POLICY BRIEF

Political Instability and Firm Performance in the Democratic Republic of Congo

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Abstract

This study analyses the effect of political instability on firm performance in the Democratic Republic of Congo (DRC), one of the most unstable countries in sub-Saharan Africa. We use pooled panel data for three waves of the World Bank Enterprise Survey of the DRC (2006, 2010, and 2013) to analyse the effect of political instability on five measures of performance: employee growth, sales growth, productivity, investment, and export status. Results from the endogenous switching model reveal that political instability adversely affects firm performance in the DRC. In the presence of political instability, employee

growth, sales growth, productivity, and investment growth significantly decline. Conversely, firms that do not experience political instability grow in terms of employee growth, sales growth, productivity, investment, and exporting activities. Our results are robust when we proxy political instability with losses due to theft, robbery, and vandalism. For purposes of policy, we recommend that political stability should be enhanced through political goodwill and legislation that advocates for peace. Firms can also push for this agenda through their business associations and platforms such as public-private partnerships that link them to the government.

Introduction

Effective institutions are strongly correlated with economic development (Acemoglu & Robinson, 2012). Policies that aim to enhance economic growth rest on the quality of political institutions, which ultimately play a leading role in determining the trajectory of economic development. For example, political stability and regime type in Africa significantly affect the gross domestic product (GDP) per capita, total factor productivity of the agriculture sector, and economic growth (Bates et al., 2013; Dalyop, 2019). As such, there is need for good institutions that implement policies and ultimately promote economic development.

A channel through which political institutions promote growth—that has recently attracted the attention of policy makers—is the business environment, given its ability to enhance firm performance (Commander & Svejnar, 2011) and its propensity to drive firm productivity (Anos-Casero & Udomsaph, 2009). Policies that have been of interest to promote firm growth have focused on reducing constraints such as financial, legal, and corruption problems (Beck et al., 2005). Smaller firms are the most constrained across all metrics. Empirical evidence has shown that financial constraints significantly increase the likelihood that firms exit the market while access to external financial resources has a positive effect on the growth of firms in terms of sales, capital stock, and employment (Musso & Schiavo, 2008). However, the effect and magnitude of these constraints vary across countries, the level of economic development, and across firm characteristics (Beck et al., 2005; Commander & Svejnar, 2011).

Asongu and Odhiambo (2019) reviewed the challenges of doing business in Africa. Issues related to the cost of starting and doing business, shortage of electricity, lack of access to finance, high taxation, and low cross-border trade were identified as prevalent across the continent. Improving the business environment by reducing the level of these constraints is costly and might take considerable time. However, as noted by Bah and Fang (2015), some constraints can be rapidly addressed in the presence of a strong political will. Equally, political instability has implications for the improvement of the business sector and firm growth. For example, it has a direct

negative effect on innovation (Allard et al., 2012), has a substantial influence on both formal and informal entrepreneurship (Autio & Fu, 2015), affects a firm's ability to export (Kapri, 2019; Elango & Pangarkar, 2020), and has a negative causal effect on firm performance (Hosny, 2017, 2020).

Empirical literature seems to agree that political instability is detrimental to the growth of firms (Hosny, 2017, 2020; Matta et al., 2018). However, existing empirical evidence suffers from two gaps that we have identified. First, it does not cover sub-Sahara Africa (SSA) and second, and most important, countries that have experienced long periods of political instability are under-researched. Most of the existing studies are entrenched in particular contexts that fuelled political instability. For example, Matta et al. (2018) and Hosny (2020) studied the effect of political instability on firms, but that instability was caused by the Jasmine revolution in Tunisia. Hosny (2017) positioned the study in the context of the Egyptian revolution surrounding the fall of President Mubarak. The striking point here is that, not only is SSA scarcely covered by the existing literature, but the region has some of the most perennially unstable countries in the world (Chacha & Edwards, 2019). This study seeks to fill this gap by examining how firms perform in a context of sustained political instability, using the case of the Democratic Republic of Congo (DRC). To the best of our knowledge, this is the first paper to study political instability and firm performance linkages in the DRC.

The DRC ranks highly in terms of political instability worldwide, yet empirical evidence on its effect on firm performance is lacking for the country. Micro-level papers in the DRC have studied how firm performance is affected by gender (Mwisha, 2012), business environment (Sebigunda, 2013), and human capital (Urban & Kongo, 2015). Furthermore, policy makers in the DRC are increasingly targeting policies that improve the performance of the private sector as a strategy for economic diversification (World Bank, 2015). Some policies include simplifying the domestic fiscal system, establishing Courts of Commerce and Labour Courts, establishing investment security mechanisms, and prohibiting nationalization and expropriation. Others are freedom to transfer generated revenue and reduced time to formally create a firm (to three days) through a single counter (ANAPI [*Agence Nationale pour la Promotion des Investissements*], 2021). Nonetheless, the success of these interventions is likely to be affected by political instability, hence the reason to inform policy in the DRC on the effect of political instability on firm performance.

Using pooled panel data from the World Bank Enterprise Survey (WBES) for the years 2006, 2010, and 2013, this study explores the effect of political instability on five indicators of firm performance, which are employee growth, sales growth, productivity, investment, and export status. We employ an endogenous switching model, which has been narrowly applied in the context of political instability, for this

exercise. Our results reveal that political instability reduces employee growth, sales growth, productivity, and investment by 419%, 54%, 36%, and 68%, respectively. These results are robust when political instability is proxied by the losses arising from theft, robbery, and vandalism (here, the probability of exporting reduces by 2.6%).

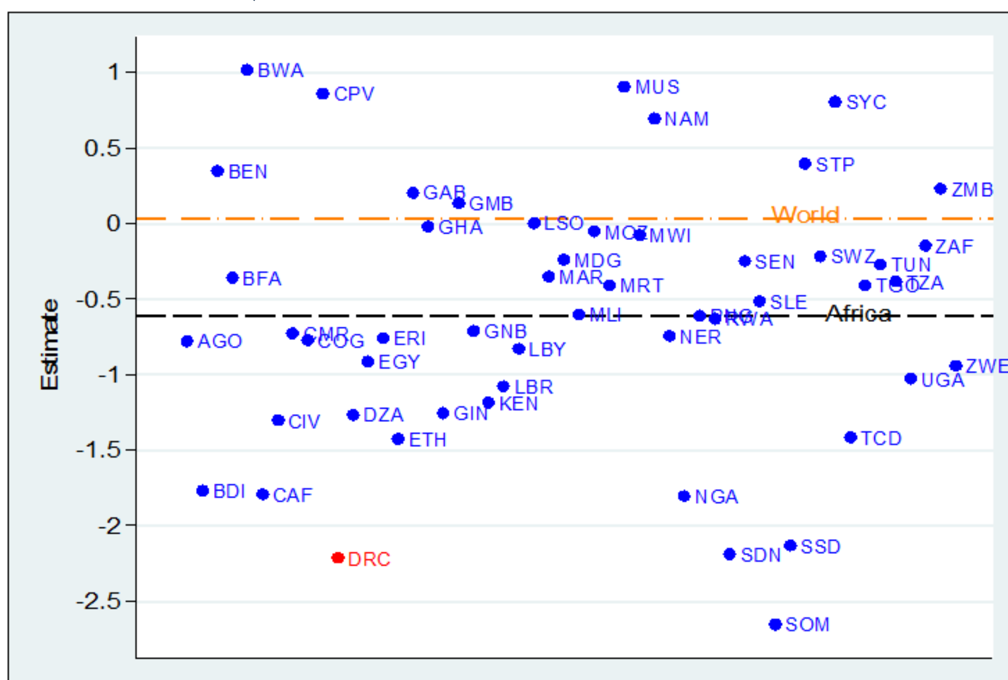
Stylized facts on political instability and firm constraints in the DRC

Since attaining independence in 1960, the Democratic Republic of Congo (DRC) has ranked as one of the most unstable countries in the world. As shown in Figure 1, the estimate of political stability in the DRC is lower than that of the world and Africa by far. The DRC is about four times politically unstable compared to the African average, and over 20 times unstable compared to the mean global political instability rate. The DRC is also the second most politically unstable country in Africa after Somalia (SOM), which means that the DRC is the most unstable country in Central Africa, a region with some of the most fragile states in the world such as Burundi (BDI), Central African Republic (CAF), and South Sudan (SSD).

Table 1 compares the performance of the DRC to that of Africa and the world across several indicators of the business environment. The DRC performs poorly on most indicators: more businesses experience losses from theft, crime, and vandalism than in African countries and the world. Most firms in the DRC source for funds internally other than from banks, indicating a weak financial system and problems associated with access to credit by businesses. The share of firms with audited financial statements in the DRC is almost half that of the African average and the world. The informal sector seems to have a bigger role in the DRC compared to the rest of Africa and the world, while more firms experience power outages in the country as opposed to Africa and the world. More firms identify business licensing and permits as a major constraint in the DRC (38%) compared to Africa (30%) and the world (22%).

Figure 2 displays major obstacles that have been reported by firms using the three waves of WBES in the DRC. Access to land, practices of competitors in the informal sector, and courts were the top three obstacles to operations of formal firms in 2006. Figure 2 shows that, in 2006 and 2010, access to land and access to finance were reported as major and standalone constraint far beyond other reported constraints. While in 2013 access to electricity is reported as the highest constraint, it is not as important as other major constraints in previous waves. Additionally, there is no single constraint that is dominant in all the three waves, and the most important constraint reported is different in each wave of the survey. The impact of some obstacles has faded over time but the severity of political instability, of all the major obstacles to firm operations, has consistently risen over time, especially in the last two waves, thereby affirming our focus on it.

Figure 1: Rank of African countries by political instability estimates (average, 1996-2019)



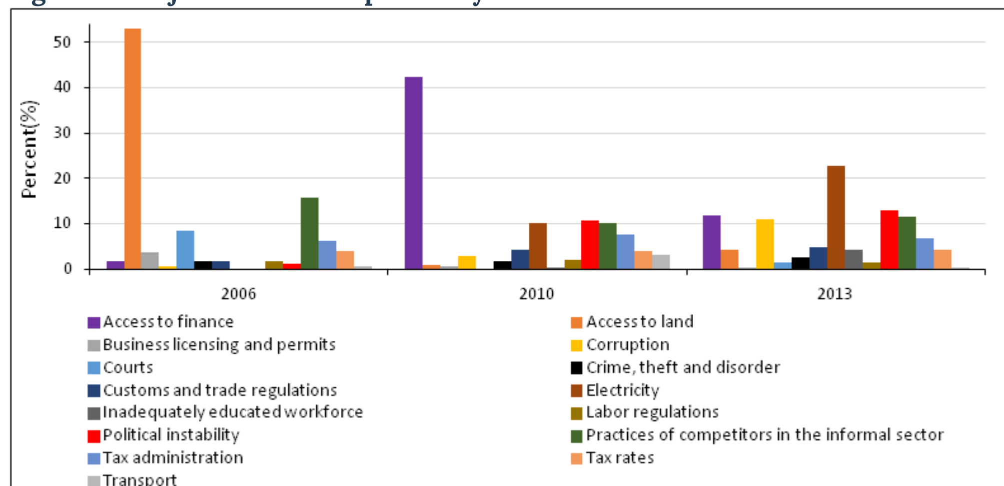
Note: Political instability estimate ranges from about -2.5 (high political instability) to 2.5 (low political instability).
Source: Authors' construction using World Governance Indicators data.

Table 1: Comparison of key indicators for DRC, Africa and World

Indicators	DRC	Africa	World
The % of annual sales losses due to theft, crime, and vandalism	8.3%	7.9%	5.5%
Proportion of investments financed internally	92.2%	74.4%	72.1%
Proportion of working capital financed by banks	1.9%	8.3%	10.8%
Annual financial statement reviewed by external auditors	25.4%	48.6%	46.5%
Female participation in firm ownership	15.1%	29.2%	33.6%
Proportion of firms competing against unregistered and firms in the informal sector	78.4%	69.5%	53.6%
Proportion of firms experiencing power outages	89.3%	77.5%	57.3%
The % of firms identifying business licensing and permits as a major constraint	38.4%	29.6%	22.1%

Source: WBES (2014).

Figure 2: Major obstacles reported by a firm



Source: WBES (2006, 2010, and 2013).

According to the WBES, as shown in Figure 2, several constraints play a role in hindering firm prospects in the DRC. However, according to the most recent survey, the DRC was doing better than the average of SSA on some of these reported obstacles. For example, while access to finance was reported as a major constraint in 2010, it is a lesser obstacle in the DRC compared to the average of SSA. Though important, other reported constraints can in some ways be linked to the ineffectiveness of institutions, a salient characteristic of politically unstable countries. Thus, one can argue that some of these obstacles are a result of lack of stability which does not allow law enforcement and competitiveness. Firms operating in such contexts tend to underperform (Yasar et al., 2011).

Conclusion

This study sought to investigate the effect of political instability on firm performance in the DRC. This is because the DRC ranks highly in terms of political instability. At the same time, the country seeks to improve the performance of the private sector which is likely to be affected by political instability. Using pooled panel data from the World Bank Enterprise Survey for the DRC for 2006, 2010, and 2013, we analyse the effect of political instability on five measures of performance: employee growth, sales growth, productivity, investment, and export status.

Results from the endogenous switching model reveal that political instability adversely affects firm performance in the DRC. In the presence of political instability, employee growth, sales growth, productivity, and investment growth decline by 419%, 53%, 36%, and 68%, respectively. Conversely, firms that do not experience political instability grow by 1,388% in terms of employee growth, 240% for sales

growth, 1,773% for productivity, 9% for investment, and 64% for exporting activities. Our results are robust when we proxy political instability with losses due to theft, robbery, and vandalism. Sales contract by 27% while the likelihood of exporting declines by 2.6% when a firm is exposed to theft, robbery, and vandalism. Firms that are not exposed to theft, robbery, and vandalism experience growth in our outcome indicators.

For purposes of policy, we recommend that political stability should be enhanced. This should be through political goodwill and legislation that advocates for peace. Firms can also push for this agenda through their business associations and platforms such as public-private partnerships that link them to the government.

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