



**ADDIS ABABA UNIVERSITY
SCHOOL OF GRADUATE STUDIES
FACULTY OF TECHNOLOGY
DEPARTMENT OF CIVIL ENGINEERING**

**TITLE: THE ROLE OF FINANCIAL INSTITUTIONS FOR THE
ETHIOPIA'S CONSTRUCTION INDUSTRY**

BY: MELESE MAMO GEBRE

**A THESIS SUBMITTED TO SCHOOL OF GRADUATE STUDIES IN
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**ADDIS ABABA
JULY 2006**



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ABSTRACT

This dissertation presents the contribution of the Financial Institutions in the capacity building as well as project financing of the domestic construction firms which are involving in the infrastructure development activities of the country.

The main objective of this paper is therefore to present preliminary assessment report regarding the role of domestic banks for the development of the construction sector especially in capacity building and project financing of the domestic construction firms in Ethiopia.

One of the main observations of this research work has been the fact that the Ethiopia Construction Industry seriously lacks capable construction firms (Financially as well as Technically and Managerially). That is why multimillion birr worth infrastructure development projects are being awarded to foreign construction companies.

The study had developed through literature survey and in addition to this questionnaire based studies were made to provide an overview of the various financial services and facilities that a certain domestic construction firm could obtain from local banks and interviews were also conducted with various parties which have direct involvement in construction activities to strengthen the ideas of the subject matter.

Finally the results of the study were analyzed and discussed. In addition to this, conclusions are made and recommendations are forwarded based on the analysis results.

SUMMARY

It is very clear that there are a large number of infrastructure development projects in Ethiopia. For the implementation of these projects, it is required to have financially as well as technically capable construction firms.

However, the development of construction industry in Ethiopia is very young and low in capacity with full of financial as well as managerial problems. In order to strengthen the capacity of the domestic construction industry for the implementation of infrastructure development activities in the country, the role of financial institutions (banks) is vital.

There are only one governmental commercial bank and six private banks are available in the country to provide services and facilities for the domestic construction firms. They are mainly providing construction loans and overdraft facilities, equipment financing and bonds and guarantees.

This thesis mainly focuses on the role of the local banks for the capacity building as well as working capital financing of the domestic construction firms. The research context mainly comprised of the contextual, the conceptual and the methodological frameworks.

The basic research instruments (methodologies) that have been used for the research survey were interviews and questionnaires. About 24 questionnaires have been distributed to construction firms of different categories, domestic banks and project owners. Since the questionnaires require more reliable data regarding the experiences of the companies how they are getting working capital and truck / equipment financing from their bankers, they couldn't be filled easily by any professionals in the companies. In addition to this the questionnaires were distributed to the loan departments of the local banks (private and government).

Accordingly, after the questionnaires collected, analysis has been made. The analysis result revealed that most of the domestic construction firms lack proper type of construction equipments, work experience, skilled manpower and managerial capability in addition to the financial problem. Beside to that the role of the domestic banks for the capacity building of the domestic construction firms is not adequate.

Conclusively, further investigations, research works and discussion forums are advisable by all stakeholders and the concerned higher government officials in order to give tangible solution for the financial problem and capacity building of the domestic construction firms.

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ABBREVIATIONS

NBE	National Bank of Ethiopia
CBE	Commercial Bank of Ethiopia
ISHOPA	Imperial Saving and Home Ownership Public Association
AIDB	Agricultural and Industrial Development Bank
ICB	International Competitive Bidding
MOPW	Ministry of public works
IHA	Imperial Highway Authority
ETBuRC	Ethiopian Building and Road Construction
EEE	Ethiopian Earthmoving Equipment
EBCA	Ethiopian Building Construction Authority
ETCA	Ethiopian Transport Construction Authority
BNCE	Blue Nile Construction Enterprise
BCE	Batu Construction Enterprise
NE&C	National Engineers and Contractors
IMF	International Monetary Fund
WB	World Bank
BDE	Building Design Enterprise
TCDE	Transport Construction Design Enterprise
BaTCoDA	Building and Transport Construction Design Authority
MoWUD	Ministry of Works and Urban Development
LCB	Local Competitive Bids
AfDB	African Development Bank
EBRD	European Bank for Reconstruction and Development
IDB	Inter – American Development Bank
AsDB	Asian Development Bank
IBRD	International Bank for Reconstruction and Development
IFC	International Finance Corporation
IDA	International Development Association

MIGA	Multilateral Investment Guarantee Agency
ICSID	International Center for Settlement and Investment Disputes
ADF	African Development Fund
BC	Building Contractor
GC	General Contractor
RC	Road Contractor

CHAPTER 1

1. INTRODUCTION

A construction industry is a service providing and implementing industry whose responsibility is to convert plans and specifications into a finished product. It also plays a leading role in the national economy. It employs over 10% of the work forces and covers about 15% of the government's capital budget in the developed world. The figures correspond to about 20% and 30% respectively, in the developing countries [22].

The construction industry performance has a marked effect both on the economy and on social conditions. This is especially true in developing countries, where much of these infrastructures and service giving industries are lacking. For the development and capacity building of the industry, the role of banks is very crucial.

With the availability of funds from international financiers and allocation of budget from the government (either Federal or Regional Government), there are different civil engineering projects under construction in Ethiopia and there are a lot of projects under study to be implemented.

Presently, Ethiopia has relatively an extensive program of infrastructure development and it is growing faster. The construction of new roads, high rising buildings, hydroelectric power generating plants, water work projects, Airfields etc. are among the major construction activities to be cited. The quality and standards of the design and construction play a significant role in the successful accomplishment of these investments. When the quality and time of completion of construction works considered, the capacity of the construction firms involved come into picture in developing countries [1].

The general state of the construction industry of Ethiopia is characterized by low capacity, which could not handle large-scale construction demands in the infrastructure development of the country. The government has taken a number of measures to

stimulate the performance of the domestic construction industry. Some of these were [44]:

- encouraging private investors to establish construction firms and participate in all areas of construction activities,
- reorganizing the state owned construction companies as independent enterprises and preparing them for subsequent privatization,
- decentralizing the rural road construction and maintenance responsibilities to regional governments,
- assisting the private contractors by awarding various infrastructure development projects.

The contractor of a certain project must obtain the capital resources to finance the costs of construction. A project cannot proceed smoothly without adequate financing, and the cost of providing adequate financing can be quite large. For these reasons, attention to project financing is an important aspect of project management. In this regard, the involvement of banks to the construction sector is very important.

The most prominent constraint contractors face in the construction sector is the difficulty to find appropriate financing for the smoothly undergoing and on time completion of the project activities.

In all the cases, financial institutions basically banks will generally not allow construction loans and other facilities simply for construction firms by setting different pre-established conditions; these include collateral, the firm's track record at the bank etc.

Domestic construction firms working in different infrastructure development projects have limited access to formal financial services. In most developing countries interest rate ceilings and collateral requirements for loan generate a gap between contractors and banks; hence, the contractors are bound to rely on informal and ad-hoc types of financial services [20].

The difficulty that contractors get a strong financial partner for their activities can strongly affect the outcomes of their project activities. This lead to a variety of sub-optimal situations where construction companies:

- delay operations,
- work with inappropriate type of equipment,
- reduce the amount and quality of materials to be used etc.

Faced with these realities, project owners are often obliged to facilitate contractors' access to build their financial capability by giving advance payments and interim payments [20].

Therefore, this study will guide domestic construction firms how they can get a financial partner for their day-to-day activities and to avoid the above described sub-optimal situations. This is very important for all parties that are involving in the infrastructure development activities of least developed countries.

The main drive for this research was my exposure to the domestic construction firms that I have observed low capacity and severe working capital problem to execute and complete projects that they have taken from their clients. This mainly insists me to assess the role of the domestic banks for financing of working capital as well as capacity building of the domestic construction firms.

This dissertation has mainly focused on the different bank services and facilities that a certain domestic construction firm can enjoy from local banks and the requirements and procedures for the facilities.

CHAPTER 2

2. THE CONTEXTUAL FRAMEWORK

THE RESEARCH CONTEXT

The research context or specific characteristics covered in this dissertation are categorized into the following four major parts:

- Banking in Ethiopia and its Historical Development,
- Financial Rules and Regulations for Banks in Ethiopia,
- Development of Construction industry in Ethiopia.
- Capacity of Ethiopia's Construction Industry.

2.1. Banking in Ethiopia and Its Historical Development

Successful construction and development both require banks capability of mobilizing resources, in particular domestic savings, and channeling them into high return investments. But, as the case of Ethiopia shows, the creation of a sound financial system together with an appropriate regulatory framework is not a straightforward task.

During the era of state socialism (1974 to 1991 GC), Ethiopia's banking institutions were charged with executing the national economic plan; state enterprises received bank finance in accordance with the plan's priorities. With the overthrow of the Derg regime in 1991, Ethiopia began its transition to a market economy. This transition has had profound implications for the financial system. New banks have emerged, the role of the private sector in the financial system has been expanded, and the role of the central bank is being formulated. Historical development of the banking sector in Ethiopia is as follows:

2.1.1. Early Banking period

The history of banking in Ethiopia dates back to the turn of 20th century. The agreement that was reached in 1905 between Emperor Minilik II and Mr.Ma Gillivray,

representative of the British owned National Bank of Egypt marked the introduction of modern banking in Ethiopia. Following the agreement, the first bank called Bank of

Abysinia was inaugurated in Feb.16, 1906 in Addis Ababa, by the Emperor.

However, the bank later was found to be a purely profit-making institution rather than promoting the banking habit as it was expected to. It was then needed to establish a government bank. With the willingness of the National Bank of Egypt, the transfer of ownership took place smoothly in 1931.

The new bank, the **Bank of Ethiopia**, retained the offices and personnel of the old bank. The new bank differed from its predecessor in ownership and functional responsibility. Thereby it became the first bank to be nationally owned in Africa.

During the period of Italian occupation, the banking business was held by Italian banks and other financial institutions which increased their branches both in the capital, Addis Ababa, and across the regions widely. Their operation came to an end, except in Eritrea, after the liberation in 1941.

In the aftermath of the liberation, the Ethiopian government took up the tasks of reorganizing the monetary and credit conditions of the country. It then established the State Bank of Ethiopia in 1943: and other circulating currencies also withdrew from the country.

The early period of banking in Ethiopia, therefore, give way for some innovative character in the business and could have done more if it were not for the frequent interruptions for different socio-political reasons. In this era of banking, the banks didn't contribute a significant role for the construction industry development. The development of banking activity that flashed in early period of the century have contributed to the development of the idea that brought into existence some specialized banks later, viz.

- the Development Bank of Ethiopia in 1951,
- the Imperial Savings and Home ownership Public Association in 1962
- the Investment Bank of Ethiopia in 1963.

2.1.2. Modern Era of Banking

2.1.2.1. The Last Decade of the Imperial Regime

A recent and important phase in the history of Ethiopian banking was started with the introduction of monetary and banking proclamation of 1963 [23]. With the coming into effect of this proclamation, the State Bank of Ethiopia was split into two separate bodies:

- The National Bank of Ethiopia (NBE) and
- The Commercial Bank of Ethiopia (CBE).

NBE assumed central banking functions of the country while CBE took up commercial banking business of the old bank.

The powers and functions assigned to the National Bank were more or less the usually accepted ones of the majority of central banks elsewhere. Basically the functions of the central bank are divided into the following major areas:-

- i. The regulation, availability and cost of money and credit.
- ii. The management of gold and international reserve assets.
- iii. The licensing and supervision of banks and other financial institutions.
- iv. Holding the central treasury of the government and rendering general banking services to government departments and agencies.

The commercial bank on the other hand took up the duties of:-

- i. Holding in deposit public's money with guaranteed security.
- ii. Giving loans for all sorts of commercial and personal needs.
- iii. Offering assistance in matter of foreign exchange to businessmen.
- iv. Providing safekeeping for an individual's most valuable possessions.

The first privately owned bank, Addis Ababa Bank Share Company, was established on Ethiopians initiative and started operation in 1964 with a capital of 2 million birr in association with National and Grindlay Bank, London which had 40 percent of the total share.

In addition to this the Agricultural and Industrial Development Bank has been established in 1970, which helps to direct funds for the development of agricultural and industrial projects.

2.1.2.2. Banking During The Socialist Regime

The Banking sector was changed into a mono-banking system during the rule of the command economic system in the country. The Housing and Savings Bank was established in 1975 by proclamation No.60/1975 [24] decreeing the transfer of all assets and liabilities of the former Savings and Mortgage Corporation of Ethiopia S.C. and the Imperial Savings and Home Ownership Public Association (ISHOPA). The bank was established with the objective of providing loans for residential and commercial construction industries. During this era small scale domestic construction firms emerged and the banks has contributed for the development and capacity building of these firms.

The Agricultural and Industrial Development Bank, which was originally established in 1970, was re-established in 1979 under proclamation 158/79 [25] as a public financial agency. This bank was used by the government as a channel to direct funds to the agricultural and industrial sector, mainly through cooperatives, state farms and other state enterprises.

The Commercial Bank of Ethiopia (CBE) became the only bank rendering universal banking services to the public. The CBE was re-established in 1980 by proclamation No. 184 [26] amalgamating all assets and liabilities of the old Commercial Bank of Ethiopia and the Addis Ababa Bank. It has been dominating the market with over 155 branches in the country. The objective of the bank during the period was rendering commercial banking services with special favor for public enterprises and service co-operatives while denying appropriate attention for the private sector. The bank has been operating under the guidelines specified in the proclamation that restricts it in providing short-term lending of up to one year.

Generally speaking all banks were operating under the administratively set rates of interest and restrictive credit policy based on rationing and sectoral priority importance. Each bank had a strict credit ceiling beyond which it has to gain approval from the central bank for disbursement.

The financial sector that the socialist oriented government left behind constituted only 3 banks and each enjoying monopoly in its respective market. The following was the structure of the sector at the end of the era.

- The National Bank of Ethiopia (NBE)

- The Commercial Bank of Ethiopia (CBE)
- Agricultural and Industrial Development Bank (AIDB)
- Housing and Savings Bank of Ethiopia (HSBE)

2.1.2.3. Banking After the Economic Reform

As part of the recently launched economic reform, different financial liberalization measures and restructuring of financial institutions have been undertaken. All the measures have the aim of promoting a competitive environment and efficient banking services to the public. The Commercial Bank of Ethiopia was re-established in 1994 by proclamation No. 202 [30] taking over the rights and obligations of the Commercial Bank of Ethiopia which was established under proclamation No. 184/1980 [26]. The bank's capital has been raised and is entrusted with engaging in all banking activities as customarily carried out by commercial banks.

The Construction and Business Bank has also been established under proclamation No. 203/1994 [31] by taking over the rights and obligations of the Housing and Savings Bank which was established under proclamation No. 60/1975 [24]. The bank's objectives include providing loans for construction, repair, modification and acquisition of dwelling houses and buildings, for construction sector activities and for the development of hotels and tourism, accepting savings, demand and time deposits, administering funds entrusted to it by the government or other institutions and carrying out all other activities as are customarily done by banks.

The Development Bank of Ethiopia has also been established by Regulation No. 200/1994 [32]. The bank took over the rights and obligations of the Agricultural and Industrial Development Bank which was established under proclamation No. 158/1979 [25]. The bank's objectives include mobilizing funds from sources within and outside the country and providing medium and long term investment credits, holding savings, demand and time deposits, acting as a trustee and other activities usually performed by development banks.

Monetary and Banking proclamation No.83/1994 [33] and the Licensing and Supervision of Banking Business No.84/1994 [34] laid down the legal basis for

investment in the banking sector. Consequently shortly after the proclamation the private banks have come into existence.

- **Awash International Bank:** the first private bank, which was established in 1994 by 486 shareholders and by 1998 the authorized capital of the Bank reached Birr 50.0 million.
- **Dashen Bank:** was established on September 20, 1995 as a share company with an authorized and subscribed capital of Birr 50.0 million.
- **Bank of Abyssinia:** another private bank which was founded by 131 shareholders in 1996 with subscribed and authorized capital of 25.0 million and 50 million, respectively.
- **Wegagen Bank:** with an authorized capital of Birr 60.0 million started operation in 1997.
- **United Bank,** the fifth private bank, was established on 10th September 1998 by 335 shareholders and now has four branches.
- **Nib International Bank,** the sixth and the last private bank to be established to date. It has started operation on May 26, 1999 with an authorized capital of Birr 150.0 million.

Given the limited number of banks operating in the economy there is an untapped market for new banks to come up with a wide branch network.

Fig.1: Ethiopia’s Financial Sector Development

EARLY PERIOD	MODERN ERA		
	LAST DECADE OF IMPERIAL REGIME	DURING SOCIALIST REGIME	AFTER THE ECONOMIC REFORM
Abyssinia (1906) Bank of Ethiopia (1931) State Bank of Eth. (1943) ✓ DBE (1951) ✓ ISHOPA(1962) ✓ IBE (1963)	NBE (1963) CBE (1963) - AAB S.Co (1964) ISHOPA AIDB (1970)	NBE CBE (1980) HSB (1975) AIDB (1979)	NBE (1994) CBE (1994) CBB (1994) DBE (1994) - Private Banks ✓ AIB (1994) ✓ DB (1995) ✓ AB (1996) ✓ WB (1997) ✓ UB (1998) ✓ NB (1999) - Micro Financial Inst.

The other main financial institutions in addition to the banks which have a great contribution in the economic financing are the **Micro Financial Institutions**. They include micro-credit windows in established retail banks; have become widespread in the developing world as an effective mechanism for mobilizing capital for entrepreneurs, especially for those who have little or no access to main stream sources of credit. These institutions have a major role in small scale construction activities, like HCB production, metal works etc.

However, these institutions have no significant role in the capacity building as well as working capital financing of the domestic construction firms. Hence, they are not considered in depth in this dissertation work.

2.2. FINANCIAL POLICIES IN ETHIOPIA

2.2.1. Banking Laws

Banking business in Ethiopia is governed by two Proclamations. The first, Monetary and Banking Proclamation No. 83/1994 [33], defines the powers and responsibilities of the National Bank of Ethiopia which is the Central Bank of the country. The second, a proclamation to provide for the Licensing and Supervision of Banking Business No. 84/1994 [34], which sets out the conditions under which commercial banks can be licensed and the supervisory requirements they should observe in the course of their operation. Specifically, the Proclamation stipulates that in order to undertake banking business in Ethiopia, a person should meet the following requirements:

- a. it should be a company;
- b. it has share capital fully subscribed;
- c. total per value of the shares has been paid up and deposited in a bank in the name and to the account of the company; (minimum required capital to start banking business is 10 million birr);
- d. it is confirmed by the National Bank of Ethiopia that the directors and officers of the company have the qualifications prescribed by it;
- e. the company has been issued with a license by the National Bank of Ethiopia;
- f. it meets other requirements of the Proclamation or Directives issued by the National Bank of Ethiopia.

At present no foreign national is permitted to undertake banking business in Ethiopia.

2.2.2. Micro-Financing Institution Laws

A Proclamation to provide for the Licensing and Supervision of the business of Micro-Financing Institutions No. 40/1996 [36] defines the requirements for licensing micro-financing institutions that cater for the financing needs of small businesses. This Proclamation also empowers the National Bank of Ethiopia to license and supervise micro-financing institutions and, to this end, issue relevant directives.

Conditions that should be fulfilled to engage in micro-financing business are:

- a. obtain a license from the National Bank of Ethiopia;
- b. be formed as a company; (a company means a share company the capital of which is owned fully by Ethiopian nationals and/or organizations wholly owned by Ethiopian Nationals and registered under the laws of, and having its head office in, Ethiopia);
- c. deposit with a bank; the minimum initial capital required by the National Bank of Ethiopia (the minimum capital is Birr 200,000);
- d. the directors and other officers of the micro-financing institution meet the requirements set by the National Bank of Ethiopia.

Most of the Directives (regulations) to be issued by the National Bank of Ethiopia are specifically stated in each Proclamation and have been issued by the Bank. However, the National Bank can issue other Directives which are consistent with the spirit of the Proclamations even if they are not specifically mentioned therein.

2.2.3. Interest Rate Policy

The interest rate policy is aimed at maintaining market-determined rates in accordance with the overall monetary policy of the country. In a gradual move from long time fixed rate of interest to a market rate, the current practice allows banks to set their own rate above and below a certain limit for deposit and lending, respectively. National Bank of Ethiopia, the central bank, has set a minimum deposit rate at 3% and a maximum lending rate at 12%. The floor and ceiling rates are subject to revision based on developments in inflation and other macro-variables in the country's economy.

2.3. The Construction Industry in Ethiopia

The construction industry in Ethiopia has been in the process of transformation. This transformation is based on improving the competitiveness of the construction industry and enhancing its ability to fulfill the national development demands.

Historical records showed that there were construction works since the early periods of Ethiopian history. Axum monuments, Lalibela Church, Fasil Compound, Harar Compound are some of examples of the then construction works.

2.3.1 The Construction Industry Development

Previous monarchies had contributed to the development of construction in Ethiopia. Historic chronicles of the 17th and 18th centuries showed that there were a number of small roads, palaces and river improvement works in Ethiopia.

Modern construction however had started during the Emperor Menilik II. He was well known for the governor of the modern Ethiopian state. Italy during its invasion (1936-1941) had also contributed to the development of the construction industry in Ethiopia. It had constructed about 6,000 km of roads. Out of which approximately 2,500 km had been surfaced with a single asphalt wearing course [43].

After Italian Invasion, the first ministry called "Ministry of communication and public works" was established during the Imperial regime. It was responsible for the construction industry in Ethiopia. This can be acknowledged to be the starting time for the construction industry development in Ethiopia.

According to the changes in the construction management processes, policies and regulations for building the capacity of the construction industry within the development of the socio-political and economical systems, Dr Wubeshet Jekale presented the development of the construction industry in Ethiopia into six distinct periods up to now [43] & [44].

Table 1: Development of the Construction Industry In Ethiopia

Period	Year	Development of the CI in Ethiopia
1	Pre 1968	Foreign companies domination
2	1968 - 1982	Emergence of small scale domestic construction companies.
3	1982 - 1987	Para-state companies domination
4	1987 - 1991	Emergence of second order fragmentation
5	1991 - 2001	Re-emergency of privatization
6	2001 - Now	Emergence of integration and capacity building

Period 1 (Pre 1968): Foreign Companies Domination

During this period (pre 1968), the construction industry was dominated by foreign contractors (Italians, Swedish, French, German, British etc) [43]. Most civil works have been procured under International Competitive Bidding (ICB), and relevant skilled man powers were also largely brought from abroad.

Public Institutions including Ministry of Public Works (MOPW) and the Imperial Highway Authority (IHA-1951) were established for the first time. These institutions were generally held responsible for all civil works including the duty of developing and maintaining public works such as highways, buildings and other infrastructures of the then Empire.

Period 2 (1968-1982): Emergence of Small Scale Domestic Construction Companies

This period was recognized by the then Imperial Government together with foreign financiers' commitment and initiative towards building the capacity of the construction

industry, which led small scale domestic construction companies to flourish. Besides, some foreign contractor started to open local branches in Ethiopia.

Due to implementation of capacity building of the domestic construction companies' interventions, construction companies including:

- BERTA Construction PLC,
- National Engineers and Contractors PLC,
- Ethiopian Building and Road Construction (ETBuRC) and
- Ethiopian Earthmoving Equipment (EEE) were established in 1970s. These were

some of the indigenous contractors who participated in feeder road and building projects in Ethiopia during the then Imperial Era. This has resulted in some of the foreign companies to establish their local branches to increase their competitiveness and contributed to knowledge, technology and skill transfer.

Period 3 (1982-1987): Para-State Companies Domination

The socialist command economy policy Ethiopia followed from 1974-1987 caused the confiscation of developing domestic private construction companies and became under state control in 1982 [43]. This led the promotion of state owned construction companies aggressively.

The then socialist government had increased monopolizing construction activities where a number of state-owned construction enterprises were established. These include:

- Ethiopian Building construction Authority (EBCA)
- Ethiopian Transport Construction Authority (ETCA)
- Blue Nile Construction Enterprise (BNCE)
- Batu Construction Enterprise (BCE)
- National Engineers and Contractors (NE & C)
- BERTA Construction PLC

The establishment of these companies reduced own force and force account operations both in the building and road sectors that led the intensification of construction works by contract. For construction by contract, projects during this time were either provided to the state owned construction companies with mostly direct award procurement system or sometimes with competitive bidding among themselves only.

Period 4 (1987-1991): Emergence of Second Order Fragmentation

This period was characterized by the establishment of consultancy offices for the design and contract administration services as independent entities. Besides, the design Bid Build Procurement method had its roots well founded under this period [43]. Small scale private consultants and contractors emerged due to the charge of economic policy of the then government.

In the road sector, ETCA's overall responsibility for all management processes including planning, designing, constructing and contract administering defused its overall responsibilities as an employer, a consultant and a contractor. This approach had strong critics from IMF, WB and other foreign financiers. Similar problem created in the building sector to that of road sector.

Following this, Building Design Enterprise (BDE in 1985) and Transport Construction Design Enterprise (TCDE in 1986), both for design and contract administration services, were made an autonomous entity from their parent organizations called EBCA & ETCA by proclamation No 275/1985 [27] and 108/1986 [28] respectively. These changes, on the one hand enabled the sector in building the capacity of consultancy services, and ensuring improvement in the monitoring and controlling phase of projects.

Following a policy change from command economy to mixed economy and establishments above, the Ministry of Construction seized to operate as a sole entity possessing both the contract administration and construction works and gave way to the establishment of Building and Transport Construction Design Authority (BaTCoDA) in 1987. BaTCoDA's purposes were to cause the preparation of designs for, follow up and supervise proper execution of construction works and to develop and direct the country's potential in connection with construction design and contract administration services (Proclamation No. 327 of 1987 [29]).

Period 5 (1991-2001): Re-Emergence of Privatization and Emergence of Decentralization

Following the change of government in 1991 transformation to market – based free economic policy and decentralization of power based on the formation of federal states has introduced the following policy reforms to the construction industry [43] & [44].

- ✚ Local and foreign investors were allowed to participate in all areas of construction activities.
- ✚ State owned construction and consulting companies were recognized as autonomous enterprises for subsequent privatization.
- ✚ Private construction companies were provided opportunities to purchase construction equipments which were under state organizations on loan bases.
- ✚ Regional governments established their bureaus for works and urban development and rural road agencies for substantial decentralized, of power and authorities, and
- ✚ Direct awards to state owned construction companies were minimized to create competitive environment.

Ministry of Works and Urban Development was established during this era (MoWUD – Proclamation No. 4/1995) [35]. As part of standards and guidelines for professional services in the industry, the MoWUD during this period produced national building codes, standards and different guidelines.

Period 6 (2001-Now): Emergence of Integration and Capacity Building

Under the Ethiopian Federal system of Government, it is the power and duty of the Ministry of Works and Urban Development to administer any construction contracts undergoing in the country financed by the Federal Government. It is the same Ministry who is also responsible to register and issue licenses and certificates of competence to those involved in the country's construction industry.

2.3.2. Ethiopia's Construction Industry Capacity

It is very clear that the private construction and consulting firms in Ethiopia are very young and the need for capacity building for these firms is very crucial. It is my opinion that the local firms can make substantial contributions for the infrastructure development in the country, by undertaking works that are now being performed by the foreign companies and ineffectively performed by government entities, by increasing their level of maturity and effectiveness as business enterprises. The role of financial institutions in this regard is very crucial.

Necessary conditions for the establishment and development of strong construction and consulting firms are common to all countries. These conditions include:

- ✚ Availability of a reasonably steady flow of project work from both government and private sector clients;
- ✚ Fair and transparent (and result oriented) selection processes;
- ✚ Financial resources to allow construction and consulting firms to become established with private financing and with a strong role for employee ownership, together with a project profitability, tax and regulatory regime that encourages such ownership;
- ✚ Increased use of modern technology by local firms;
- ✚ Managerial ability within the firms to allow firms to be managed profitably &
- ✚ Strong and well managed industry associations, which are able to articulate the position of member firms on the full range of issues that affect the financial and professional health of the industry.

There are a lot of obstacles for the development and capacity building of the local firms.

The most common are:

- ✚ Discrimination of local firms in favor of foreign developed countries firms,
- ✚ Inadequate sources of finance for establishment of private firms,
- ✚ Lack of transparency in evaluation and award of projects,
- ✚ Lack of joint-ventures agreement with the foreign firms,

- ✚ Unacceptable contract conditions,
- ✚ Cash flow problems,
- ✚ Bureaucracy in implementation (Payment delays, etc.)
- ✚ Corruption etc.

Different studies concluded that the general state of the domestic construction industry in Ethiopia is low. According to these studies the main deficiencies are:

- ✚ An inadequate capital base, specifically to construction contractors,
- ✚ Old and limited number of equipment and their low levels of utilization,
- ✚ Deficiencies in human resources with regard to technical, managerial, financial and entrepreneurial skills and
- ✚ Very limited experience and participation in private sector for road, bridge and water related construction works and provision of consulting service.

Due to insufficient capacity of local contracting firms, it became normal practice to offer multimillion Birr worth projects to foreign contractors. This fact indicates that some means has to be devised to raise the capacity of competent local contractors so that they can engage themselves in major construction undertakings be it locally or at international level. For this a large contribution is expected from financial institutes mainly the Banks. The other possibility to raise their capacity is merging of two or more contracting firms or joint venture deals (as Lalibela Engineering made with the chines company) can be considered among the possible ways of upgrading local contracting firms' capacity.

CHAPTER 3

3. THE CONCEPTUAL FRAMEWORK

The most prominent constraint the developing countries construction industry face is the difficulty to find appropriate financing for the smoothly undergoing and on time completion of project activities; i.e cash flow problem. [20]

3.1. Role of Banks for a Construction Industry

Choosing an appropriate financial option and implementing a comprehensive project management plan are vital for the successful completion of any construction project. Banks contribute a vital role for a construction industry by providing:

- i. Construction Loans Including Overdraft Facilities
- ii. Equipment Financing
- iii. Bonds and Guarantees

3.1.1. Construction Loans and Overdraft Facilities

A loan is the purchase of the present use of money with the promise to repay the amount in the future according to a pre-arranged schedule and at a specified rate of interest [18]. In banking and finance, loan contracts formally spell out the terms and obligations between the lender and borrower.

In all construction activities costs occur earlier than payments. Hence, contractors in least developed countries often obtain the capital resources to finance the costs of construction. Due to their low capacity, they are in difficulty to cover earlier costs. Hence, to cover the costs that are related to mobilization and commencement of a project, the project owners will facilitate advance payment for the contractors at the early period of the project.

A project cannot proceed without adequate financing, and the contractor should incur costs for adequate financing for its projects. For this reason, attention to project finance

is an important aspect of project management. Project financing mainly comprise the different types of loans based on their time to maturity.

The different term loans with their time of maturity in the domestic commercial banks are:

- ✓ Short Term Loan: **Up to 1 Yr.**
- ✓ Medium Term Loan: **1 Yr to 5 Yrs.**
- ✓ Long Term Loans: **More Than 5 Yrs.**

In essence, project finance problem is to obtain funds to bridge the time between making expenditures and obtaining revenues (payments). Based on the conceptual plan, the cost estimate and the construction plan, the cash flow of costs and receipts for a project can be estimated. Normally, this cash flow will involve expenditures in early periods. Covering this negative cash balance in the most beneficial or cost effective fashion is the project finance problem.

Normally banks will not give loans with out securing the repayment of the loan. Assets pledged as security against loan loss are called collateral. An asset purchased by the loan or assets owned before the loan may serve as collateral. In other cases, the borrower puts other assets, including cash to be collected, additionally that can be considered as collateral. Credit backed by collateral is thus known as secured debt, while unsecured debt relies on the earning power of the borrower. Most Governments survey figures suggest that around 40 percent of all commercial and industrial loans are secured debt with collateral [18].

The options for borrowing by contractors to bridge their expenditures and receipts during construction are relatively limited. For small or medium size projects, overdrafts from bank accounts are the most common form of construction financing. Usually a maximum limit is imposed on an overdraft account by the bank on the basis of expected expenditures and receipts for the duration of construction. Contractors who are engaged in large projects often own substantial assets and can make use of other forms of financing which have lower interest charges than over drafting. This can help in reducing the working capital problem of contractors in least developed countries.

In general, commercial banks in developing countries are reluctant to lend to small contractors for a set of various reasons [20]:

- The contractors are often first-time borrowers without any track records at the bank;
- They are unable to full-fill the collateral requirements of the bank;
- They can not present their last years' financial statements to the bank;
- They are unable to finance 20-50% of the investment from their own resources as required by the bank.

Banks often require collateral or third party guarantees as compensation for the perceived higher risk involved in lending to contractors. In some situations project owner can facilitate contractor's access to bank finance by providing them with guarantees.

Banks also can provide loans and guarantees for trustworthy contractors without securing the repayment of loans with collateral or third party guarantee only considering the contractor's track record at the bank.

For a contracting agency there are three different possible ways to stand guarantee for a contractor to get loan from banks [20]:

- i. Guaranteeing work,
- ii. Guaranteeing work payments,
- iii. Guaranteeing loans.

i. Guaranteeing Work

The simplest solution from the perspective of the project owner is to prepare a letter guaranteeing the contractor a certain amount of work. By showing this letter to the bank the contractor will access some amount of credit. In most instances a document guaranteeing work by itself will not be sufficient for contractors to access credit. A project owner can only guarantee work for a certain period, not for the duration of the whole program.

ii. Guaranteeing Work Payments

In cases where banks consider letters of guarantee as described above as insufficient, the project owner could agree to make payments to the contractors through the bank, allowing the bank to withhold parts of the payments in case of bad loan repayment by the contractor. However, the bank is legally not allowed to withhold such payments and in all instances the consent of the contractor has to be sought. Any contract, signed by the three parties, would have to state clearly the conditions under which the bank can withhold payments.

The contract should have to state clearly which sums the bank would be allowed to withhold at what moments:

- ✓ the amount of repayment
- ✓ penalty interest
- ✓ outstanding principal
- ✓ legal expenses etc.

Care should be taken in using this method even in countries where the legal framework supports it. The advantage of the method is that the contractors are backed in their efforts to establish contacts with a formal financial institution at no additional costs and collateral requirement.

This method has been developed and started in Ethiopia by Commercial Bank of Ethiopia it is known as “**Tri-Partite Agreement**”. This has been intended in order to build the capacity of local construction firms and to facilitate a good working capital for their projects. The bank developed this method if and only if project owners / Employers are government organization duly organized under the laws of Ethiopia. In this agreement the local construction firm should authorize the employer to channel all the payments of works executed directly to a special proceeds account that has been opened in one of the bank’s branches. The bank will service the loan repayment according to the terms of repayment of the loan contract out of the special proceeds account and the bank will transfer the remaining amount, if any, to the contractor’s account up on receipt of his application. A sample of the Tri-Partite Agreement format is attached in Appendix A4 of this dissertation.

iii. **Guaranteeing Loans**

A third possible way to facilitate contractor's access to bank finance is to guarantee the loans that the contractor taken from a bank; this is commonly known as third party guarantee. In practice this means that the project owner would set up a guarantee fund on the basis of which it can provide the contractors with letters of guarantee. In a letter of guarantee the project owner agrees to share the loan risk with the bank. In case the contractor fails to repay the loan, the project owner pays part of the outstanding debt instead.

Banks Lending Procedure

The current procedure for lending in most domestic banks includes:

1. An inquiry stage.
2. An application stage.
3. Site visit.
4. Preparation of an appraisal note.
5. Evaluation by the board / committee.
6. Issuance of letter of intent.
7. Preparation of a legal agreement for lending for suitable project.
8. Lending the approved amount.

At each stage of the application for a loan, a company is required to provide any relevant information which is required by the banks.

3.1.2. Equipment Financing

Most contractors in developing countries are unable to use their own funds and savings to invest in equipment. In situations where the contractors have insufficient capital to purchase new equipment, they will look for second hand trucks and machines on the local as well as foreign markets. This is seen in local construction firms clearly nowadays [20].

Guiding Principles to Support Contractors Finance

Scarcity of construction equipments of contractors can pose serious threats to the quality of the works performed and to the time for completion of the construction project. The owner of a project either pre-finances equipment by giving advance payments or by giving guarantee for bank loans or sets up a leasing scheme in order to build the capacity of the contracting firm with regard to equipment capability for a better quality & on time completion of a project.

The different possibilities of financing equipment for construction firms are [20]:

- Outright Purchase,
- Truck/ Equipment loan,
- Leasing Schemes,
- Hire Purchase Scheme,
- Pre-payment (Advance payment) of equipments by the project owner,
- Suppliers Credit/ Credit Sales.

Outright Purchase

In outright purchase the company immediately owns the plant/ Equipment and has title to it. The plant is an asset, which will appear in the company books. The company has full control over the plant/ Equipment and can use it as and where it wishes, sell it etc. However, outright purchase requires a large initial capital outflow. This is not easy for construction firms in least developed countries.

Truck/ Equipment Loan

Truck/ equipment loan is a loan facility provided for construction firms in order to purchase the required equipments for their construction projects by securing the repayment of the loan by the equipment that is to be purchased. The contractor has full ownership over the equipment.

Leasing scheme

One of the possibilities for contractors to finance their equipment is to look for a leasing arrangement. Leasing is a common way for small and medium sized enterprises around the world to finance trucks and equipments.

Financial leasing is a contractual arrangement that allows one party (the lessee) to use an asset owned by the leasing company (the lessor) in exchange for specified periodic payments. During the lease period legal ownership of the asset is retained by the lessor. Most leasing contracts will include the option for the lessee to purchase the asset at the end of the lease term for a nominal price.

The great advantage of lease finance for contractors is the absence of collateral requirements. A leasing arrangement can be concluded quicker and simpler than a

bank loan. Rather than looking into the credit history and the asset structure of the client, leasing companies will focus on the clients' ability to generate sufficient cash through the investment financed in the leasing arrangement.

Leasing may be attractive to a company which has no adequate working capital; because it enables him to keep his financial resources as working capital for the payment of salaries and construction materials. Another advantage of leasing over hiring of equipment is the incentive that contractors have to properly maintain the equipment.

Leasing companies offer different options for the client at the end of the lease term:

- ✓ The equipment can be purchased at residual value. The residual value is estimated at the beginning of the lease term, based on the likely market value at the end of the period.
- ✓ The client can renew the lease at a significantly reduced rental rate. Rentals during a secondary period are lower than in the primary period.
- ✓ The client receives a share in the profits of the equipment sale. At the end of the lease, the equipment will be sold to a third party and the client will be allowed to share in the benefit of the sale proceeds according to a distribution of proceeds defined in the lease contract.

The end-of-lease option is an important part of the lease contract. A pre-set purchase price stated in the contract enables the contractor to foresee how much funds he needs for the final purchase. Contractors who have the intention to buy the asset at the end of the lease term have an incentive to maintain the equipment properly.

The lessor is usually a financial institution (Finance Lease) or a manufacturer/supplier (Operator Lease). In a finance lease, the lessor has no interest whatsoever in the plant – only in the financial payments that he is to receive under the lease, and possibly the resale or scrap value of the plant at the end of the lease. However, where a manufacturer or supplier provides plant on a lease, he may be responsible for the operator, maintenance, spare parts etc.

Hire Purchase

The company pays a regular hire charge and after a predetermined time pays a nominal sum and actually acquires the plant. There is almost normally a fairly large initial deposit. The company may have effective control but does not have total control over the plant until the end of the predetermined time. There may also be other restrictions on the use and location of the plant since it technically belongs to the hiring company until the end of the predetermined time. The plant cannot therefore be included as one of the construction company's assets.

Normally the interest charges on the hire purchase contract are likely to be higher than those available to the company through its normal overdraft facilities, so that an outright purchase or credit sale is likely to be cheaper.

Pre-Payment of Equipments by the Project

In many construction contracts, the equipment required for the work is purchased and pre-financed by the project. From the point of view of preparing contractors to sustain operations in real life situations, the option of pre-financing equipment is most important. The contractors are not faced with the procedures and realities of financial institutions and do not build up track records with the bank. However, for the sake of simplicity pre-financing equipment seems a viable option for construction projects.

In most schemes the client of a project becomes the defacto owner of the equipment. At the moment the equipment is handed over to the contractor, a loan agreement is signed between the owner of the project and the contractor. The agreement allows the contracting firms to deduct loan repayments from the work payments. In case of exclusion of a contractor from the work for whatever reason, the client will attempt to repossess the equipment and hand it over to new contractors entering the projects.

Pre-payment arrangements and loan contracts with the client can run into problems as soon as the client becomes unable to either provide work or to pay contractors in time. More complications arise when delays in payment are due to bad or slow performance of the contractors or to circumstances beyond the control of both parties. A loan contract should have to stipulate clearly in which circumstances the contractors are allowed to suspend their repayment schedule.

Suppliers Credit

Supplier credit seems to be the most common source of external financing of contractors' equipments. A construction company immediately owns the plant/ Equipment, but the purchase price is paid in installments, usually with a fairly large deposit. Full control is with the purchasing company. The installments include the purchasing price and the financing costs.

Competition on the suppliers market defines whether equipment vendors sell on credit and what they charge in terms of down payment and interest. In many developing countries however, equipment firms only provide supplier credit to larger and very well known firms. The facility is restricted to trust worthy clients that have an established relation with the firm. For example in Ethiopia, Hagbes, dealer for Daewoo Dump Trucks, is arranging such kind of credit sell for the known construction firms that are trust worthy customer.

Administration of the Schemes By A Financial Institution

In some cases the project owner as well as the suppliers opts to subcontract a financial institution for the administration of the leasing, hire purchase or suppliers' credit scheme. The involvement of a financial institution would ensure efficient financial management and administration of the credit scheme. The cost of hiring the services of a financial institution though can be high; however, it will give relief for the project owner or the suppliers in relation to the payment collection for the equipment financing schemes.

3.1.3. Bonds and Guarantees

A bond is a legally enforceable financial guarantee given by a third party (the guarantor) to a project owner (client) to guarantee the obligations of a contractor under a contract [10]. The guarantor agrees to pay the client a sum of money if the contractor fails to perform his obligation under the contract. The purpose of requiring a bond is to help the client meet the extra expenses to remedy the default and /or complete the contract.

Bonds are generally provided by the financial market, either by a bank or a surety company. The contractor and the guarantor will seek to establish the terms and conditions under which the bond can be called. Clients, for their part want to know that the guarantor issuing the bond is a sound, reliable and responsible corporate body and be satisfied that if there is need to call the bond for payment the guarantor will comply promptly.

Mostly in Ethiopia, bonds and guarantees are provided for domestic construction firms by the domestic commercial banks (both private and government) and insurance companies. Commissions for bonds and guarantees requested by the banks are relatively expensive than that of insurance companies. However, some project owners may oblige the contractors to provide bonds and / or guarantees only from banks.

Generally, the cost of a bond is relatively small in comparison with the price of the contract. This will depend to some extent on the terms and conditions the client requires and the degree of risk the guarantor attaches to the ability of the contractor to give a counter indemnity and to reply any sum that is called.

A guiding principle of procurement best practice is that normally a contract should not be placed with a contractor for guarantee/ bond if there are reasonable doubts about the contractor's ability to meet the terms and conditions of the contract satisfactorily. Such doubts may arise in relation to the adequacy of the contractor's management and technical resources to deliver on time and to the required quality standard, or where

information available suggests the contractor may have inadequate financial resources with consequent risk.

Bonds are not always necessary and are not substitute for considered judgments about the risks of a particular contract and the capabilities and financial resources of the available contractors. A decision to require a bond must be part of an overall approach to risk management and should take account of available measures to reduce the risk of default, including a proper prequalification of tenderers. Basically there are different types of bonds which are adopted in a construction activity. The main are:

1. Bid Bond / Bid Security.
2. Performance Bond
3. Advance Payment Guarantee / Bank Guarantee
4. Retention Money Guarantee.

Bid Bond / Bid Security

Bid bond / Bid Security is a bond furnished by a bidder/ contractor, as part of its bid for the amount labeled in the bid document from a legally registered bank. In most tenders the bid security amount is about 1% of the contract amount. The maximum limit set in most local competitive bids (LCB) is 100,000.00 Eth. Birr (One hundred thousand Birr).

The terms and conditions of a bid bond determine the circumstances and mechanisms by which the bond can be called. The bank undertakes to pay the employer of a project up to the amount specified in the bid bond.

The conditions of the bid bond obligation are:

- i. If the bidder withdraws its bid during the period of tender validity specified in the tender document.
- ii. If the bidder refuses to accept the correction of errors in his tender. For example: Error in unit prices, arithmetic errors etc.
- iii. If the bidder having been notified of the acceptance of his tender by the employer during the period of bid validity and ,
 - Refuses to sign the contract agreement.

- Fails to furnish the performance security.

Performance Bond

A performance bond is usually provided after contract award, for an agreed percentage of the total contract value (normally 10 percent). The guarantor/ bank will agree to guarantee the due performance of the contract according to the terms and conditions of the contract agreement. The guarantor agrees with the employer in such a way that, if the contractor in any respect fail to execute and complete the contract or commit any breach of his obligations there under, then the guarantor will indemnify and pay the employer the sum of amount of guarantee, such sum being payable in the types and proportions of currencies in which the contract price is payable. If the contract amount increases, or the duration of the contract extends, then the bond may need to be amended accordingly.

A performance bond will not by itself ensure that contracts are carried out efficiently and to time, but it will be one of a number of pressures on the contractor to perform well.

Advance Payment Bonds/ Bank Guarantees

This bond allows advance payments under an awarded contract to enable initial purchase of essential materials required to perform the work. This provides significant cash flow benefits to the contractor in order to start the new project according to the stipulated time.

Retention Bonds / Maintenance Bonds

These bonds provide the project owner with a guarantee to the value of the bond that the contractor will fulfill its defects or maintenance obligations as stated in the contract to release the retention money that should has been deducted from the contractor's interim payments. As works of a project are completed, the contractor is paid fully for the executed works without any deduction. The client of a project is protected against default at the end of the defects liability or guaranteed maintenance period up to the amount of the bond.

These bonds are still rare in use in Ethiopia. However, their use should have to be increased in order to relieve the cash flow problem of the domestic construction firms to some extent.

The traditional retention system is to withhold a percentage from interim payments made during the course of the contract to accumulate a fund that is available to the client if the contractor fails to rectify defects in accordance with the contract. According to MOWUD the retention money that has to be hold is 5 percent of the value of the contractor's work up to certified completion, reducing to 2.5% up to final acceptance of the project works. Retention bonds give access to contractors full payment of the project at all stages without deduction of retention money. This will create access for the contractor to use the retention money to relieve the cash flow problem.

CHAPTER 4

4. THE RESEARCH METHODOLOGICAL FRAME WORK

4.1. Stakeholders of a Construction Process

To study the constraint and to find appropriate solution, identifying the key parties (stakeholders) involved in the decision-making at various stages of the construction process is vital. These stakeholders can be: [43]

- i. Project Owners
- ii. Project Sponsors
- iii. Project Regulators
- iv. Project Doers
- v. Other Interest Groups

4.1.1. Project Owners

Project owners constituted clients (Implementing Agencies) and Beneficiaries. The term is more generally used for the organization which needs the end product and has full authority and the money to order and approve it. The owner can be an individual, government organization, group of people or institution etc.

4.1.2. Project Sponsors

Project sponsors cover those groups who finance the projects and undertake budgetary services. These parties are mainly the local and foreign financiers and are the major part of this study.

Local Project Financers

The local project financers could be one of the following:

- **Government Finance** – projects can be implemented / sponsored from Federal and Regional Governments allocated budget.
- **Business Financial Organizations** - these include the banks, micro financial institutions (at small level) and other creditors. Banks usually understood to mean

commercial banks, which are the main providers of debt financing for construction firms. Banks mainly support short, medium, and long term financing in the form of credits either for project owners or contractors.

- **Development Financial Organizations** – these include the national development banks that provide finance for construction project owners or investors. In Ethiopia the only Development Financial Organization is Development Bank of Ethiopia.

Foreign Project Financers

These mainly include the multilateral and bilateral financial institutions. They are supposed to contribute to the development of the lesser developed countries, to promote environmentally and socially responsible investment and technical assistances targeted to enhance the performances of such investments, such as capacity building services.

Foreign financers play a major role in providing loans and grants for the lesser developed countries, including Ethiopia, for infrastructure development activities. This has indirect contribution for the capacity building of the domestic construction firms since they will get projects which are supported by the financers.

In strictly financial terms the key word is “**additionality**”, i.e. they are not supposed to replace the commercial and national development banks, but to provide ‘additional’ service where commercial financial institutions are unable or unwilling to provide finance. Multilaterals that are active in the construction sector mainly include: **[3]**

- ✓ The World Bank Groups
- ✓ African Development Bank (AfDB)
- ✓ European Bank for Reconstruction and Development (EBRD)
- ✓ Inter-American Development Bank (IDB)
- ✓ Asian Development Bank (AsDB)

Only the first three are providing finance and technical assistance for the Ethiopia government for infrastructure development of the country.

World Bank Group is a group of five international organizations responsible for providing finance and advice to countries for the purposes of economic development and poverty reduction, and for encouraging and safeguarding international investment [15]

The Bank came into formal existence on **27 December 1945**, commenced operation on **25 June 1946**. The Bank's activities are focused on developing countries, in fields such as:

- human development (**e.g.** education, health),
- agriculture and rural development (**e.g.** irrigation, rural services),
- environmental protection (e.g. pollution reduction, establishing and enforcing regulations),
- infrastructure development (**e.g.** roads, urban regeneration, electricity), and
- good governance (**e.g.** anti-corruption, legal institutions development).

The World Bank Group consists of:

- the International Bank for Reconstruction and Development (**IBRD**),
- the International Finance Corporation (**IFC**),
- the International Development Association (**IDA**),
- the Multilateral Investment Guarantee Agency (**MIGA**), and
- the International Centre for Settlement of Investment Disputes (**ICSID**),

The World Bank Group's mission is to fight poverty and improve the living standards of people in the developing world. It provides **long term loans, grants, and technical assistance** to help developing countries implement their poverty reduction strategies. In addition to financing, the World Bank Group provides advice and assistance for developing countries on almost every aspect of economic development. Their major activities are described in Table 2 below.

Table 2: Major Activities of World Bank Groups

It. No.	WB Group	Yr. Of Estab't	Major Activities
1	IBRD	1945	Provide loans and development assistance to middle income countries & credit worth poor countries
2	IFC	1956	Promotes private sector investment to reduce poverty and to improve peoples lives
3	IDA	1960	Provide long term (35-40Yrs) loans at zero interest to the poorest of developing countries
4	MIGA	1988	Does not finance projects but insures them
5	ICSID	1966	Facilitate the settlement of investment disputes b/n governments and foreign investors

African Development Bank (AfDB) is a development bank established in 1964 with the intention of reducing poverty and promoting sustainable economic growth and social development in Africa. [13]

It groups together:

- the African Development Bank (AfDB),
- the African Development Fund (ADF) and
- the Nigeria Trust Fund (NTF)

It has 77 member countries from around the world and has four principal functions:

- Make loans and equity investments for the economic and social advancement of the Regional Member Countries (RMCs).
- Provide technical assistance for the preparation and execution of development projects and programs.
- Promote investment of public and private capital for development purposes.
- Respond to requests for assistance in coordinating development policies and plans of RMCs.

European Bank for Reconstruction and Development (EBRD)

EBRD is founded in 1991 and uses the tools of investment to help build market economies and "democracies". The EBRD is owned by 60 countries and two intergovernmental institutions (European Community and European Investment Bank).

It provides project financing for banks, industries and businesses, both new ventures and investments in existing companies. It also works with publicly owned companies to support privatization, restructuring state-owned firms and improvement of municipal services.

4.1.3. Project Regulators

These parties undertake contractual regulatory services. Regulatory services can be done in two ways; i.e financial auditing or direct work / service goods audits.

In most situations projects regulation is done by governments (either Federal or Regional). Governments involve mostly in: **[3]**

- Facilitating construction operations.
- Setting the rules of engagement.

The two areas overlap and form the construction policy of a country.

- Facilitating operations is mainly achieved by doing the ground work, i.e. setting up the licensing system or preparing the regulatory framework for the different construction, and consulting firms in the country.
- Setting the rules means laying down more specific regulations and criteria that have to be met before a construction project can go ahead. All projects must always comply with regulations (by obligation).

4.1.4. Project Doers

Project Doers are the two implementing or executing groups who actually realize the concepts into real and modeled products. These constituted project consultants and contractors and they are meant for carrying out services and works respectively. They involve during the implementation phase of a project often contractually. **[43]**

Consultants are professionals that are responsible for designing and supervising the project activities. Consultants must be qualified by education and experience to provide competent engineering services.

However, construction firms (contractors) and their subcontractors play a vital role in finishing projects on schedule with the required quality and cost. Construction firms are totally responsible to construct and commission the project to the owner according to the design and specification prepared by the consultant.

4.1.5. Other Interest Groups

These parties are Professional and Business Associations, Educational Institutions and key informants. Mostly in least developed countries, these parties have no direct involvement and influence at any phase of a project.

4.2. Basic Research Instruments

The literature survey was used to limit the scope of the queries that has been raised in the research. It was also used for explanation of the basic terms used in the study.

The basic research instruments (the research methodologies) that have been used in this dissertation are:

4.2.1. Interviews – Basically interview has been conducted to the finance department workers in the construction company at which I am working in. I have used the interview data to fill the gaps in the conceptual framework of the study and also I have used it to make myself familiar with the financial terms.

In addition, the majority of commercial banks in Addis Ababa were approached and requested for information regarding the different services and facilities that they are providing for the domestic construction firms.

4.2.2. Questionnaires - I have designed questionnaires and reviewed by my advisor before distributing them to the intended parties. The questionnaires were designed and distributed for construction firms of various classes, domestic banks (private and government) and project owners. Copies of the questionnaires are included in Appendix A1-A3.

Questionnaires have been distributed to a randomly selected:

- **thirteen** domestic construction firms,
- **seven** domestic banks, and
- **Four** Project owners.

Out of the thirteen Construction firms

- **eight** of them were GC-I,
- **two** were BC –I,
- **one** was GC II,
- **one** was GC III and
- **one** was BC III.

The contractors to whom questionnaires were distributed selected to be class III and above. The main reason was that these contractors are participating relatively in big infrastructure development projects and are facing financial problem in higher degree than the others.

Intensive follow up was carried out in the case of collecting questionnaire responses. Immediately receiving the distributed questionnaires, the research analysis and discussion were conducted.

The analysis had started with examining information from the distributed questionnaires. In the case of questionnaire survey, the data was prepared for coding as part of the analysis. Consequently, responses were coded in Microsoft Excel, spreadsheet software, rates and frequencies were computed.

4.3. The Research Scope and Limitations

My first motivation for this research work was to look for solutions for the current low capacity and cash flow problem of the domestic construction firms from my practical exposure to the construction industry and the firms. The first motive that leads me to this research work was the practical problem that the domestic contractors are facing in relation to capacity and cash flow. It was my expectation that the domestic banks could contribute a lot to minimize the problems encountered and that is why I have delimited the scope of this research in assessing role of the domestic banks in the capacity building and working capital financing of the domestic contractors.

The main limitations encountered during conducting, processing and writing the research work were:

- ✚ Strong influence on the research work from my practical knowledge and experience regarding the low capacity and working capital problem of the domestic construction firms.
- ✚ Little participation from the domestic banks group, because they could not easily be accessible and not volunteer to disclose some of their practices in relation to loans.

CHAPTER 5

5. THE RESEARCH ANALYSES AND DISCUSSIONS

The study revealed that the Ethiopia's construction industry is full of financial scarcity. This has been indicated from the collected data of the distributed questionnaires and / or the interviews. Basically the research has been designed for the assessment of the role of the domestic banks in the capacity building and working capital financing, in equipment financing and in providing bonds and guarantees for the domestic construction firms.

Out of the distributed 24 questionnaires to the three groups, 23 of them have returned the questionnaires. This represents **95.83%** of response rate.

Table 3: Summary of Questionnaires Distributed and Collected

Item No.	Party	Distributed Questionnaires	Collected Questionnaires	Response Rate (%)
1	Contractors	13	12	92.31
2	Banks	7	7	100
3	Project Owners	4	4	100
Total		24	23	95.83

5.1. Assessment of the Role of Banks for the Ethiopia's Construction Industry

5.1.1. Role of Banks in Capacity Building and Working Capital Financing

From the questionnaires that have been distributed to construction firms, all of the firms established after the economic reform which means in the 5th period of

the Ethiopia's construction industry development (1987 – 1991), "during Re-Emergence of Privatization and Emergence of Decentralization."

As it is known, the availability of construction projects is very crucial for the establishment and development of a construction firm. Since Ethiopia lacks infrastructures, there are a lot of projects under construction and there are also a lot under study. This will create a large job opportunity for the domestic construction firms.

The collected data showed that about 57% of the class I construction firms have projects at hand with a total cost more than One Billion Ethiopian Birr and annual turnover greater than One Hundred Million Ethiopian Birr.

According to the data obtained from the distributed questionnaires, all of the responding construction firms disclosed that finance is very important and major resource in construction projects. Like the finance 67% of the respondents considered manpower capacity as a very important tool in their organization. The value given for the different resources by the requested construction firms is summarized in figure 2 below.

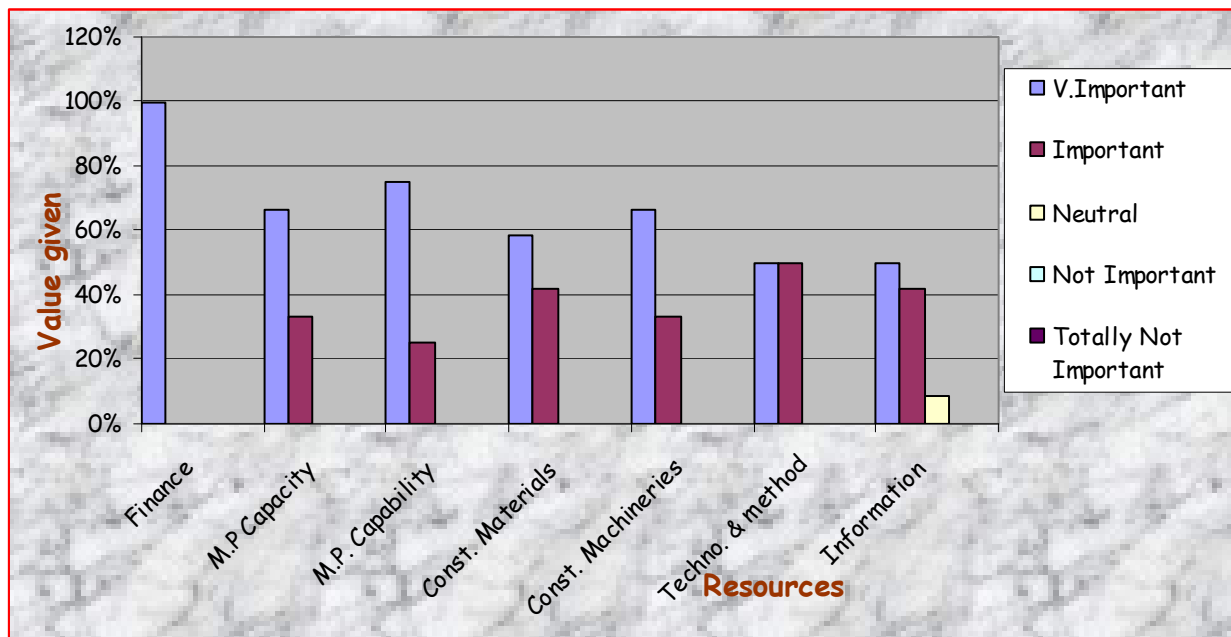


Fig. 2: Value given by domestic construction firms for Major Resources.

As it is discussed in chapter 3 of this dissertation, financial resources and construction equipments are the basic key for establishment and capacity building of a certain construction firm. The study revealed that all of the contractors have financial as well as equipment deficiency to run and complete their projects smoothly with the required time, cost and /or quality.

About 50% of the responding construction firms disclosed that there is skilled manpower incapability in their organization and 67% of them have managerial incapability to manage their projects and organizations properly. Similarly about 42% of them lack work experience in constructions of large infrastructure development projects.

The questionnaire survey also indicated that the local availability of finance and construction machineries is not sufficient for the execution of infrastructure development projects of the country. However, the local availability of construction materials, manpower capability and capacity is relatively sufficient. This is summarized in fig. 3 below.

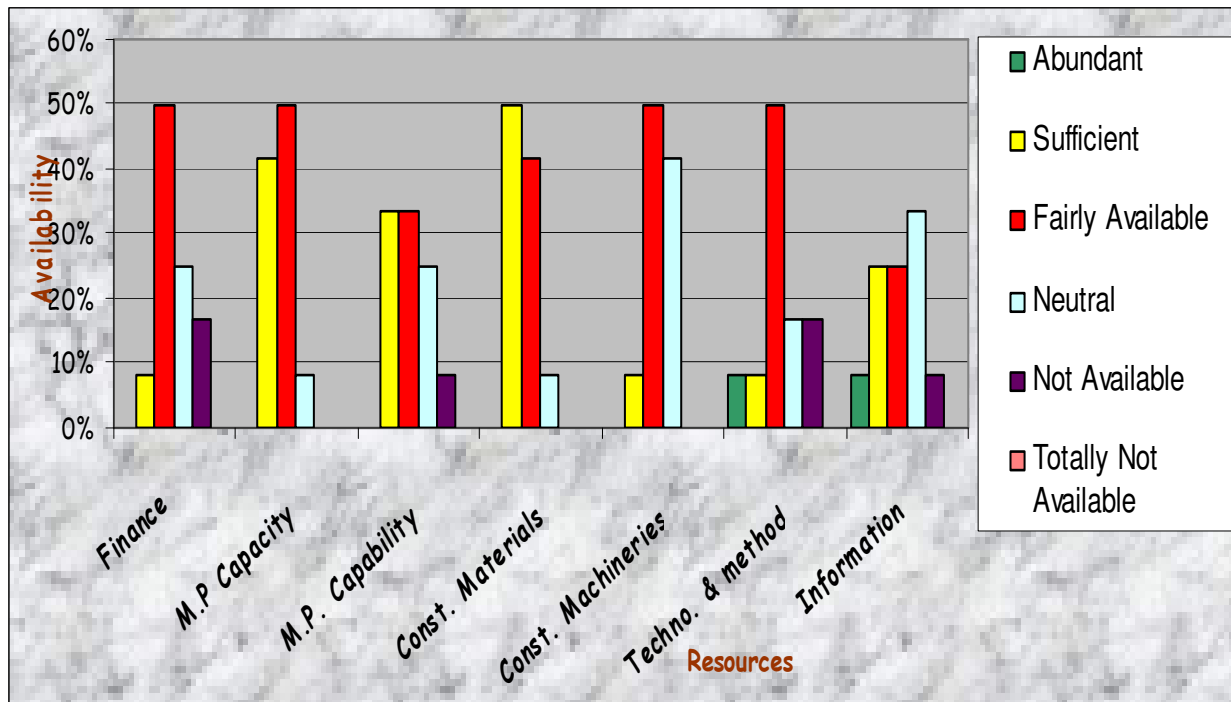


Fig.3: The Local Availability of Construction Resources

All the parties that have been involved in the questionnaire survey have indicated that all the necessary conditions that are described in chapter 3 (conceptual Frame Work) of this dissertation are very crucial for the establishment and capacity building of domestic construction firms. However, even if the construction projects are available in Ethiopia, it is very difficult to get the financial resources in the country easily. In this regard, the role of banks is very important and use of modern technology is directly related to the financial capability of any construction firm.

It has been found from the study that all the construction firms that have been involved in the study have identical argument on the obstacles for the development and capacity building of domestic construction firms, which have been described in chapter 3, and they have indicated that these obstacles have high to extreme significance on the industry's development.

It is very clear that the private construction firms in Ethiopia are very young. For the development and capacity building of these firms, it is obvious that they should have strong financial partner. According to this study, about 83% of the selected construction firms disclosed that they will prefer the private banks for the different facilities and bank services. The main reason that they have pointed out for their preference is fast and efficient services relative to the government banks.

It has been described in the literature review that financial institutions contribute a vital role for a construction industry by providing different services and facilities. According to the study survey, all the banks are providing the following services and facilities for the domestic construction firms:

- ✓ Construction loans,
- ✓ Bonds and Guarantees,
- ✓ Overdraft facilities,
- ✓ Truck/ equipment loans.

However, any of the banks are not providing equipment financing schemes (hire purchase, leasing etc.). The distributed questionnaires revealed that all of the construction firms are getting construction term loans, bonds and guarantees from the domestic banks. Some of the firms are not enjoying an overdraft facility. The main reason that has been given by the construction firms was that for the overdraft facility their banks requested them to provide only a building as collateral. However, the firms couldn't provide it.

Most contractors in least developed countries are not capable to execute and complete the projects that they have taken from their employers due to their severe working capital problem. Hence, the contractors should get financial sources to obtain adequate working capital; for this the main one is loans from their financial partners. This includes term loans (short, medium and long term loans), track/equipment loan and overdraft facility.

The questionnaires survey on local banks indicated that all of the banks are providing short and medium term loans, track/equipment loan and overdraft facility for the domestic construction firms. However, only three of the seven banks are providing long term loans.

Furthermore, the research survey clearly indicated that all of the domestic construction firms are getting short term loans from the local banks. 58% of them are taking medium and 17% long term loans. This is shown in Fig. 3 below.

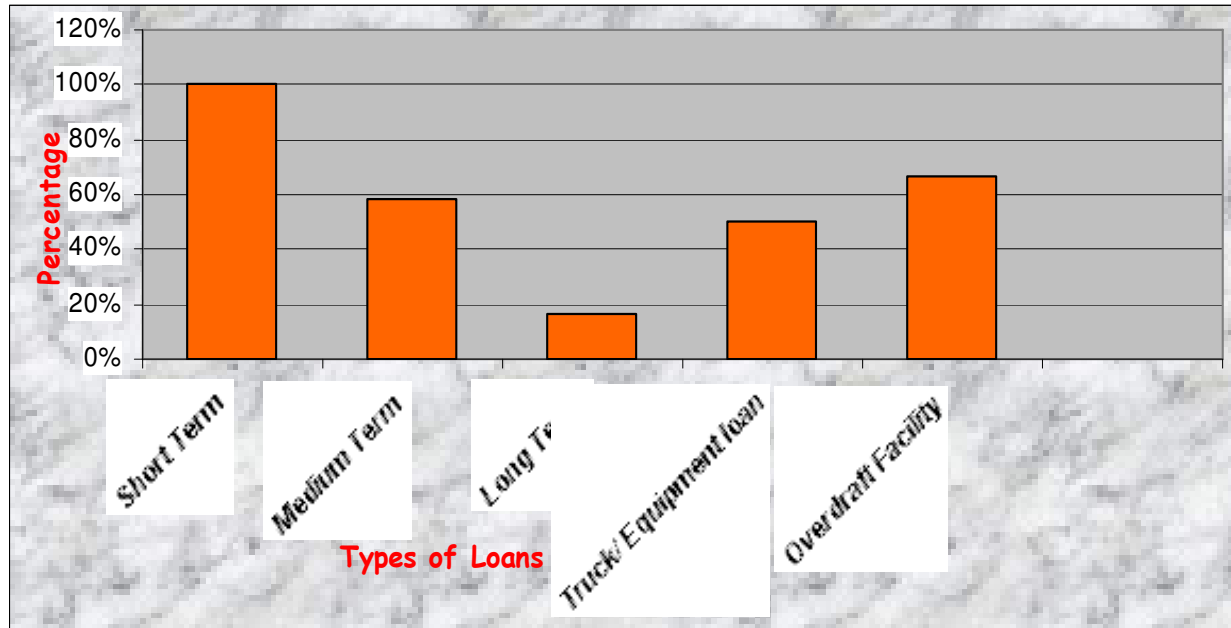


Fig. 4: Loans & Facilities which are enjoyed by the domestic construction firms from the Local Banks.

For the services and facilities that they have provided, banks will take a certain percentage of commission from their customers. The banks' benefits (commissions) differ from one bank to another. It is shown in table 4 below.

Table 4: Banks' Benefits for Different Facilities and Services

It. No	Type of Facility / Service	Bank's Benefit/ Commission
1	Short Term Loan	7.5 - 7.75% per annum
2	Medium Term Loan	7.5 - 9% per annum
3	Long Term Loan	10% per annum
4	Overdraft Facility	7.5 - 7.95% per annum

*5	Bank Guarantee	0.5 - 1% for one period (3 Months)
6	Bid Bond	0.5 - 1% for one period (3Months)
7	Performance Bond	0.5 - 1% for one period (3Months)

* The commission will be lower than this if the bank guarantee is against cash.

It is obvious that banks will not give loans without securing the repayment of the loan. The study indicated that all of the banks will request the construction firms to provide collateral as compensation for the perceived risks involved in lending money to the firms.

All of the local banks will request the domestic construction firms to provide owned assets and an asset that is going to be purchased by the loan (in truck/equipment loan) as collateral.

In some situations project owners can facilitate contractor's access to bank finance by providing them with guarantees. However, only three of the domestic banks indicated that they will allow third party guarantee to secure loans and only one of the banks will provide loan for a construction firm if a client of a project guarantees work payments to pass through the bank.

Nevertheless, any of the domestic construction firms didn't get a client who guarantee work as well as work payments to get loan from the banks. The project owners also responded that they won't guarantee work and / or work payments for their projects' contracting firms to get loan from banks.

The other possibility that can be used by the banks to provide loans and guarantees for construction firms is by considering the firm's healthy relation with the banks. Three of the banks have indicated that there is a possibility in their bank to provide loans and guarantees for domestic construction firms without securing the repayment by collateral or by any other guarantee considering only the firms' track record in the bank (if they are proved to be credit worthy in the bank), their experience in the business and their financial strength. It is ideal to get such kind of domestic construction firm due to their low capacity.

One thing that has been observed in this study is the safety margin set by the domestic banks for collaterals secured for Bank guarantees and construction loans. The banks will assume a safety margin up to 50% of the book value of an asset that is secured for loan repayment. This is very high and the domestic construction firms are unable to provide the required amount of fixed assets due to their low capacity. If the construction firm able to provide a building as collateral, then the safety margin will be lower than this.

Interview with one of the domestic GC-I construction firm indicated that the firm is enjoying the following facilities from one of the private banks:

1. Overdraft facility -----	12,000,000.00 ETB
2. Truck / Equipment Loan -----	6,400,000.00 ETB
3. Term Loans -----	<u>8,162,963.83 ETB</u>
Total -----	26,562,963.83 ETB

However, all these loans and facilities (amounting 26,562,963.83) have been secured with collateral amounting over 73 million ETB. This indicates that the bank has assumed more than 64 % safety margin.

Most of the domestic construction firms have high cash flow problems. Due to shortage of owned assets to use as collateral, the construction firms will not get construction loans easily. In this regard the study indicated that over 58% of the responding firms will finance their projects by taking loan from individuals with high interest rate (8 – 10% per month). In addition to this, they will also use suppliers' credit, extend creditors payment period, use payments of other projects etc.

5.1.2. Role of Banks in Equipment Financing

Construction equipments play a major role for any infrastructure development activities. Scarcity of the required equipments will pose a serious problem on the quality of the works to be performed and on the time for completion of the projects.

It is observed that out of the surveyed construction firms, the building contractors and firms which have relatively strong capacity are not enjoying truck /equipment loan from their banks. One thing that has been understood from this was that the firms in the first category are not enjoying this facility since they won't require that much large number of equipments as the General Contractors require and the firms in the second category can use outright purchase of equipments from their reserved capital.

If there have been leasing companies for construction equipments in the country, the contractors will have access to own equipments without investing the projects advance payment for outright purchase of equipments. Outright purchase will greatly affect the working capital of a construction company to run their projects smoothly. In addition to this the contractors are not expected to provide collateral or guarantees as they do in truck / equipment loans.

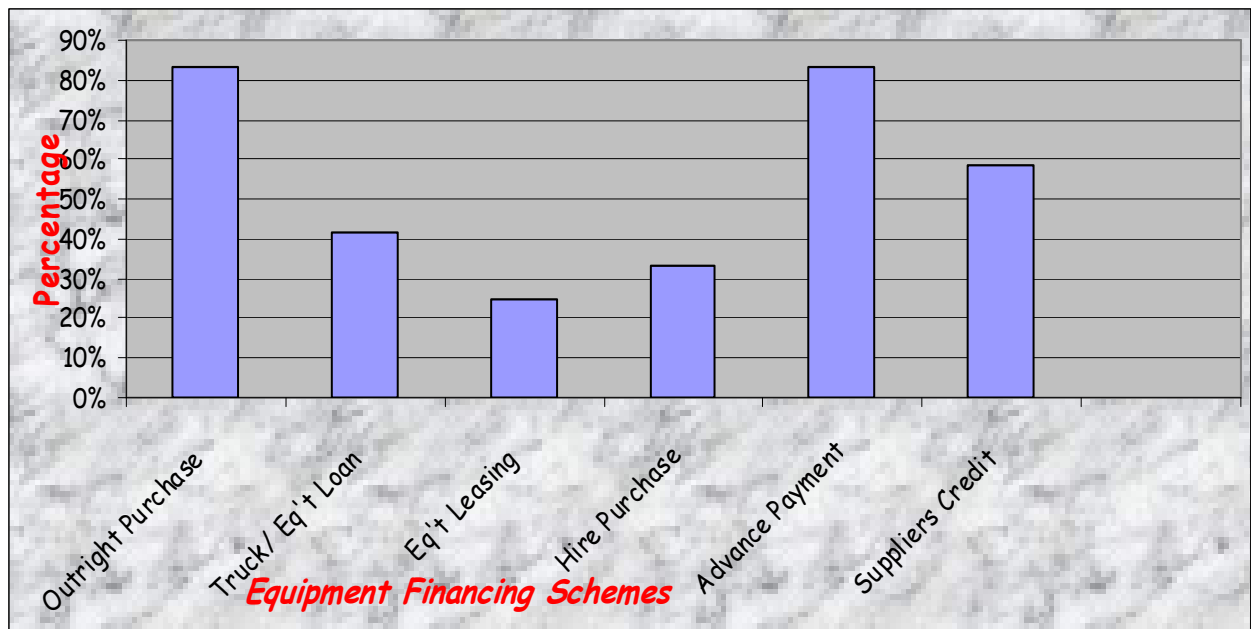


Fig.5: Possibilities used By Domestic Construction Firms to Finance Equipments

Fig. 5 shows that about 83% of the responding construction firms are using outright purchase to finance their equipments. This is mainly due to unavailability of other equipment financing schemes (leasing, hire purchase etc.).

On the other hand the same percentage of the respondents indicated that they will use the projects' mobilization advance payment that they have taken from their projects employers for trucks and equipments purchase. This will greatly affect the projects' activities.

Some of the responding construction firms are using equipments leasing and hire purchase schemes. These schemes are not provided with legally registered leasing companies in the country; they are individuals who owned construction equipments.

5.1.3. Role of Banks in Providing Bonds and Guarantees

Basically there are different types of bonds that are provided for a construction firm to guarantee the obligations of the firm under the contract. According to the questionnaire survey, all of the construction firms are getting Bid Bond, performance bond and bank guarantees for advance payment from the local banks and similarly all of the banks are providing these bonds and guarantees.

However, half of the responding contractors will not use retention/ maintenance bonds to release the retention money that should have been deducted from each interim and final payment. Furthermore, out of the seven banks, only two of them are providing this type of bond for domestic construction firms. Similarly, three of the four project owners disclosed that they will not accept retention / maintenance bonds for the release of retention money.

The study revealed that the banks will require seven to thirty days to evaluate and approve loan and other facilities request of the domestic construction firms.

It has been found from the study that the banks have no any mechanism to follow and evaluate the contractor's performance and ability to meet the terms and conditions of the bond /guarantee satisfactorily after the banks have provided

bonds and guarantees for a certain domestic construction firm. The main reason that they have pointed out was they have taken collateral to be in the safest side. One important issue indicated in the research survey was that, the banks will impose the maximum limit of overdraft facility for a construction firm and / or other clients based on its asset and capital position as well as the firm's revenue turnover in the bank. In addition to this over drawl on overdraft will be allowed for a firm considering its track record in the bank.

CHAPTER 6

6. THE RESEARCH CONCLUSIONS & RECOMMENDATIONS

After analyzing the collected data, the following conclusions were made and recommendations are forwarded.

6.1. CONCLUSIONS

✚ **The development of construction industry in Ethiopia is very young with full of financial scarcity.**

The analysis of the collected data appears to suggest that the development of construction industry in Ethiopia is very young with full of financial scarcity. All of the domestic private construction firms established after the economic reform; which means they are 10 to 15 years old. In addition to the construction firms, the development of the domestic private banks is also at the same age.

✚ **Cash Flow Problems are exhibited as one of the major problems of the domestic construction firms.**

It is also very clear that there are a large number of infrastructure development projects in Ethiopia. For the implementation of these projects, it is required to have financially as well as technically and managerially capable construction firms. It is indicated from the collected data of this dissertation that most of the domestic construction firms have acute financial scarcity to execute and complete their projects.

✚ **The construction industry in Ethiopia lack major resources in addition to the financial deficiency to run the projects smoothly.**

The research also indicated that most of the domestic construction firms lack proper type of construction equipments, work experience, skilled manpower and managerial capability in addition to the financial problem in order to lead their organization properly and to complete and handover their projects with the required quality, time and cost.

✚ The limited number of financial institutions (Banks) in Ethiopia prohibits the banks from giving attention for the construction industry development.

There are only six private and one governmental commercial bank in Ethiopia which are providing services and facilities for construction, domestic trade and services, imports and export, manufacturing, transportation, agriculture, hotel and tourism etc. sectors. If we consider the number of banks and the amount of services and facilities they are providing and the number of clients they are serving, it is not compatible. This will prohibit the banking institutions in the country from giving attention for the construction sector with regard to capacity building of the firms which are involving in the infrastructure development activity of the country, which is a key for the development of any country.

✚ All of the domestic banks are providing short and medium term loans, truck / equipment loans and overdraft facilities with a huge amount of security for repayment.

Attention to project finance is an important aspect of project management. Project financing mainly comprises overdraft facility, the different types of term loans (Short, Medium, and Long) and truck / equipment loans based on their time to maturity. The research survey indicated that all of the domestic banks are providing short and medium term loans by securing the repayment of the loan by a huge amount of fixed assets (Collateral).

✚ Most of the domestic banks are not providing Long Term Loans for the construction firms' capacity building.

Most of the banks will not provide long term loan for construction firms. Hence, due to unavailability of long term loans, the domestic contractors are unable to build their capacity. It is obvious that both short and medium term loans will be used directly for working capital and long term loans for capacity building of firms.

✚ The domestic construction firms' low capacity prohibits them from providing the required collateral.

In order to secure the repayment of loans, banks require either a fixed asset or an asset that is going to be purchased by the loan as collateral. Domestic construction companies are unable to provide the required fixed asset due to their low capacity to get loan and guarantees from their banks.

✚ **The domestic banks will not accept and the project owners also will not provide third party guarantee and work and / or work payment guarantees for loans.**

All the banks will not accept third party guarantee, work and / or work payment guarantee by project owners for the security of loans repayment and the project owners are also were not willing to provide such kind of guarantee for the construction firms. Hence, the domestic contractors are in a big difficulty to get collateral to secure bank guarantees and / or term loans.

✚ **Safety margin set by the domestic banks for assets pledged as collateral obliged the domestic contractors to provide a large amount of assets for collateral.**

Collateral assessments will be made by legal assessors which are certified by National Bank of Ethiopia and beside to that the banks will consider a large percentage of safety margins even up to 50% of the market value of the assets. This will reduce the value of the assets that the construction firms provided to secure the repayment of loans which they are going to take from the banks and hence, the firms will subject to provide a large amount of assets for collateral. This has become a major problem for the domestic construction firms due to their low capacity.

✚ **The country did have very limited equipment leasing and / or renting facilities or pools.**

As there are limited (almost no) equipment financing schemes in Ethiopia, the domestic construction firms mostly use outright purchase of construction equipments using the projects' advance payment and from their capital. Since outright purchase requires a huge initial capital, the domestic construction firms will oblige to invest their working capital and projects' advance payments on

equipments purchase. This will create a great working capital problem on them to run their projects smoothly.

✚ Old and limited number of equipments reduced the domestic contractors' capacity to perform equipment intensive projects.

Domestic contractors were found deficient in capital and construction equipments ownership. As a result of this old and limited number of equipments reduced their capacity to perform big infrastructure development projects that are equipment intensive.

✚ Retention money release bonds/maintenance Bonds are rare in use.

All of the domestic banks are providing bid bonds, performance bonds and bank guarantees. However, only two of the banks are providing retention money release bonds. Hence, all the banks should provide this bond to relieve the cash flow problem of the domestic construction firms to some extent.

6.2. RECOMMENDATIONS

This paper is believed to guide all stakeholders involved in construction industry to find mutual solutions for the financing of construction projects and capacity building of the domestic construction firms. Based on the results of the study, the following recommendations are forwarded to enhance the financial position of the domestic construction firms and to build their capacity for the development of the construction industry in Ethiopia.

- 1.** Since construction firms are the main players in the infrastructure development activities of the country, the banks should create conducive environment for lending and give attention for the financing and capacity building of the domestic construction firms rather than taking into considerations their contextual realities.
- 2.** The domestic construction firms should use the mobilization advance payment particularly for the project activities rather than expending it for other purposes which can create cash flow problems and using it for other projects.
- 3.** The domestic construction firms should provide reliable data on their previous years' financial situation of their company from certified auditors. This will help the local banks to have a clear picture about the firms.
- 4.** Private investors should have to be motivated to participate in banking business in order to increase the limited number of banks in Ethiopia and to create the competitiveness spirit between them such that they can

- create policies for the development and capacity building of construction industry.
5. The domestic construction firms should employ project based financing and accounting systems in the name of each of their projects and they should allow the projects to deposit their advance as well as interim payments in their system in order to clearly identify which projects are at loss and which ones are at profit.
 6. The domestic banks should give attention in providing long term loans for the domestic contractors to urge them in using the mobilization advance particularly for the project activities only.
 7. Consultants and Project Owners should play their role in minimizing cash flow problems by certifying and effecting payments timely.
 8. The concerned governmental body has to make sure that the contractors come with the required sufficient capital and equipments to upgrade their classes and to be registered in the infrastructure development activities of the country.
 9. The construction firms should assign managerially capable and cost conscious personnel in their projects.
 10. Merging two or more domestic construction companies together as a share company or forming a joint venture agreement will help them to form financially as well as technically and managerially strong domestic firm.
 11. Construction Equipments hire purchase as well as leasing schemes should be developed in the country and hence, the construction firms will not expend their working capital for outright purchase of the required construction equipments.

- 12.** The domestic construction firms should develop good relationship with potential suppliers to use credit facility for construction equipments as well as materials purchase.
- 13.** In all the cases the domestic banks require collateral to secure the loans and guarantees they provide for construction firms. However, the firms couldn't provide the required collaterals due to their low capacity. Hence, the banks should take this in to consideration and accept work and / or payment guarantees by project owners and third party guarantees as part of the collateral.
- 14.** Banks should reduce the safety margin set for collaterals secured for bank guarantee and construction loans. As much as possible they should take the value of the assets equivalent to the value specified by the legal assessors that are certified by the National Bank of Ethiopia.
- 15.** The current requirement set by international financiers towards awarding the implementation of infrastructure development activities to foreign international construction firms needs to be reviewed in line with the capacity Building requirements of the Construction Industry.
- 16.** The domestic construction firms should have to develop the use of retention money release bond / maintenance bond and the banks also provide this type of bond in order to relieve the financial problem of the construction firms to some extent.
- 17.** Further investigations, research works and discussion forums are advisable by all stakeholders and the concerned higher government officials in order to give a tangible solution for the financial problem and capacity building of the domestic construction firms.

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APPENDICES

APPENDIX: A1

QUESTIONNAIRE SURVEY

ASSESSMENT ON THE ROLE OF FINANCIAL INSTITUTIONS FOR THE ETHIOPIA CONSTRUCTION INDUSTRY

Questionnaire for Construction Firms

- You are not obliged to answer any of the questions which you do not want to.
- If you have any query on this survey, you are kindly requested to contact me directly on tel. **0911–13 16 26**.
- Since this survey is required for academic research, your prompt response is highly appreciable.

Objective of the Research

The objectives of this research are:

- to provide overview of the various financial services and facilities that a certain domestic construction firm can obtain from domestic financial institutions in order to finance its construction projects and build its capacity.

- to guide all stakeholders involved in construction industry in finding mutual solutions for the financing of construction projects and capacity building of domestic construction firms.
- in order to review the relationship between the financial institutions and construction firms in Ethiopia.
- to discuss the laws set by financial institutions vis-à-vis regulatory requirement in relation to the construction sector.
- to discuss and comment on the different laws set by the domestic banks in relation to construction activities.

1. Respondents Name (Optional): _____
2. Name of the Construction Firm (Optional) _____
3. What is your category as per the MoWUD of Ethiopia? (GC____, RC____, BC____). If it is any other please specify _____
4. When did your firm established? _____
5. How much has been your turnover (for the construction works only) for the last year (1997E.C)? _____
6. How many projects do you have at hand currently and how much is the total cost of them? _____ & _____
7. In your opinion, which of the following are considered as major resources in construction projects? Select all that are applicable and rate these resources according to the value given them in your organization.

It. No	Description	V. Important	Important	Neutral	Not Important	Totally not Important
1	Finance/ Money					
2	Manpower Capacity					
3	Manpower Capability					
4	Construction Materials					
5	Construction Machinery					

6	Technology & Method					
7	Information					

* If there are others please specify and rate them accordingly.

8. Which of the following deficiencies have you seen in your organization?

- a) Inadequate Finance
- b) Equipment Incapability
- c) Skilled Manpower incapability
- d) Managerial Incapability
- e) Lack of Work Experience
- f) None

If there are others please specify _____

9. In your opinion, how do you rate the local availability of the following resources for the successful accomplishment of construction projects?

It. No	Description	Abundant	Sufficient	Fairly Available	Neutral	Not Available	Totally Not Available
1	Finance/ Money						
2	Manpower Capacity						
3	Manpower Capability						
4	Construction Materials						
5	Construction Machinery						
6	Technology & Method						
7	Information						

* If there are others please specify and rate them accordingly.

10. In your opinion, how do you rate the necessary conditions for the establishment and capacity building of domestic construction firms?

It. No	Description	V. Important	Important	Neutral	Not Important	Totally not Important
1	Availability of Projects					
2	Fair & Transparent selection process					
3	Financial Resources					
4	Use of modern technology					
5	Managerial Ability					
6	Strong Construction Firms Associations					

*If there are others please specify and rate them accordingly.

11. In your opinion, how do you rate the impact of the different obstacles for the development and capacity building of domestic construction firms?

It. No	Description	Extreme significance	High Signif	Ave. Signif.	Minor Signi.	No Signifi.
1	Favoring foreign companies					
2	Inadequate sources of finance and cash flow					
3	Lack of transparency in evaluation and award of contracts					
4	Bureaucracy in implementation (Payment delay etc.)					
5	Corruption					

* If there are others please specify and rate them accordingly.

12. Which bank do you select mostly for the different bank services and facilities?

(Government/Private) _____

Why? _____

13. What services and facilities you are getting from the local banks? Select all that are applicable.

- a. Construction Loans
- b. Equipment Financing Schemes
- c. Bonds and Guarantees
- d) Overdraft Facilities
- e) Truck Loans

If there are others please specify

14. What types of loans you are getting from your banks?

- a) Short Term Loan
- b) Medium Term Loan
- c) Long Term Loan
- d) Track/ Equipment Loan

If there are others please specify

15. Will your banks require collateral as compensation for the perceived risks involved in lending to your company?

- a) Yes b) No C) Do not know

16. Will your banks require third party guarantees as compensation for the perceived risks involved in lending to your company?

- a) Yes b) No C) Do not know

17. If your bank has secured the loan by collateral, what will you use as collateral?

- d. Owned Assets c) Payments that are to be collected
e. An asset that will be purchased by the loan

If there are others please specify

18. Have you got a client who guarantees work to let you get loan from banks for your cash flow problem?

- a) Yes b) No C) Do not know

19. Have you got a client who guarantees work payments to let you get loan from banks for your cash flow problem?

- a) Yes b) No C) Do not know

20. What possibilities do you use to finance the required construction equipments in your organization? Select all that are applicable.

- a) Outright Purchase d) Hire Purchase Scheme
b) Taking Truck/ Equipment loan e) Advance Payment of the Project
c) Equipment Leasing Scheme f) Suppliers Credit

If there are others please specify

21. In your opinion, which of the above possibilities of equipment financing is most appropriate for the domestic construction firms and why? _____

22. What type of bonds and guarantees you are getting from your banks?

- a) Bid Bond/ Bid Security
- b) Performance Bond
- c) Advance Payment Guarantee
- d) Retention Bonds

If there are others please specify

23. If you have a cash flow problem and are not able to get loan from a bank, how you will try to solve your cash flow problem of your projects?

24. What do you recommend as a solution for the financial problem of the domestic construction firms other than bank facilities? _____

25. What is your opinion, concerning the role of banks for the development of the construction industry in Ethiopia and capacity building of the domestic construction firms? _____

APPENDIX:A2

ASSESSMENT ON THE ROLE OF FINANCIAL INSTITUTIONS FOR THE ETHIOPIA CONSTRUCTION INDUSTRY

Questionnaire to be filled by Banks

- You are not obliged to answer any of the questions which you do not want to.
- If you have any query on this survey, you are kindly requested to contact me directly on tel. **0911–13 16 26**.
- Since this survey is required for academic research, your prompt response is highly appreciable.

Objective of the Research

The objectives of this research are:

- to provide overview of the various financial services and facilities that a certain domestic construction firm can obtain from domestic financial institutions in order to finance its construction projects and build its capacity.
- to guide all stakeholders involved in construction industry in finding mutual solutions for the financing of construction projects and capacity building of domestic construction firms.
- in order to review the relationship between the financial institutions and construction firms in Ethiopia.
- to discuss the laws set by financial institutions vis-à-vis regulatory requirement in relation to the construction sector.
- to discuss and comment on the different laws set by the domestic banks in relation to construction activities.

1. Respondents Name (Optional): _____

2. Name of the Bank (Optional): _____

3. When was your bank established? _____
4. What services and facilities you are providing for domestic construction firms?

Select all that are applicable.

- a. Construction Loans
- b. Equipment Financing
- c. Bonds and Guarantees
- d) Overdraft Facilities
- e) Truck Loans

If there are others please specify _____

5. What types of loans you are providing for domestic construction firms? Select all that are applicable.

- a) Short Term Loan
- b) Medium Term Loan
- c) Long Term Loan
- d) Track/ Equipment Loan

If there are others please specify _____

6. According to your bank's policy, what is the time of maturity for the following loans?

- a) Short Term: Up to _____ Yr;
- b) Medium Term: _____ to _____ Yrs;
- c) Long Term: More than _____ Yrs.

7. What preconditions should have to be fulfilled by a construction company to get a loan from your bank?

- a) Collateral Requirement
- b) Third Party Guarantee
- c) Work guarantee by project owners
- d) Work payments guarantee by owners

If there are others please specify _____

8. Is there a possibility for a construction firm to obtain loan without securing the loan by collateral or by any other guarantee?

- a) Yes
- b) No
- C) Do not know

If your answer is yes, specify all other ways you use please?

9. If your bank has secured the given loan by collateral, which type of collateral is acceptable from construction firms?

- a. Owned Assets
- b. An asset that will be purchased by the loan
- c) Payments that are to be collected

If there are others please specify _____

10. If a construction firm is small in capacity, a first time borrower without any track records at your bank and has fulfilled the required pre established conditions for loan, will the bank allow him to get loan?

- a) Yes
- b) No
- c) Do not Know

If your answer is no, what is the reason? _____

11. Will the bank provide loan for a construction firm if the client of a project guarantees work?

- a) Yes
- b) No
- C) Do not know

12. Will the bank provide loan for a construction firm if the client of a project guarantees work payments of the project to pass through the bank?

- a) Yes
- b) No
- C) Do not know

13. What facilities do you provide for construction firms in order to finance the required construction equipments and/ or trucks?

- a) Providing Truck/ Equipment loan
- b) Equipment Leasing Scheme
- c) Advance Payment for equipments
- d) Hire Purchase Scheme

If there are others please specify _____

14. What are the required criterions for a certain firm to enjoy these facilities?

- a) Collateral Requirement
- b) Third Party Guarantee
- c) Work guarantee by project owners
- d) Work payments guarantee by owners

If there are others please specify _____

15. What type of bonds and guarantees are you providing for domestic construction firms?

- a) Bid Bond/ Bid Security
- b) Performance Bond
- c) Advance Payment Guarantee
- d) Retention Bonds

If there are others please specify _____

16. After your bank has provided bonds and guarantees for a certain domestic construction firm, how do you follow up and evaluate the contractor's ability to meet the terms and conditions of the bond / guarantee contract satisfactorily?

17. From what bases you will impose the maximum limit of overdraft facility for a construction firm and any other clients?

18. What do you recommend as a solution for the financial problem of the local construction firms?

19. What is your opinion, concerning the role of banks for the development of the construction industry in Ethiopia and capacity building of the domestic construction firms?

APPENDIX: A3

ASSESSMENT ON THE ROLE OF FINANCIAL INSTITUTIONS FOR THE ETHIOPIA CONSTRUCTION INDUSTRY

Questionnaire for Project Owners (Clients)

- You are not obliged to answer any of the questions which you do not want to.
- You are earnestly requested to contact me directly at tel0911–13 16 26 if you have any query on this survey.
- Since this survey is required for academic research, your prompt response is highly appreciable.

Objective of the Research

The objectives of this research are:

- to provide overview of the various financial services and facilities that a certain domestic construction firm can obtain from domestic financial institutions in order to finance its construction projects and build its capacity.
- to guide all stakeholders involved in construction industry in finding mutual solutions for the financing of construction projects and capacity building of domestic construction firms.
- in order to review the relationship between the financial institutions and construction firms in Ethiopia.
- to discuss the laws set by financial institutions vis-à-vis regulatory requirement in relation to the construction sector.
- to discuss and comment on the different laws set by the domestic banks in relation to construction activities.

1. Respondents Name (Optional): _____
2. Name of organization/ Enterprise (Optional): _____
3. Will you give your projects for construction firms or construct it by yourself?

4. How many projects do you have now at construction stage and how much is the total cost of these projects? _____ & _____
5. Where will you get finance for your projects implementation?
 - a) From government allocated budget,
 - b) From banks and other financial institutions,
 - c) From foreign Financers, (Please specify them)
 - i. _____
 - ii. _____
 - iii. _____

If there are others please specify them _____
6. If you are getting your projects finance from foreign financers, in what way do you get it?

- a) Loan b) Grant

If there are others please specify them _____

7. In your opinion, how do you rate the necessary conditions for the establishment and capacity building of domestic strong construction firms?

It. No	Description	V. Important	Important	Neutral	Not Important	Totally not Important
1	Availability of Projects					
2	Fair & Transparent selection process					
3	Financial Resources					
4	Use of modern technology					
5	Managerial Ability					
6	Strong Construction Firms Associations					

8. In your opinion, how do you rate the impact of the different obstacles for the development and capacity building of the domestic construction firms?

It. No	Description	Extreme significance	High Signif.	Ave. Signif.	Minor Signi.	No Signifi.
1	Favoring foreign companies					
2	Inadequate sources of finance and cash flow					
3	Lack of transparency in evaluation and award of contracts					
4	Bureaucracy in implementation (Payment delay etc.)					
5	Corruption					

9. Have you given a third party guarantee for your contractors to get loans from banks?

- a) Yes b) No C) Do not know

10. Have you ever guarantee work for contractors to get loan from banks?

- a) Yes b) No C) Do not know

11. Have you ever guarantee work payments of contractors to pass through bank to get loan from the bank?

- a) Yes b) No C) Do not know

12. Have you ever given an advance payment for contractors without securing the repayment by advance payment guarantee?

- a) Yes b) No C) Do not know

13.What types of bonds and guarantees do you request construction firms to provide?

- a) Bid Bond/ Bid Security
- b) Performance Bond
- c) Advance Payment Guarantee
- d) Retention Bonds

If there are others please specify _____

14.As you very well know that cost of providing bank guarantee for advance payments from the domestic banks is high and the contractor is required to provide collateral to secure the repayment. Nowadays, it has become very difficult for the domestic construction firms to provide collateral for the banks to get the advance payment guarantee. As a project owner, what another option do you propose to secure the advance repayment by the contractor instead of advance payment guarantee from banks?_____

15.What do you recommend as a solution for the financial problem of the domestic construction firms?

16. What is your opinion, concerning the role of banks for the development of the construction industry in Ethiopia and capacity building of the domestic construction firms?_____

Role of Financial Institutions for The Ethiopia Construction Industry

APPENDIX: A4

Tri – partite Agreement

This tri- partite Agreement is made and entered into between the Commercial Bank of Ethiopia, a public enterprise existing and operating under the laws of Ethiopia, located at Addis Ababa city, Woreda ___ kebele ___ herein after referred to as “ The Bank”

And

M/S _____, a government organization duly organized under the laws of Ethiopia located at Addis Ababa city, woreda, ___ kebele ___ herein after referred to as “The Employer”

And/ M/S _____, address _____ city/town, Woreda ___ kebele ___ House No. _____ (herein after referred to as “The Borrower”)

Whereas under the loan contract made and entered into between the Bank and the Borrower on the _____ (herein referred to as the loan contract) the Bank has extended a maximum short and /or medium term loan of Birr _____ to the borrower,

Whereas under Construction agreement made and entered into between the Borrower and the employer on the _____ (herein after referred to as the construction agreement) the Borrower agrees with the Employer to construct, complete and maintain the works in conformity in all respects with the provisions of the construction agreement and the Employer agreed to pay total contract price of _____ for the execution of the construction project.

Whereas, the Borrower authorized the Employer that all the payment be channeled directly to a special proceed account to be opened at Finfine Branch

and the Bank, the Borrower and the Employer have agreed to such proposal,
Now therefore, the parties here to have agreed as follows,

Article 1

The Bank has agreed to grant a term loan of Birr _____ of the total contract price of Birr _____ to the Borrower as per the construction agreement made on _____.

Article 2

The Employer has awarded the _____ project of _____ of the total contract price of Birr _____ to the Borrower as per the construction agreement made on _____.

Article 3

The loan contract and the construction agreement shall be considered as integral parts of this tripartite agreement (The copies of which shall be annexed herewith)

Article 4

If for any reason the construction agreement is cancelled or suspended, the Employer shall inform the bank immediately.

Article 5

The borrower shall open a special proceeds account, in one of the bank's branches.

Article 6

6.1 The Borrower authorizes the employer to transfer all payments to be made as
Per this contract to the special proceeds account opened in the Bank.

6.2 Accordingly, the Employer hereby undertakes to credit all payments related To the contract through cheques payable in account to the special proceeds Account opened as per Art. 3 However, the Employer may deduct the following:

- a. Proportion of Advance payment made to the Borrower.
- b. Retention amount stipulated in the contract
- c. Liquidated damage as per the construction agreement
- d. Any other sum to be deducted as per the construction agreement

6.3 The Bank shall service the loan repayment according to the terms of repayment of the loan contract out of the special proceeds account prior to the servicing of other financial obligations by the borrower.

6.4 The Bank is obliged to transfer the remaining amount, if any, to the Borrower's Account upon receipt of borrower application.

Article 7

Both the Borrower and the Employer shall be liable for damages incurred to the bank because of gross negligence in the performance of the obligation assumed under Article 6.

Article 8

The Bank shall retain ___% of the proceeds to the social account until that amount equals a sum of one installment payment. Such amount shall be deposited in an interest bearing account. This amount will be paid back to the Borrower if the Borrower settles its bank fully.

Article 9

This agreement shall be interpreted and construed in accordance with Ethiopian laws.

Articles 10

Any dispute that may arise under this agreement shall be amicably solved. If amicable solution is not possible, any of the parties may present its case to Ethiopian Court having jurisdiction.

Article 11

11.1 No verbal arrangements or understanding or presumption shall alter or change the provisions and execution of this contract.

11.2 All the terms and condition of this contract shall apply as of the date of signature.

11.3 The parties hereto executed this contract in quadruplicate counter parts on the date and year of signing of this document.

Article 12

Without prejudice to the duty of the employer to transfer outstanding payments to the Bank, the termination or suspension of the construction contract automatically terminates this tripartite agreement. Either party may terminate this agreement if the obligations provided in this agreement are not implemented as agreed or by giving a notice of _____ days.

In witness, whereof, the parties here to have signed this contract on the _____.

For the Bank

For the Borrower

For the Employer

In the presence of

1. _____
2. _____
3. _____