

CrossRoads Uganda: On the road to better construction

Ninety per cent of imports and exports travel by road in Uganda. However, the quality of these roads is often poor. Narrow roads with numerous potholes are dangerous for passengers and slow down the flow of critical products. Behind this visible challenge is a road construction industry beset with many issues, not least a loop of poor reputation and low trust. The CrossRoads programme aims to build trust between local construction firms and banks so that government expenditure on roads is more effective.

Foreign companies taking lion's share

Roads play a key role in connecting urban and rural communities in Uganda where 90 per cent of imports and exports travel by road. The government plays a significant role in this sector, financing the construction and maintenance of all major road contracts, many of which are currently won by foreign companies.

In 2011, CrossRoads' analysis showed that access to finance played a crucial role in how the roads construction industry was structured. Cash outlays were needed to bid for jobs and to meet early working capital requirements before payment was received. However, banks believed Ugandan contractors would misuse funds. They built this risk into the price of their loans, charging very high interest rates. They also required contractors to commit property or money that they would forfeit if they failed to repay their loans.

These requirements largely restricted Ugandan contractors to only bid for one project at a time, often losing out to foreign companies. On top of that, local firms' inability to bid on multiple contracts restricted competition. The industry was trapped in a loop of poor reputation, low trust, low quality and poor performance. Economists would label the market failures as unequal access to information (banks lacking information on trustworthiness of local contractors) and high costs of establishing agreements (collateral requirements). In order to break this cycle, CrossRoads needed to find a way to improve the reputation of local firms.

Rebuilding trust

CrossRoads sought to rebuild trust between banks and Ugandan road contractors without funding new projects itself. The programme designed an innovative financing model, called the Construction Guarantee Fund (CGF). The fund was launched in January 2012 to show banks that contractors were less risky than they believed.

Guarantee fund

The CGF has an endowment of £2 million, which is used to guarantee half of the losses to banks in the event local contractors fail to deliver and the guarantee is called by the employer.

The fund is managed by aBi Finance, a Ugandan business with strong expertise in agribusiness finance. Banks are required to cover 50 per cent of the losses in the case of a failed contract. This puts pressure on banks to thoroughly assess each applicant.

Local contractors have to meet criteria that include past performance and credit worthiness. They also have to provide 50 per cent collateral (cash or real estate) which they lose to banks if they fail to meet their contractual obligations.

During the first year, five local banks joined the CGF and provided bonds to more than 20 local road construction companies. As more local firms started to experience the benefits of being able to bid on contracts, they put pressure on other banks to join the fund, threatening to close their accounts unless they did. This market response was a spontaneous and unplanned development on the part of the local contractors.

Financial firms crowd in

As of September 2015, 14 financial institutions had joined the CGF. More than 1,400 guarantees had been provided to local contractors, valued at roughly £10 million. Not every guarantee led to contractors winning a contract, but more participation in bidding raised competition. To date, at least 15 local contractors have won bids that

guarantee them work for the next three years. Crucially, not a single default has been reported, indicating that banks were judging local contractors too harshly.

The CGF has proved its value by building mutual trust and confidence between banks and local contractors. Looking to the future, the government is planning to replicate the fund in the soon to be created Uganda Construction Industry Commission (UCICO). The proposed fund will improve access to finance for all contractors in Uganda. Over time, as banks start to fundamentally re-evaluate the risk of local contractors, the CGF may become unnecessary. Of course there are risks of having the fund managed by government sponsored institution. UCICO will need to develop its capacity to manage the fund, as it will be under very different pressures than aBi Finance.

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