that government should avoid picking winners (let alone ruling out supporting declining sectors), and that there should be uniform application of any investment incentives, avoiding selective support to specific investors.

the weak business environment (e.g. weak private sector, lack of efficient financial systems, poor infrastructure and dysfunctional markets, among others), the governments should pursue their own "industrialisation strategies" that identify and support prospective leading industries with a focus on latent potentialities in *individual* economies.[4]

The JICA study contends that observation of national contexts is essential to establish and pursue successful strategies. The growth paths taken by Asian countries in the 1980's afterwards have reflected their particular socio-economic conditions. While the role played by each government was significant, its policy measures and implementation styles were diverse. In contrast, in Africa, the role of governments has virtually been limited. Approaches to industrial development have become more or less identical, relying heavily on the private sector (particularly foreign capitals), notwithstanding its weakness in an underdeveloped market. Under the strong guidance by the international financial institutions, African countries followed the so-called 'best practices' with little consideration given to their diverse situations.

It is, however, unrealistic to expect all African governments have enough capacities to pursue full scale strategies (namely, so-called *industrial policy*[5]) from day one. The extent of governmental intervention should be based on the country's institutional capacity. Policy measures commensurate with the institutional capacity should be adopted, and the institutional capacity should be strengthened through trial-and-error. The JICA study as such stresses that the international community should allow African countries to take diverse approaches at diverse paces as well as short-term errors in the course of the processes.[6]

3. Service sector and growth: Global and Asian experience

Building on the discussions in the previous section, this paper proposes to build strong knowledge-based service industries in Uganda for exports to the global market. To support such a strategy, we offer in this section evidences in the global economy and in Asia that service sector is one of the key to sustain high growth rates in particular Ugandan context.

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4 The term "industrialisation" refers not only to manufacturing sectors but to a broader range that includes agriculture and services industries as well.

5 The literature largely regards industrial policy as selective government interventions for structural transformation of national economies, aiming at either promoting certain industries (or firms) or soft-landing declining industries (e.g. coal). The former looks i) to providing public goods and services and ii) to market imperfection and externalities, for example, while the latter is intended to address the imperfection of production factor mobilization and sank cost problem. (This article is concerned with the former case.) While "direct," major measures of industrial policies include subsidies, tax concessions, soft loans, preferential procurement, import restrictions, and export promotions, even "indirect" policies such as in exchange rate and education can be considered as the measures of industrial policy.

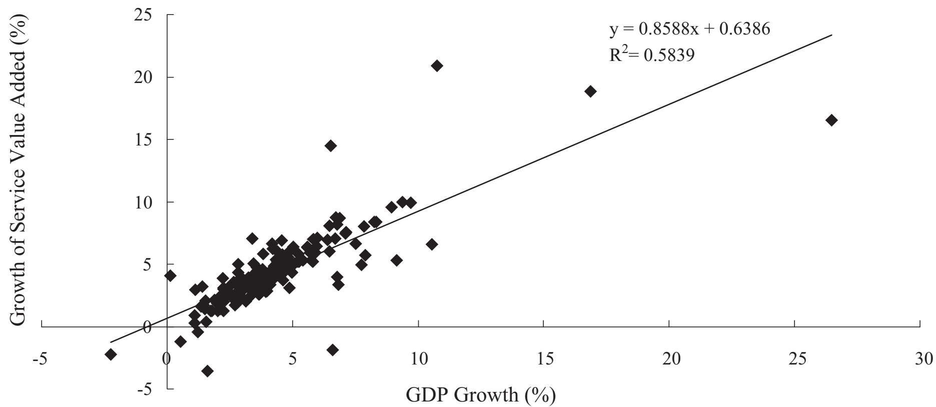
6 The study discusses the necessary conditions to pursue successful strategies (e.g. effective public-private partnership) and the way to attain the capacities. See JICA/JBIC (2008) for details.

3.1 Global Experience

Economic growth is associated with the development of service sector. Figure 1 shows the average GDP growth of 168 countries and their growth rates of services value add for the decade of 1996-2005. There is a strong, positive relationship between GDP growth and service sector growth. More rapidly growing countries have experienced expansion of service sector at faster rate than other countries during the period. As the production processes of goods become global, a major portion of value-added (from 30 to 70 percent) comes from services inputs (UNDP 2005).

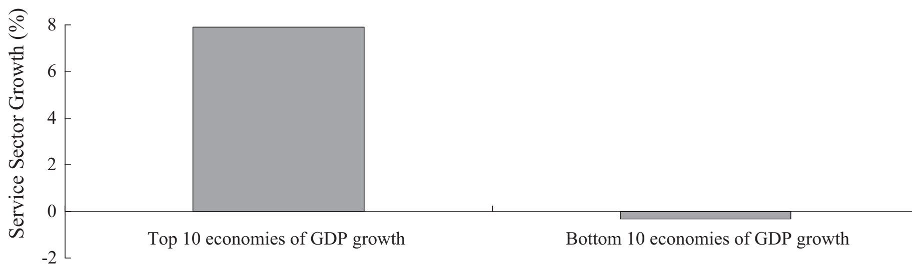
Growth in services most effectively fuels overall economic growth. Figure 2 compares the average annual growth rates of service value add during 2000-2005 period for the top 10 (non-oil producing) economies in terms of GDP growth rate and the bottom 10 (excluding conflict affected ones). In the former group, the service sector grew at average 7.9 percent per year, while

Figure 1. Service sector and growth



Source: Data taken from World Development Indicators

Figure 2. Growth performance: GDP and service



Source: World Development Indicators

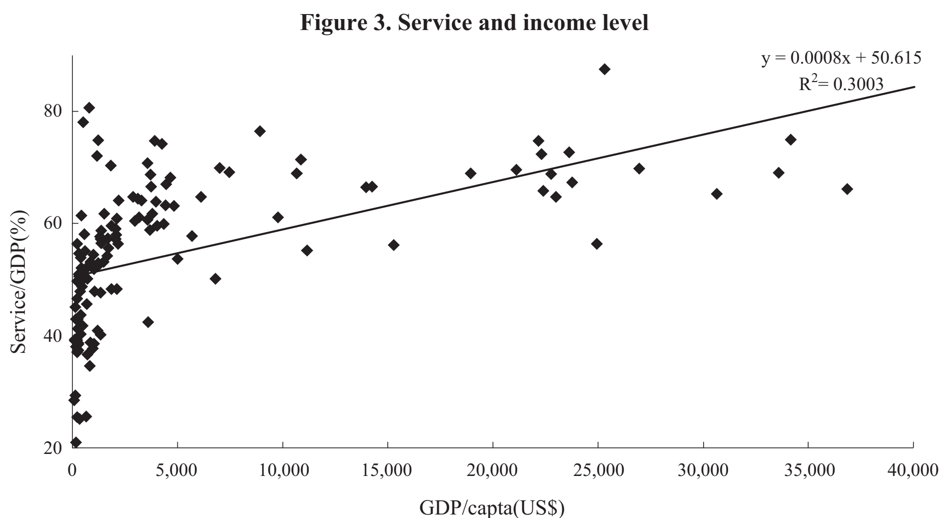
the latter's service sector declined at 0.08 percent per year.[7] The growth of service sector directly corresponds to the economic performance. The two figures illustrate that the recent trend of economic performance in the world over is largely accounted for by the development of service sector.

In fact, the pattern of foreign direct investment (FDI) flows is shifting to services. UNCTAD (2007c) points out services account for 58 percent of inward FDI stock in developing countries in 2005—in business activities, finance, trade, transport, storage and communications—whereas 31 percent was for manufacturing and 9 percent for primary sector. These developments clearly show a paradigm shift of investor's interest in FDI to developing countries from conventional low-skilled, labour-intensive manufacturing to new knowledge-based and/or service sectors.

As the share of service in an economy increases, its income level also rises. Figure 3 reports GDP per capita of 138 non-oil producing countries and their share of service sector in GDP for 1996-2005. The positive correlation between the two suggests that the countries of higher income level tend to see higher share of service sector in their economies. Expansion of service sector has been a key to achieve economic growth and long-term economic development.

Development of service sector is largely attributed to technological innovation which qualitatively changes services and the way they are provided. Besides the traditional services such as retail and distribution, services are now provided in entire production processes, i) as up-stream inputs (e.g. research and development, product design and staff training), ii) as on-stream inputs

Figure 3. Service and income level



Source: Data taken from World Development Indicators

7 The top 10 are Chad, Armenia, Cambodia, Estonia, Latvia, Mozambique, Ukraine, Bhutan, Lithuania and Belize. The average GDP growth rate of these was 8.5 percent per year. The bottom 10 are Guinea-Bissau, Gabon, Italy, Papua New Guinea, Eritrea, Dominica, Uruguay, Guyana, Seychelles and Zimbabwe. The average GDP growth rate was 0.09 percent.

(e.g. accounting, legal services, process engineering, technical testing, computer services, equipment repair and maintenance, finance, and telecommunications), and iii) down-stream inputs (e.g. advertising, distribution, transportation, and storage). Many of the business services, which were perceived as 'non-tradable', are now outsourced beyond boundaries. The business process outsourcing (BPO) services have grown rapidly in the last decade. The average annual growth rate of BPO exports of Brazil and China during 1995-2005 was 15 percent, and 25 percent for India. The trend is largely explained by the global competitive pressure, in which companies' competitiveness is increasingly determined by the access to low-cost and high-quality services. There are also chances even for non-ICT top runners. Recently the more advanced countries in BPO activities, like India, are moving from low-end services to more integrated and higher-end services, such as customer care, human resource management, product design and development. This move is creating space for other developing countries, like Senegal, to step into the more standardized segments of the BPO market (see Footnote 2).

3.2 Asian evidence: Non-traditional pattern of growth: the case of Philippines

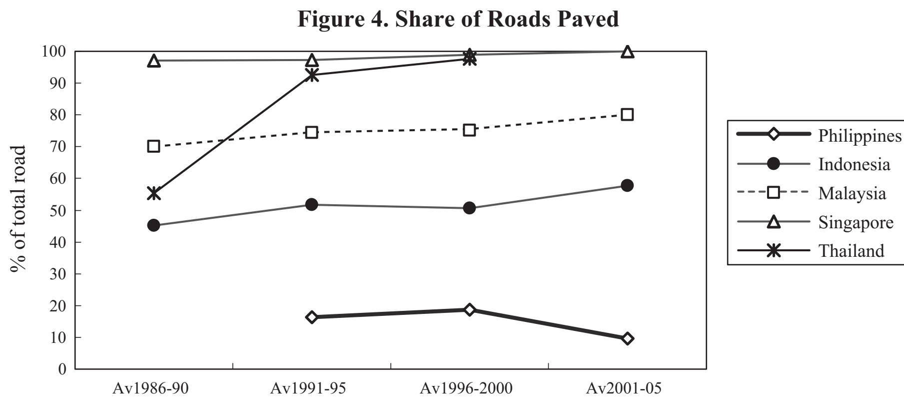
Philippines' experience illustrates a successful case of service-led growth. While the countries of the Association of Southeast Asian Nations (ASEAN) saw rapid economic growth in the 1980 afterwards, Philippines fell behind other members. Table 1 reports the comparison of economic performances of the five ASEAN members. Filipino economy grew at slower pace than others until the early 1990s: the average annual growth in the 1991-95 period was 2.2 percent, while other economies saw rapid export-led industrialisation and grew at 8 percent or more; Filipino economy even shrank in 1991 due to the political instability, drought, and the great eruption of the Pinatubo volcano. The government was unable to manage the economy well. Inflation rate has been always higher than other ASEAN economies (except Indonesia in the late 1990s after-

Table 1. ASEAN: economic performances

		1981-85	1986-90	1991-95	1996-00	2001-05
GDP growth (annual %)	Philippines	-0.1	4.7	2.2	4.0	4.5
	Indonesia	6.2	7.1	7.9	1.0	4.7
	Malaysia	5.5	6.9	9.5	5.0	4.4
	Singapore	7.0	8.5	8.9	6.4	4.1
	Thailand	5.4	10.3	8.6	0.6	5.1
Inflation (GDP deflator: annual %)	Philippines	20.0	8.4	9.8	7.7	5.4
	Indonesia	12.4	9.2	8.1	26.3	9.8
	Malaysia	3.3	1.8	3.5	4.1	4.2
	Singapore	4.2	2.7	3.2	-0.3	0.0
	Thailand	5.6	4.8	4.9	2.9	2.4

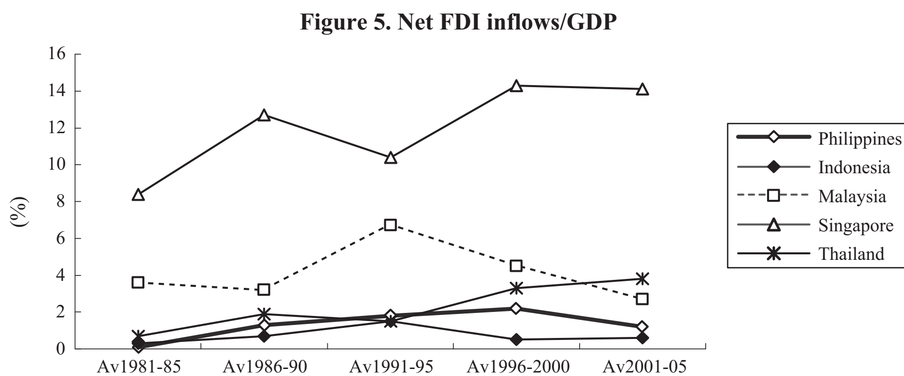
Source: World Development Indicators

Figure 4. Share of Roads Paved



Source: World Development Indicators

Figure 5. Net FDI inflows/GDP



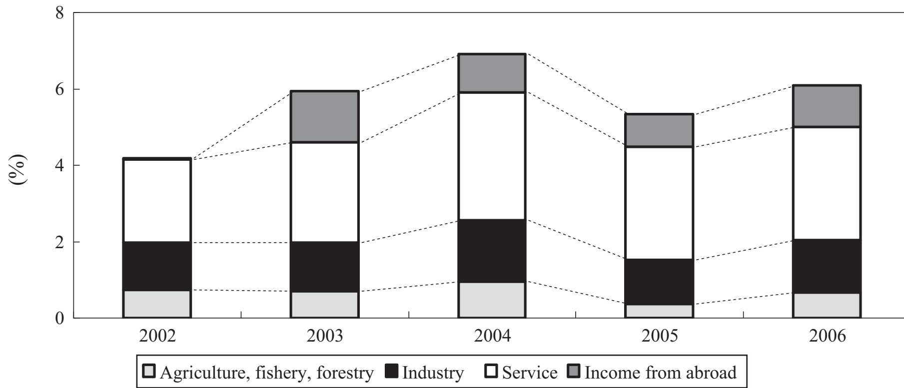
Source: World Development Indicators

wards). In addition, infrastructure is weak: for instance, the ratio of paved roads has been far lower (Figure 4). These conditions discouraged foreign investors to operate in the country. The level of FDI inflows lagged behind other economies in the region throughout the 1980s (Figure 5).

After the modest shock of the 1997 financial crisis, however, the country has seen stable economic growth at 4-7 percent in recent years, largely due to service sector growth (Figure 6). The recent growth is largely accounted for by the contribution of service sector, such as financial, retail and personal services. In 2004, the GNP growth rate was 6.9 percent, of which service sector growth accounted for 3.3 point. In fact the economic structure is shifting to service sector whose share in the economy increased from 44 to 54 percent in 1990 and 2005, respectively, while agriculture sector shrank from 22 to 14 percent (Figure 7).

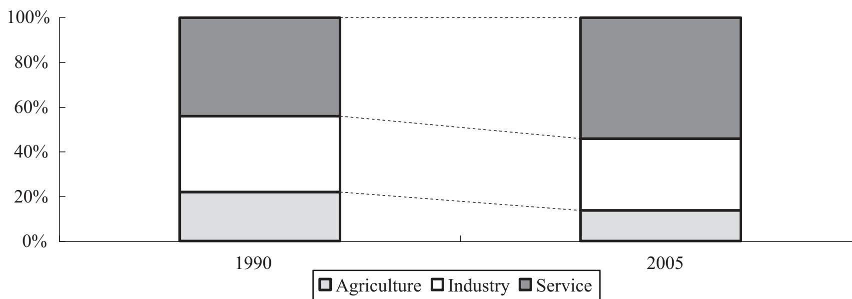
The sector's growth was a result of inflows of foreign capital into the financial sector and

Figure 6. Phillipines' GNP growth and contribution by sector



Source: Central Bank of Phillipnes

Figure 7. Transformed structure of economy



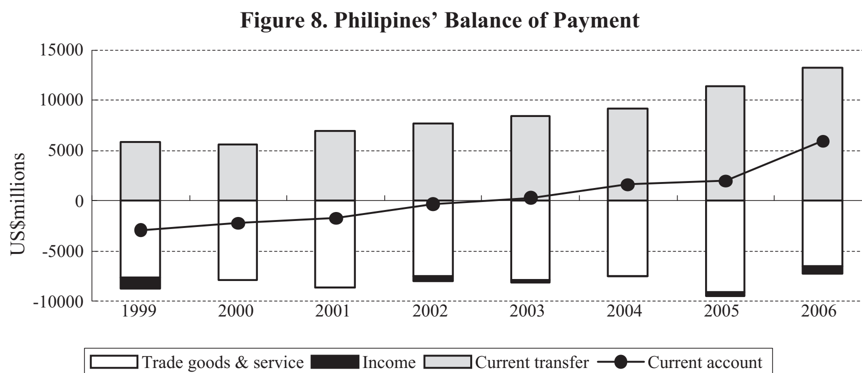
Source: World Development Indicators

ICT services, such as software programming, and business process outsourcing (Horie 2007). For example, the IBM outsources back-office operations (e.g. personnel management, payroll accounting, financial accounting, and customer management) to the Philippines. The DELL has recently opened a large-scale call centre in the country. These developments are facilitated by English-speaking ability of the people in the country.

Besides such BPO services, one of the most prominent characteristic of Philippines' economy is its reliance on remittance from abroad (Figure 8). Although the country's trade balance in goods and services are persistently in deficit, current transfer (i.e. remittance) cancels out the deficit and makes the current account surplus from 2003. This remittance allows the expansion of domestic retail and personal services sectors—which uphold the recent economic growth as mentioned above.

Table 2 and 3 report the destinations and types of business of overseas workers (OWs). The

Figure 8. Philipines' Balance of Payment



Source: Central Bank of Philippines

Table 2. Overseas workers by region: 2005

	Number	Share (%)
Middle East	394,419	39.9
Asia	259,209	26.2
Europe	52,146	5.3
Americas	14,886	1.5
Africa	9,103	0.9
Trust territory	7,596	0.8
Oceania	2,866	0.3
Others	135	0.0
Sea based	247,497	25.1
TOTAL	987,857	100.0

Source: Overseas Employment Statistics, Philippine Overseas Employment Administration

Table 3. Overseas Workers (New hires) by occupation

	1992		2006	
	Number	Share (%)	Number	Share (%)
Administrative, manager	289	0.1	817	0.3
Agriculture, forestry, fisherman	2,023	0.7	807	0.3
Clerical workers	5,369	2.0	7,912	2.6
Production, transport operator	95,062	36.4	103,584	33.6
Professional, technical	72,881	28.0	41,258	13.4
o/w Nurses	5,747	2.2	13,525	4.4
o/w Medical dental veterinary	924	0.4	1,038	0.3
Sales worker	2,701	1.0	5,517	1.8
Service worker	82,267	31.7	144,321	46.8
o/w Domestic helper, household	57,903	22.2	91,412	30.0
o/w Care taker	n.a.	n.a.	14,412	4.7
TOTAL	260,593	100.0	308,122	100.0

Source: Overseas Employment Statistics, Philippine Overseas Employment Administration

most popular destination of Filipino OWs is Middle East (about 40 percent), followed by Asia (26 percent) and Europe (5 percent). The prejudice that OWs are non- or low-skilled, such as construction workers, does not bear out in the Philippines' case. Although 'Production, transport operator' represented by construction workers and 'Domestic helper, household' account for large part of the deployed population (combined 63.6 percent in 2006), 'Nurses' and 'Care taker' have seen an increasing trend. The number and share in total overseas Filipino workers of newly hired nurses more than doubled from 1992 to 2006 (i.e. 5,747 to 13,525). In 2006, 14,412 care takers (who provide care for children, elderly persons or persons with disabilities in private homes) were deployed in foreign countries (4.7 percent of the total OWs)—this shows a spectacular increase from 1992 when there was virtually no such type of deployment (even considering the difference of statistical classification). (See Appendix 1 for the Government's policy in OWs.)

Philippines' economic growth strategy is increasingly dependent on human resources through export of services, i.e. business outsourcing and natural persons. Although the country is surrounded by sea, the economic development is no longer dependent on the geographical condition. In a broad sense, deployment of domestic labour is also considered as exporting services. In the situation where domestic infrastructure is inferior to neighbouring countries to promote industries, Philippines finds a means of pursuing economic success by taking advantage of the country, i.e. human resources. This example is relevant to Uganda because English speaking (and Western style of education) is an essential part of Philippines' success and because the success in service has nothing with the geographical condition as an island country. The next section explores the possibilities in services in Ugandan context.

4. Uganda's comparative advantage and possibilities

4.1 Manufacturing vs. services exports

The above evidences from the global economy and Asia suggest that developing countries do not necessarily have to look only to manufacturing sector development in order to sustain high economic growth over a long period. This is good news for Uganda, because it is landlocked and the costs of transporting goods to the coast are high. For instance, Robusta coffee prices were between US$380 and 390 per ton, of which US$75, or 19 percent, is the flight cost to Mombassa (The National Resources Institute & the International Institute of Tropical Agriculture 2002: 36). Delay in transport also poses additional burden for Ugandan products. It takes 42 days to export a container from Kampala and have it on the ship ready for transit at the Mombassa Port (The Republic of Uganda 2007a). As a result, Ugandan firms on average lose 1.8 percent of domestic sales and 1.1 percent of exports because of the delays in transportation services (World Bank 2007b: 133). This implies that Uganda's comparative advantage may lie more in the trade of services such as BPO and overseas employment of educated Ugandans (which are not bound by

the geographical location) than in manufacturing. Then, can Uganda realistically expect to develop these service industries?

The evidence suggests that in Uganda, international trade of such services has actually been growing rapidly, and that their potentials should not be dismissed. As shown in Table 4, the value of service export increased from slightly above US$200 million in 2000 to more than US$500 million in 2005. The share of services in total export has been constantly more than 30 percent. The service sector has been in fact the driving force for economic growth in Uganda in the last two decades (Table 5). The contribution of the service sector to overall GDP growth has been higher than any other sectors since 1990. The service sector now accounts for more than 40 percent of GDP, higher than that of agriculture.

Travel has traditionally been the major contributor for service exports, followed by transportation. However, exports of new services (e.g. computer and information, financial service, insurance, communications, and other business services) have seen an increasing trend. The share in total service export increased from 3.8 percent in 2000 to 22.5 percent in 2006 (Table 6). As such the possibility of expanding new service sub-sectors has a realistic ground.

One of the background of the policy to promote the service sector is unemployment of younger generations. The population of Uganda is projected to increase at 3.7 percent per year between 2005 and 2010, the highest level in the world. Labour force will increase at a rate far above that, given that a disproportionately large share of population is expected to enter the la-

Table 4. Export of Goods and Services ($US million)

	2000	2001	2002	2003	2004	2005	2006
Goods	449.9	475.6	480.7	563	708.9	864.2	1003.9
Services	213.2	216.9	224.7	265.7	358.3	507.7	489.8
Total	663.1	692.5	705.4	828.7	1067.2	1371.9	1493.7

Source: Balance of Payments Statistics Yearbook 2007, IMF

Table 5. Sectoral Composition and Growth of GDP (1990-2005)

	Sectoral contribution to GDP growth		Sectoral shares in nominal GDP	
	1990-99	2000-05	1990-99	2000-05
Supply of GDP	6.3 %	5.5 %	100.0 %	100.0 %
Agriculture	1.8 %	1.3 %	46.4 %	33.8 %
Industry	1.8 %	1.6 %	18.5 %	24.6 %
Services	2.7 %	2.6 %	35.1 %	41.6 %

Source: World Bank (2007b: 11)
Note: GDP at factor cost

Table 6. Export of Goods and Services ($US million)

	2000	2001	2002	2003	2004	2005	2006
GOODS	449.9	475.6	480.7	563	708.9	864.2	1003.9
SERVICES	213.2	216.9	224.7	265.7	358.3	507.7	489.8
o/w Transportation service	31.5	29.2	31	8.9	9.6	10.7	10.9
o/w Travel	165.2	165.4	171.5	184.2	255.8	381.2	354.9
o/w Communications	8.1	12.1	9.1	16.6	18.7	17.9	19.4
o/w Insurance		1.7	1.9	3.2	4.1	7.2	6.6
o/w Financial				12.8	16.4	16.9	17.9
o/w Computer and information			0.1	0.7	7.9	32.8	31.5
o/w Royalties and license fees				0.6		7.4	2.4
o/w Other business services			2.3	28.4	33.9	20.8	32.4
TOTAL	663.1	692.5	705.4	828.7	1,067.2	1,371.9	1,493.7

Source: Balance of Payments Statistics Yearbook 2007, IMF

bour market. Currently, Uganda's labour force participation rate is 81.3 percent, while the annual labour force is growing at 3.6 percent (Uganda Bureau of Statistics 2006). Given the situation, it would be unrealistic to expect to absorb all the growing workforces domestically. Even if the economy was to grow at 8-9 percent annually, the associated increase in demand for labour could not match that of the labour force. As such the government purports to expand exports of knowledge-based services to deal with the expected growth in labour force through both outsourcing and employment overseas. The global demand for such services is huge in relation to the potential supply from Uganda. What is needed is to improve the quality of such supply, as the rise in wages in India, China and elsewhere is creating openings for late comers such as Uganda.

4.2 Potentials for overseas employment and BPO

Given the emerging role of services in Ugandan economy, what are the emerging 'strategic' areas in services? The key is Uganda's skilled human resources. The growing literature shows that remittance has positive effects on the receiving countries' economy. The recent case studies on remittance—Orrenius and Zavodny (2009) on Mexico, and Adams, Cuecuecha, and Page (2008) on Ghana, among others—support the positive effects of remittances to development through labour markets (i.e. lower unemployment and increase in wages) and increase investment in human capitals. Although remittances were expected to decline in 2009 by 7-10 percent by a World Bank report (Ratha et al. 2009) due to the current global financial crisis triggered by the collapse of an US investment bank in 2008, the negative impacts on economic performance have been smaller than expected.[8] In Ugandan context, Kihangire and Katarikawe (2008) tested the linkage between

8 According to the Central bank of Philippines (2009), for instance, the country saw remittances from overseas Pilipino workers of US$ 11.3 billions during January to August 2009 which was 3.7 percent higher compared to the previous year.

remittance and GDP per capita and found positive association between them. Remittances also tend to increase trade for the country.[9]

The level of migration outflow of highly skilled labour has been high in Uganda. In 2000, 21.6 percent of tertiary education graduates left for employment abroad, and 20 percent of Ugandan medical doctors are reported to reside in the U.S. and Canada (UNCTAD 2007a). Another data (Shaw 2007) shows that 37 percent of Ugandan college graduates reside in the Organisation for Economic Co-operation and Development (OECD) countries in 2000. Russell et al. (1990) point out that in many countries like Uganda, education has expanded faster than the absorptive capacity of the economies, leading to disparities between supply and demand of highly skilled manpower and hence to constant out-migration of trained workers who are unable to find suitable jobs at home. Table 7 supports this story. Remittances of Ugandans working abroad are already quite large. They amounted to US$ 856 million in 2007, equivalent to 8.2 percent of GDP.

Table 7. Workers' inward remittances in Uganda (US$ million)

	2000	2001	2002	2003	2004	2005	2006	2007
Remittances	238	342	421	306	371	423	814	856
Share of GDP (%)	4.0	6.1	7.2	4.9	5.4	4.8	8.7	8.2

Source: World Bank Migration and Remittances Factbook, World Economic Outlook Database 2007

Uganda is one of the top thirty remittance-receiving countries in the world in terms of the ratio to GDP. As shown in Table 8, the top two counties, Moldova and Tajikistan, received remittances of 36 percent of their respective GDP in 2006. Uganda's performance (8.7 percent) is about the same as Bangladesh and Sri Lanka; but is one of a few countries in Sub-Saharan Africa in the list. What is remarkable for Uganda is that average Ugandan migrant sent US$ 5,260 to his/her home country, which was the fourth highest after Lebanon, Honduras, and Guatemala. This illustrates that Ugandans working overseas are employed with high salary job at least statistical data covers (Kihangire and Katarikawe 2008). An OECD document (Dumont and Lemaître 2005) also suggests that Ugandans working overseas earn comparatively high salary because the share of highly skilled in total Ugandan expatriates is 39.2 percent—which is the same level as that of United Kingdom and slightly above that of Kenya.[10]

9 Other positive effects of the skilled emigration (e.g. technology/skill transfer and improvement of social institution in home country) are identified in the literature. See World Bank (2006), for example.

10 Some literature employing cross-country regressions claimes that educated OWs remit less, and concerns that further increase in skilled OWs will hamper remittance growth. However, Bollard et al. (2009) and Clemens and MacKenzie (2009) augue that skilled (and more educated with more earnings) migration remits more. A survey by the former shows that there is a strong positive relationship between education and the amount remitted. For example, African physicians typically remit much more money than it cost to train them. This implies that public professional tranings (even for future migrants) by developing countries can pay.

Table 8. Top 30 Remittance-Receiving Countries: 2006

Countries	Remittance (% of GDP)	Value of remittances (US$million)	Migration stock (000's)	Remittance per capita (US$)
Tajikistan	36.2	1,019	80.6	1,279
Moldova	36.2	1,182	70.5	1,675
Tonga	32.3	72	5.6	1,396
Kyrgyz Republic	27.4	739	61.3	1,201
Honduras	25.6	2,367	415.0	5,704
Lesotho	24.5	361	258.6	1,396
Guyana	24.3	218	417.5	522
Lebanon	22.8	5,183	622.0	8,334
Haiti	21.6	1,070	834.4	1,282
Jordan	20.3	2,883	641.1	4,497
Jamaica	18.5	1,946	1,037.6	1,875
Armenia	18.3	1,175	812.7	1,446
El Salvador	18.2	3,330	1,128.7	2,950
Nepal	18.0	1,453	753.7	1,928
Bosnia.Herzegovina	17.2	1,943	1,471.6	1,320
Serbia Montenegro	16.9	4,703	2,298.4	2,046
Albania	14.9	1,360	860.5	1,581
West Bank, Gaza	14.7	597	955.0	625
Philippines	13.0	15,250	3,631.4	4,199
Gambia	12.5	64	56.8	1,128
Nicaragua	12.2	656	683.5	960
Cape Verde	12.0	137	181.2	756
Guatemala	10.3	3,626	685.7	5,288
Dominican Republic	10.0	3,044	1,069.0	2,848
Kiribati	9.9	7	4.8	1,447
Morocco	9.5	5,454	2,718.7	2,006
Guinea-Bissau	9.2	28	116.1	241
Bangladesh	8.8	5,428	4,885.8	1,111
Uganda	8.7	814	154.7	5,260
Sri Lanka	8.7	2,350	935.6	2,512

Sources: World Migration Remittances Factbook, World Development Indicator 2007, Datasets created by University of Sussex and the World Bank.

4.3 Potentials for ICT services and BPO

Telecommunication services have shown a remarkable growth in Uganda. The number of mobile phone subscribers increased fourfold from 1999 to 2007 reaching 3 millions (Table 9). There are now 17 internet service providers (both domestic and foreign capitals) from 2 providers 10 years ago, and ICT-related businesses are gaining markets in Europe and North America as well as in Africa.[11]

11 IF (2006a) reports that there are 17 ICT companies engaged in outsourcing business as of 2005 in software development and training, internet and e-commerce related consulting, ICT consultancy services (e.g. software designing, call centre, customer relationship management, desk outsourcing services), telecom value-added services, data processing, book-keeping as online outsourcing. World Bank (2007b) points out that the English speaking population and the presence of a large number of unemployed university graduates reinforce Uganda's potential for the further development of ICT exports in the long run.

Table 9. Uganda's Communications Sector

	Fixed phone lines	Mobile phone Subscribers	Internet Service Providers	Courier Service Providers
Dec 1996	45,145	3,000	2	2
Dec 1999	58,261	72,602	9	11
Dec 2002	59,472	505,627	17	11
Dec 2005	100,777	1,525125	17	22
Mar 2007	137,916	3,015,493	17	25

Source: Uganda Communications Commission website

To promote outsourcing businesses in Uganda, a series of public support has been launched. For example, in 2006, the government has launched a joint programme with private companies, which is intended to increase the capacity in BPO, offering ICT education specifically designed for call centre technologies and management. Besides this, in order to address the problem of internet connectivity—which has been identified in various studies as the major constraints for Uganda's ICT service exports, the World Bank is supporting the East African Sub-marine Cable System connecting the countries in East Africa with 10,000-kilometer fibre-optic cable. Other projects are planned with support of the Commonwealth Business Council or the Chinese government.

5. Issues ahead in knowledge-based service export

To support the strategy to harness knowledge-based industries and export in the long run, it is obviously critical not only to strengthen education at all levels but to focus in particular on higher education and vocational training. Historically, Uganda used to have a strong higher education system. The Makerere University (MUK) used to represent a high quality education in Africa. After established in 1922 as a technical college to serve students from the British East African territories of Kenya, Tanganyika and Uganda, affiliated to London University and produced many renowned graduates in Africa. As of July 2007, the number of students in MUK is 33,488 (of which 1,626 are postgraduates; 2,128, or 6.4 percent, are international students from over 10 countries) and up to 5,000 students graduate annually (See www.makerere.ac.ug). However, the current level of higher education in Uganda seems to lag behind globally and regionally. According to the Webometrics Ranking of World Universities (http://www.webometrics.info), the current ranking for MUK is 53 out of 100 African universities, that is far below the ranking of the University of Dar Es Salaam (21st) or the University of Nairobi (23rd). The percentage of Uganda's enrolment for secondary school has been approximately 15 percent since 2000, again lagging behind other regional countries, Kenya (40 percent), Ghana (36 percent), Ethiopia (25 percent) and Zambia (24 percent) (Table 10).

Table 10. Secondary School Enrolment rate, 2004

Country	Rate
Philippines	61 %
Cape Verde	55 %
Botswana	55 %
Gambia, The	45 %
Bangladesh	44 %
Kenya	40 %
Lao PDR	37 %
Ghana	36 %
Ethiopia	25 %
Malawi	25 %
Zambia	24 %
Uganda	15 %
Burkina Faso	10 %
Mozambique	4 %

Source: World Development Indicator 2007

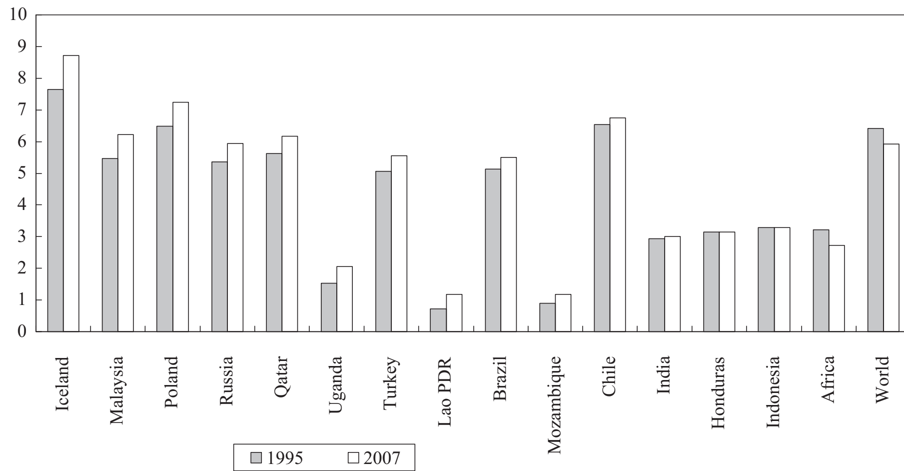
The policy shift towards primary education by both donor support and the government in the 1990's afterwards may have contributed to the deterioration of Uganda's higher education. Such a shift occurred in most African countries with the introduction of the Poverty Reduction Strategy endorsed by the World Bank. Uganda's effort was more pronounced than that of other countries, which in turn undermined the budget allocation for higher education.

An emerging good sign, however, is that an increase in enrolment ratio is observed in the secondary and tertiary education; the increase of the secondary is from 12.0 percent to 18.7 in the decade from 1995 to 2005, and that of tertiary is from 1.7 percent to 3.4 during the same period (World Bank Edstats website). In addition, Uganda remains as an higher education hub, especially for students from the neighbouring countries. In 2005, over 28,000 secondary students and about 5,000 higher education students studied in Uganda from abroad (The Republic of Uganda 2007b). Most of them are from Kenya (20,716), Tanzania (5,211), Sudan (2,457), Rwanda (1,228) and Democratic Republic of the Congo (2,435). As of March 2005, foreign students comprised approximately 8 percent of the total number of students in the major tertiary institutions in Uganda. Another good sign is that Uganda's position in the Knowledge Economy Index of the World Bank is improving while that of entire Africa sees a decline (Figure 9). Uganda's Knowledge Economy Index improved by 0.52 point from 2005 to 2007. The improvement of 0.52 point is ranked 6th among the world.[12] To ensure the trend, the government may want to establish an integrated policy and make a longer-term commitment in the area.

Given the tight fiscal situation, public investment in infrastructure must be targeted, with its

12 The Knowledge Economy Index of the World Bank assesses to what degree the country's environment is conducive for knowledge to be used effectively for economic development. It is based on four factors: Economic Incentive Regime, Innovation, Education and ICT.

Figure 9. Knowledge Economy Index



Source: Knowledge for Development databse, World Bank

priorities consistent with the country's comparative advantages and industrialisation strategies outlined above. In particular, the basic infrastructure for ICT, such as fibre optic connections and power generation capacities, is a prerequisite, if Uganda is to capitalise on its potentials for BPO and other export of services.

This paper identifies development of service sector as Uganda's long-term growth strategy. The textbook manufacturing-led industrialisation may not necessarily be appropriate for land–locked Uganda as export of manufacturing goods is handicapped by high transport cost and inevitably depends on uncertain situation of neighbours. What is important for a developing country is that diverse development strategies has to be established by itself, considering the unique national contexts which deserve different policies and implementation sequences in the rapidly changing global situation.

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Appendix 1

Having been recognising the contribution of remittance to the economy, the government finds one of its national economic strategies in deploying OWs. The Filipino government established the Philippine Overseas Employment Administration (POEA) in 1982 to promote deployment and support OWs through, for example, concluding bilateral agreements on overseas employment (Table A1). The POEA's mandate includes i) to regulate private agencies in hiring and deploying workers, ii) to promote and supervise overseas employment, iii) to guard welfare and rights of overseas workers, iv) to recruit and coordinate deployment of professional/skilled workers under bilateral agreements, and v) to train returned workers and to promote recruitment of them.

Deployment of nursing and care workers is one of the priorities of the Government. Filipino nurses are proficient in English and receive American style nursing education—these make the wage level of Filipino nurses higher than other nationals. There are 28 medical schools and 191 nursing schools in the country: every year 1,500-3,000 doctors and 5,000-30,000 nurses are newly registered. Besides nursing, the number of deployed caretakers is increasing. For example, Philippines and Canada jointly established a 'Live-In Caregiver Program' which carries out caretaking training and orientation courses in Canadian culture before coming to Canada. In addition, Canadian government offers Filipino caretakers the permanent residency of Canada after 2 years of the job. (See *http://www.cic.gc.ca/ENGLISH/work/caregiver/index.asp* for details of the Program.)

Table A1. Philippines' Bilateral agreements on overseas employment

	General Agreement on labour movement
Taiwan Saudi Arabia	Taiwan provides information on employment situation (to ban trafficking by brokers) Saudi Arabia regulates minimum wage for Filipino workers
	Health care-related agreement
Norway UK	Provision of condition for Filipino nurses working at public hospitals in host countries; Provision of pre-deployment training contents
	Agreement on sea workers
Denmark Norway Netherlands	To approve the sailor qualification issued by Philippines authority
	Agreement on Filipino Workers at US military bases
US	To promote employment of Filipino workers at US bases in Guam, Okinawa, Taiwan as well as to ban discrimination and exploitation

Source: Department of Labor and Employment, Philippines

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F a x : 81-78-803-7059
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