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THE CONSTRUCTION SECTOR AND THE INFORMAL FINANCIAL MARKET IN BANGLADESH

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PREFACE

As in many developing countries, the informal financial markets in Bangladesh are alleged to provide the bulk of the credit needs of the economy, particulary to the small scale sector which has little access to the formal (institutional) sources of credit. Despite various attempts to control and regulate informal financial transactions, their scale and pervasiveness of operations have expanded unabated. In the long debate on the usefulness and the performance of the informal financial market operations, and associated issues like the determinants of interest rates, inter-linkages among transactions, etc., some have labelled the markets as usurious, as 'fetters on growth' while others have considered them as desirable adjuncts to the process of brisk growth in trade and commercial operations. Corresponding to these two views, two diametrically opposite policy frameworks are envisaged; the first aims at controlling and ultimately eliminating informal financial transactions while the second aims at expanding the fund flows and increasing the competetiveness in the informal sector. Both lines of arguments however agree that there are imperfections in informal financial markets and that the interest rates usually obtaining in these markets are on the higher side.

Despite the considerable operational significance of the issues involved, and the implications these have for developing an optimal policy environment, information on these markets in Bangladesh remain highly inadequate. The study on the informal financial markets in Bangladesh, conducted by the Bangladesh Institute of Development Studies (BIDS) and sponsored by the Asian Development Bank and the US-Agency for International Development (US-AID), attempts to fill-up this gap in information and analyse some select issues such as the growth and the structure of the markets, formation of interest rates, mobilisation and use-efficiency of resources. A series of case

studies have been conducted under the project; all of them are now being reproduced as working papers. A survey to collect some primary level information on the markets and the characteristics of lenders and to know more about the organizational aspects of informal finance gathering and distribution has also been conducted. The survey findings along with those of the case studies are being used to prepare an overview paper on the informal financial markets in Bangladesh.

In this study Mr Ghausul Alam Khan examines the informal credit transactions in the construction sector of Bangladesh. More specifically, he examines the brick making industry, the steel industry, trade in cement, sand and stones and the contracting business in house construction. The author finds instances of high rate of interest as well as widespread use of the advance system in the construction sector. The study, by exploring a rather unexplored area, assembles together some interesting information and clearly depicts the channels of fund flows. The information contained in the study can be used to ask more pointed question in future along these lines.

Atiq Rahman
Project Director

CHAPTER ONE

Background

This case study is a component of a larger study on the Urban INFORMAL FINANCIAL MARKET (IFM) in Bangladesh. The larger study, taken up by the Bangladesh Institute of Development Studies (BIDS) and financed by USAID, has the following broad objectives:

(i) to identify role played by the Urban Informal Financial Market (IFM) in providing financial support to Urban small scale enterprises.

(ii) to find out whether it is desirable to develop Urban IFM for promoting the urban informal sector, particularly the small scale enterprises who have little access to formal sector institutions; and

(iii) if found desirable, to trace out the modalaties for promoting Urban IFM.

It may be further noted that the urban informal financial market study is a part of a yet bigger study on the informal financial market in Bangladesh, the rural component of which is being financed by the Asian Development Bank.

Line of Activity Studied

Construction being an important activity in most countries, including Bangladesh, accounted for about 5.2% of our GDP and created employment for 321,000 persons or 1.15% of the total employment generated by major industries in the year, 1984-85.

The construction sector - may be classified into three broad subsections i.e.:

(i) buildings and dwellings (housing)

(ii) land improvement

(iii) Other construction.

In 1976-77, these three subsectors accounted for about 65%, 20% and 15% respectively of the total investment in construction activities for that year (amounting to about Tk. 10,337 million).

Investment in buildings and dwellings accounts for a major share of total investment in the construction industry. In 1976-77, private sector investment in buildings accounted for about 82% of total private sector investment and for about 40% of total investment (public and private) in the industry.

Urban buildings accounted for about 65% of total investment in buildings and dwellings and for about 42% of total investment in construction.

This case study has focused on activities involving urban building construction with respect to its informal sector financial transactions in order to provide some insights into the working of the urban informal financial market. The areas of study have been further segmented into sub-activities as follows:

(i) Construction Materials Procurement/Supply
(ii) Contracting
(iii) Real Estate Development
  a. Commercial Building (Shops/Offices/Others)
  b. Housing

Methodology

The study was conducted through an anthropological approach, as such numerous informal discussions were held with a number of persons involved in the different sub-activities, such as construction material producers, distributors, whole-sellers, retailers, importers, as well as contractors, real estate developers, private owners.

Discussions for information collection were also held with officials of Commercial Banks, Government Agencies, and Sector Corporations, namely those related to government sector contracts for construction works.

Investigations were conducted at Pagla, Demra and Mohammadpur, for sand, stones, bricks and at Dhaka and Chittagong for cement and steel, and Dhaka for contracting/real-estate development.

General Information

The Construction Industry:

After food and clothing, shelter is the third most important basic need of human beings, as such the construction industry in any society represents a very important and substantial portion of the total economic activity in that society and Bangladesh is no exception either.

The construction industry in Bangladesh is still at an elementary stage of development in comparison to that of most industrially developed or moderately industrially developed countries. For example there is virtually no pre-fabrication of building elements, i.e. industrialized building systems are not employed here to any degree whatsoever. Moreover very little mechanisation is used at the construction site for constructing buildings, manual labour is still the prime mover of the construction engine. As such most building materials are still used in their basic form at the construction site. Items like sand and stone are directly transported from their source of origin to the construction site without any form of intermediate processing. Bricks are only graded into three different quality grades in order to fix their respective sales prices. Cement and M.S. rods can be considered as construction materials which involved truly industrial processes for manufacturing. Though some other items such as electrical materials doors/windows, sheet glass, sani-

tary fittings, and paint finishes and wood, C.I. sheet etc. also constitute important construction materials they were not included in this study on account of the fact that on an individual basis each of them would constitute a proportionately very small cost component of any building constructed as compared to the sand, cement, bricks, M.S. rod. As such it was assumed that a study of the role of IFM in relation to the business in connection with these items would suffice to shed sufficient light on the IFM on the procurement/ supply of construction materials.

The Government still represents the single biggest and most important client in the construction industry for the contractors. Hundreds of contractors are constructing roads, bridges, canals, buildings, houses, factories etc. for the government. Although there are also many private sector clients, their number and size of operations are still negligible compared to that of the government agencies.

But nevertheless the private sector does constitute an important part especially in the urban areas. In view of the growing importance of the private sector there is no doubt that the private sector "client" shall become a worth-while door to knock in the near future.

As a matter of fact some of the private sector clients" may be identified as real estate developers who themselves are the client/contractor at the same time, i.e. They are constructing buildings for sale to other private sector parties or individuals. Though this form of development still represents a very small fraction of the construction industry it was still studied, vis-a-vis the role of IFM, on account of the fact that this form of development represents a major form of activity in industrially developed free market economies and therefore its role in Bangladesh's construction industry is bound to increase to a substantial degree in the not so distant future. Housing and shops are the main form of buildings which are built/sold by these developers because these are "easy to sell" products.

CHAPTER TWO

The Brick-making Industry:

The study on the brick-making industry was limited to Dhaka and its environs.

The main sites where bricks are manufactured around Dhaka are:

i) Pagla
ii) Munshikhola
iii) Mirpur
iv) Mohammadpur
v) Panchaboti
vi) Pakepara
vii) Baburghat
viii) Savar

Pagla and Munshikhola are the most important brick-making sites, followed by Mirpur and Mohammadpur.

The ownership of the brick-fields at these sites mostly are partnerships or proprietorships. Of these interviewed 53% of the firms were partnerships and the remaining 47% were proprietorships.

Almost all of the fields are owned by the local people. Some of the fields are owned by the second or third generation of the same families, i.e. the fields were originally started by a grand-father or father/uncle of the present owners.

Virtually all of the brick-manufacturing companies are managed by the owners. In the case of some of the fields which were seen to be managed by hired managers such managers were usually some kind of relative of the owners.

BRICK TRADE DISTRIBUTION NETWORK:

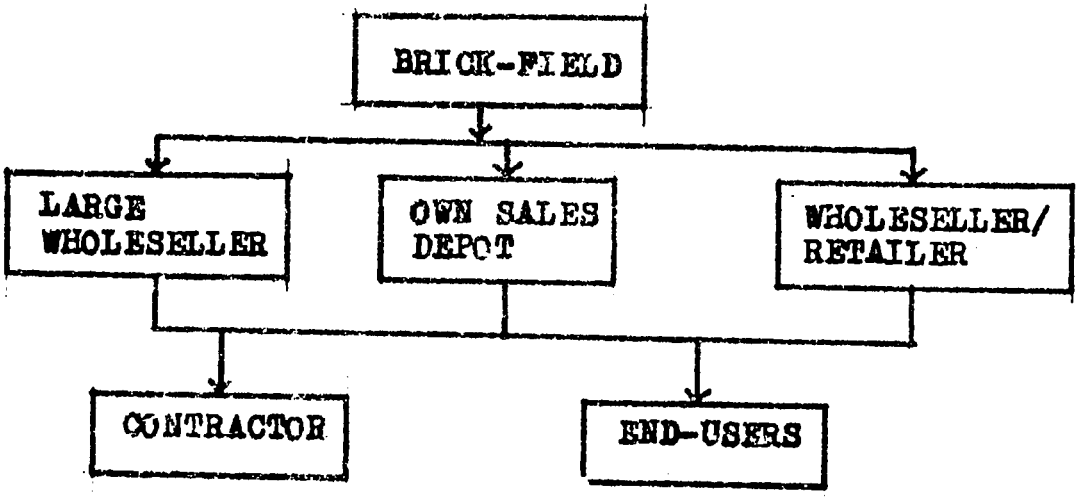

Diagram - II

Size of Market:

There are about 300 brick-fields in the Pagla-Munshikhola area. The brick-fields consist of one, two or three sections, each section can produce about 22-23 lac (1 lac = .10 million) bricks in a season, but the minimum economical output per section is approximately 14 lac bricks per season. If we assume an average of 1.5 sections per field with a minimum production of 14 lac bricks per section, @Tk. 1100 per 1000 bricks - i.e. Tk. 23,10,000/- per brick field thus the average annual total sales of the brick-fields in the Pagla-Munshikhola region amounts to approximately Tk. 69.30 crores at the minimum, it may even go as high as Tk. 100 crore - depending upon the volume of production in a fixed season.

As such the Informal Financial Market (IFM) size in the brick-making sector is substantial, because about 50% of the financial needs of the manufacturers are fulfilled by means of some form of informal finance.

The brick manufacturing period is limited only to the dry season, so the finance required is for a duration of about 6 months. In each field the investment required is about Taka 25 lacs, including the cost of the land & equipment through their own capital and therefore they have to borrow from formal financial institutions (Banks). It was gathered that the banks are unable or unwilling to bridge the full financial gap, moreover, due to excessive formalities there is considerable delay in receiving loans in due time. The industry requires the bank loan just prior to commencement of production, i.e. around August/September but the banks are unable to disburse the funds before November/January. The formal financial sector is meeting about one-third of the market needs for finance.

Nature of Credit Operation:

The nature of credit, as it was observed to exist, in the brick manufacturing industry is truly informal in the sense that it is

not termed as a "credit" or "loan" by the "borrower" or "lender" most possibly due to socio-religious inhibitions, i.e. for Muslims, to charging or paying interest.

The credit system in this industry is based on a form of advance selling of the products, i.e. the brick-maker sells his bricks to a whole-seller or any other buyer at a pre-determined price which is definitely lower than the expected market sale price of the products. Thus the buyer purchases in advance @Tk. 1100 per 1000 bricks, but it is already known to both the seller and the buyer that the market sale price of bricks shall be at least Tk. 1400 per 1000 bricks after a period of 2/3 months - which is the earliest date of possibly receiving the bricks from the seller.

Thus for the buyer there is an obvious out-right financial gain of about Tk. 300 to 400 per 1000 bricks, which represents a rate of return of about 27.27% to 36.36% on his investment in a time span of only five to six months.

From the Brick-maker's, i.e. seller's view-point there is also an out-right gain because though he is receiving an advance payment from the buyer, he does not deliver his first consignment of products produced with these funds to the buyers but sells it to another buyer against cash, therefore the advance money received by the seller is revolved at least 2-3 times before he actually delivers to the buyer, thus the seller is able to recoup the hidden "interest" which he has to pay to the buyer through the profits made.

Market Segmentation:

Since the IFM as it exists in the local brick-making industry is a sort of "latent" phenomenon as such these is no clear segmentation of the market in terms of local political groupings because the buyers of the products (through advance payment), who may be termed as "lenders" in this case, transacting business deals which are of substantial financial value and yet concentrated in a very

small number of brick-fields. The influence of the "lender" with the "borrower" may be very strong but the number of "borrowers" with whom a single "lender" deals with is too small to enable him to proliferate his political influence, if any.

There can be no denying of the fact that the "lenders" and "borrowers" have been introduced to each other through local/familial/political lineages, but such introductions have had the sole purpose of reinforcing the trust and good-will and mutual faith that must exist between two parties willing to transact any business deal, the financial stakes are high enough to negate all non-financial goals or objectives that either side may otherwise have.

The advance payment received by the brickmaker is used to pay for the labour, procurement and transportation of clay, pay off fuel bills, transportation of the finished products from the fields to the whole-sale depot, thus it ccan be said that in the brick-making sector. The "borrowed" funds are primarily used for productive purposes.

Identification of Lenders:

The "lenders" in this industry are mostly experienced businessmen/traders who have sufficient knowledge of the nature of business to encourage them to make advance payment to the brick-maker. Once an advance payment is made to the brick-maker, the brick-makers can rest at ease because his product is already sold, but the buyer (in reality the "lender") has thus acquired a stock of bricks which he must sell (unless he is an enduser himself, which is not so in most cases). Therefore the initiator is almost never a pure money-lender or investor looking for a better rate of return but rather always is a brick wholeseller or contractor/sub-contractor or someone already involved in the brick trade in some way.

The brick-makers have access to a number of sources of funds, besides their own capital, as has been shown in diagram-I (please

see ANNEX A). there are namely (1) Banks, (2) Private lenders, (3) Whole-sellers, (4) Contractors.

Officials of a number of Bank Branches were interviewed, i.e. namely of Janata Bank Branches at Pagla Fatulla and Shyampur as well as the Sonali Bank, Dapa Branch.

The rate of interest charged by Janata Bank is 16% per annum for amounts below Taka 1 lac and for loan amounts exceeding Taka 1 lac the rate of interest being 18% per annum. The Sonali Bank rate of interest is 16% per annum for any amount. But in case of unsatisfactory recovery, that is for delayed repayments the bank imposes an additional percentage of interest as fine (penalty) which may be as high as 20% per annum.

For example, if a loan repayment was due to the Bank in the month of December and the party fails to pay up, then the party is charged a rate of interest as follows:

FOR JANUARY	:	16% + 1% = 17% per annum
FOR FEBRUARY	:	17% + 1% = 18% per annum
FOR MARCH	:	18% + 1% = 19% per annum
FOR APRIL	:	19% + 1% = 20% per annum
FOR MAY & ONWARDS	:	20% per annum

The brick-makers are in most need of finance in the beginning of the brick-making season, i.e. August/September/October but due to delays in processing by the banks the loans are not made available to the parties before November/December and in some extreme case even as late as January. Loan amounts ranging between Taka 1.5 to 5 lacs being common for the Janata Bank Branches, whereas for the Sonali Bank the loans range between Taka 2 to 8 lacs. According to the Bank Managers the rate of loan recovery is better than average.

But because the banks are late in disbursing the loans to the brick-field owner and even then not as much as really needed, so they have no alternative but to take recourse to the informal sources of finance (please see diagram-I at ANNEX-A).

The brick-makers have three possible sources of informal finance, which can be categorized as follows:

1) Private lender: from this type of lender the brick-maker will receive cash and pay back in cash.

2) Whole-seller: from this type of lender the brick-maker will receive cash as advance payment for bricks and will pay him back only in the form of goods.

3) Contractor: from this type of lender the brick-maker will also receive cash as advance payment but will pay back only in the form of goods.

The private lenders themselves may be further classified into three types as follows:

1) Investor: One who "lends" money without any fixed interest and shares in the profit or loss of the business in proportion to the volume of his investment. This type of person is usually a person with a long-standing or strong relationship with the "borrower" on account of which he places sufficient trust upon the borrower and therefore does not expect the borrower to deprive him of his true share of profit. There is usually no deed of agreement in this type of arrangement and the whole business is conducted simply on the basis of mutual trust.

   This lender is usually not well versed in the business modalities of the brick-making industry but only knows that he will get a better return on his investment than a deposit in a bank. Most of these people are service holders with sufficient savings to enable them to invest.

   One may classify an investor as a partner in the specific brick-field but in the case of our study we are classifying short term investors as lenders, because such persons are not true owners of the brick-field. This type of lender/investor plays

the role of a short-term sleeping partner and has no long-term goals like a true partner or equity-shareholder who has a vested interest in the brick-industry itself.

2) Friend/Relative: One who lends money to the brick-maker primarily because he has a close personal relationship with him. The personal/familial bond between him and the borrower is strong enough to be the sole reason for lending. The lender usually, in this case, lends in order to fulfill some earlier obligation or in order to further strengthen the existing familial/friendly bonds. In most cases of this type the lender does not usually charge any interest, but in some cases interest may be charged. When such interest is charged, it usually is done in order to justify the loss which the lender may incur due to withdrawal from the bank, and the rate of interest so charged by the lender is normally at par with a bank or at the most may be marginally higher to justify the extra trouble that may be incurred. Thus both the lender and the borrower feel that they are getting a "fair deal", a necessary condition for preservation of their existing personal relationship.

3) Lender: One who lends money solely on interest. Such lenders are acquaintances of the borrowers and charge a fixed rate of interest for their loan. These lenders are mostly people who have alternative opportunities of investment, therefore unless they charge sufficient interest they have no incentive to lend, as such in comparison to the formal financial institutions their rate of interest is exorbitant. The rate of interest may even be as high as 30% for a period of 6 months.

Categories of Borrowers:

The brick-makers are mostly seasoned businessman with years of experience in the trade and have already developed some sort of goodwill or reputation in the market, that is among their suppliers/

fellow brick-makers/buyers. Naturally the reputation or degree of goodwill that each brick-maker has acquired depends upon his past performance as well his present practice/system of business operation. Each brick-maker has his own brand-name for selling bricks and therefore the reputation of a brand-name determines how easily a certain brick-field can sell its products and thereby repay any loan that may have been taken. Thus the lenders have to grade the borrower on the basis of the strength of the brand-name in the market as well as the reliability of the borrowers' commitments/promises, which is determined by the personal reputation of the brick-maker himself or by his past performance with the lender.

Since the operation of the lender himself is not at all undertaken in a truly systematic or professional manner, any form of categorisation that exists is based upon the personal intuition and experience of the lender. As such there is no clear cut segmentation of different categories of borrowers, the only definite way of determining the "rank" or "status" of any brick-maker would be by means of the existing production capacity of his field, i.e. in terms of the number of kilns in the field in question. Anyhow the lenders prefer not to lend more than a certain amount to any single brick-maker and spread their risks among a number of brick-makers. But it must nevertheless be borne in mind that the brick-makers, i.e. brick-field owners are a category by themselves because they already are in possession of certain assets/advantages which place them in a certain bracket. The fact that the brick-field owners own land, equipment and some capital classifies them as more or less "bankable" borrowers.

Nature of Relationship:

Even though it is widely believed that in the case of rural credit operations the lenders have some non-credit goals in order to strengthen their political power, such is not the case with the brick-filed owners and the lenders at Pagla/Munshikhola. It is

fairly obvious that the brick-field owner has more than one source of credit, i.e. the wholeseller, the contractor, and the lender, and so the lender does not have sufficient control over any single brick-field to enable him to pursue any non-credit goals. The wholeseller has to sell the products which he has bought by paying in advance and therefore his primary desire would be to receive good quality products at a competitive price, thus enabling him to sell faster with a better profit margin, the whole-seller cannot afford to take the risk of neglecting his pure business interests, which are dictated by the market situation and his buyers/customers.

The contractor who also buys bricks by paying in advance has even less scope, than that of the wholeseller, as he himself is the enduser of the product and the success of his construction project may depend upon the price/quality of the product which he bought, as well as upon the maintenance of the delivery time promised by the brick-field owner. The financial capabilities of the brick-field owners places them in a better than average position in the business community and cannot be classified as a "vulnerable" group. As such financial transactions that are undertaken between the lenders and borrowers in the brick-making industry are mostly not clouded by any socio-political objectives of the lenders.

It must nevertheless be emphasized that the very nature of the informal credit market requires some form of personal relationship between the lender and borrower for the sake of trust which is necessary to convince the lender of the security of his funds even if there was no direct friendship/acquaintance between the lender and borrower then there was some introduction/reference through some mutual/common acquaintance of the lender/borrower.

Nature of Credit Operation:

The level of sophistication of the credit operation as it exists in the brick-making industry is of a very rudimentary nature. The lenders even have no specific place of work which may be designated

as a place of work to enable the prospective borrowers to call upon them. The organization consists of one or two owners who themselves operate their own credit operation, they themselves are in control of all the lending arrangements, i.e. their employees (if any) have no authority to promise/disburse any loan to anybody and the physical transfer of the money itself is handled by the lender.

The credit operators are mostly operating as "one-man shows", and if there is a partner or associate then he usually is a close member of the family, i.e. father/brother/son. As such, these operators have no existing organisation worth mentioning.

Source of Funds:

The lenders have a number of sources of funds ranging from their own savings, relations' foreign remittances, black money, money borrowed from bank for some other business, capital diverted from other business seasonally, etc.

According to the borrowers (i.e. the brick-field owners) the source of fund of the lenders who give cash loan is mostly savings, and in some cases their profits from other business. In this case a specific example of such a lending operation may be mentioned. A certain brick-field owner who needed some cash funds just before the commencement of the brick making season approached some of his friends (who were mostly his college/school friends and are now serving as either private/government employees) suggesting them to invest in the brick making business on a short term basis. These "investors" would "buy" bricks in advance and "sell" at a later date at a higher price, thus they acted as a substitute/alternative to the whole-seller for the brick-field owner. The full operation of the deal was managed by the brick-field owner himself, i.e. the lenders had to do no work except count their profits. The owner got a better deal from his friends than he would have got from a whole-seller, whereas the lenders got a better deal than a bank fixed deposit. The lenders invested their personal savings in this deal, all

the lenders are in their late 20's or early 30's and are service holders but were interested to make a little extra money by investing in some "safe" business. Their personal relationship with the owner/borrower and the nature of the business itself convinced them to invest in this project. They are all satisfied with their profit margin and are waiting for the next season to start.

In the one or two cases of professional money-lenders the money is from some other business, this other business being of a seasonal nature or short-term trading type of business, thus when such funds are idle in their own business they may lend the same.

The source of money of the whole-sellers who buy the bricks in advance is their own business capital.

Uses of Funds:

In the brick-making sector the funds borrowed by the brick-field owners are naturally used for productive purposes. The borrowed funds are used to purchase raw materials, to pay the wages of the workforce, to pay for the fuel, and to pay for the cost of transportation of the bricks from the fields to the sales depot.

Collateral Security:

There is usually no collateral security involved in the lending/investing operations in the brick-making industry. The personal relationship between the lender and the borrower is the "corner stone" of most of the transactions, in those cases where they are unknown to each other then there is an intermediary who is a "common friend/acquaintance" to each of them and is trusted by both of them. But nevertheless there is some form of legal deed/agreement covering the terms and conditions of the specific transaction between the lender and borrower. Such a deed is common practice for transactions undertaken between the whole-seller and brick-field owner. The borrowers would prefer to go to a bank if they had to give any asset security to lenders.

Interest Charges:

Brick-fields are divided into sections, for example: 1 section, 2 sections, 3 sections, a single section can produce a maximum of about 22 to 23 lac bricks in a season. Though the minimum economical production is approximately 14 lack bricks most brick-fields have an average production of between 20 to 22 lac bricks per season. Depending upon the production one single section may require as much as 220 workers in a season. And the manufacturing season starts in the beginning of the dry season, August/September and continues until the coming of monsoon.

In order to operate a single section brickfield for a single season with a production of 22 lack bricks it requires 22 lac taka. In almost all the cases the full amount cannot be met by the operator alone and therefore credit facilities from both the formal and informal sectors are sought. But since the formal financial institutions are unable/unwilling to meet their full requirements of credit, informal financing has become a routine for the sector. But the brick-making informal financing operations have special characteristics of their own, for example the term "interest" is not used but the term "profit" is used because of socio-religious inhibitions. The predominant portion of the lending operation is handled by the wholesellers in the form of advance purchase of the bricks.

In this system the manufacturer receives money from the wholeseller as advance payment for bricks which he is to supply after a mutually agreed upon date at a mutually agreed upon price. The terms and conditions of this deal are noted down in an agreement/deed, for example if the market price of bricks at the time of signing the agreement is Taka 1100 per 1000 bricks the manufacturer may still agree to supply at the same price after six months when the market price will be more, possibly about Taka 1500 per 1000 bricks. So, if an advance of 1.1 lac taka is made at the beginning of the season and if the price has been fixed at Taka 1100 per 1000 bricks then the manufacturer will be bound to supply 1 lac bricks to the wholeseller at any time after the agreed upon date.

Normally the loan duration is for a minimum of 3/4 months, i.e. October to January/February. But this time the brick price (as in the case of 1987) may rise to Taka 1300 per 1000 bricks. So, the difference in price is Taka 200 per 1000 bricks, which is 18.18% in four months on the principal amount taken by the manufacturer. The manufacturer could have made an extra profit of 18.18% if he had used his own funds instead of selling the bricks in advance. If we consider this advance sale as a loan then the manufacturer has paid an interest of 18.18% in four months, which amounts to an annual interest rate of 54.54%.

But normally the wholesellers take delivery of the bricks in the month of March/April when the price of bricks, this year, was Taka 1450 per 1000 bricks. So the loss in profits for the manufacturer was Taka 350 per 1000 bricks. Similarly the interest turns out to be 31.8% for six months, i.e. 63.6% per annum. It should be noted however, some whole-sellers take delivery of the bricks even later when the price has risen to Taka 1600 to 1700 per 1000 bricks, average Taka 1650 per 1000 bricks, thus a price difference of approximately Taka 550 per 1000 bricks results in a profit loss or "interest" of 50% in eight months, which amounts to an annual interest rate of 75%.

It should be noted that under this system of advance sale the manufacturers prefer that the wholeseller take delivery of the bricks as late as possible because that enables the manufacturer to roll the funds a number of times in order to recover the cost of the funds.

Some cash loans are also taken by the brick-makers from their personally known friends or relatives. But the amount taken from each lender is usually not exceeding Taka 50,000/-. The duration is usually for 2-3 months. In some cases interest @ 2-6% per month is paid.

Only a very few cases of professional money-lenders are found in the Pagla-Munshikhola area. These people are actually involved

in brick manufacturing and whole-selling and use their surplus funds to loan out at an interest rate of 40% annually. They normally do not lend more than Taka 1 lac per brick-field.

In the Mirpur-Mohammadpur zone borrowing/lending of money on interest is much more prevalent than that of the Pagla-Munshikhola region. The professional money-lenders lend money at an interest rate of 20-30% per season, i.e. 6 months, which turns out to be an interest rate of 40-60% per annum. Of those brick-field owners interviewed at Mirpur-Mohammadpur, the majority borrowed from the professional money-lenders, i.e. almost all of them. The maximum amount that anyone of them had borrowed from a single money-lender was Taka 1 lac.

It should be noted that even after the payment of this high rate of interest the borrowers are still able to come out with a profit. The loan amounts usually range between Taka 50,000/- to Taka 100,000/-.

It was gathered that the money-lenders are of two main categories,

a) People who like to invest their savings but want a guaranteed return.

b) People who have excess funds and want to invest with a minimum amount of hassle, these people have strong backing, i.e. muscle power to recover the loans with force if necessary.

The main reason why the brick field owners at the Mirpur-Mohammadpur area borrow money from professional money-lenders is the absence of the advance sale/purchase of bricks on a wide scale, this is due to the fact that the quality of the bricks at Mirpur-Mohammadpur is not as good as that of Pagla-Munshikhola so there is less demand for them in the market.

Trends:

Unfortunately very little could be gathered about the past activities of the lenders or borrowers in the informal financial market. But what was basically gathered was that the lending operations in the past were much more widespread, i.e. the lenders were lending to more people because the borrowers used to properly pay up their debts whether in cash or kind, but a number of lenders have been cheated by the borrowers and as a result the lenders do not have the confidence or courage to lend as they used to do in the past. Even people who have been introduced by proper references have turned out to be defaulters, in the opinion of the lenders as well as borrowers due to the lowering of the moral standards of the people nobody is really considered trustworthy anymore.

Brick Wholesale Trade:

There are generally three types of wholesale establishments, such as follows:

1. Wholesale companies owned by brick manufacturers and dealing only in products manufactured by themselves.
2. General wholeseller, dealing in products of any manufacturer.
3. Retailer/Wholeseller.

The wholesale establishments not owned by the brick manufacturers are mainly of two types, depending upon the strength of their financial resources, such as follows:

i) those who sell on commission basis, have been classified as "retailer/wholeseller" and

ii) those who can afford to buy bricks in advance and also sell bricks on commission basis, have been classified as "General wholeseller".

Bank loans require collateral security which most of the wholesellers and retailers cannot provide, so very few of them are able to receive bank loans, but some wholesellers in the Pagla-Munshikhola area do receive bank loans.

The bigger wholesellers who buy bricks in advance generally take recourse to the informal financial market. 30% to 40% of the wholesellers interviewed purchased bricks in advance according to the system described earlier. And in most cases they borrow money from friends or relatives, at no interest if possible or if necessary at the market rate of interest of 2-6% per month.

In Pagla most wholesellers do not take money from the professional money-lenders but rather from relatives or friends. But in the Mirpur-Mohammadpur area some wholesellers do borrow from professional money-lenders at the high rate of interest. In most cases bricks are not supplied on credit to the contractors/end-users, but some contractors are given bricks on credit on the basis of their goodwill as well as against a confirmed work-order, in such cases the credit duration is between 1 to 2 weeks. Though the sellers claim that they do not charge extra for such a credit but the contractors claimed otherwise, i.e. there is an excess charge of 3-5%. The retailers who sell on commission basis get a credit from the manufacturers, the duration of which is not more than a few days.

CHAPTER THREE

The Steel Industry:

The steel manufacturing sector is an important part of the construction materials industry because steel used as reinforcement is a vital building component and because of the high cost of steel it represents a major share of the total cost component of the materials bill and therefore is a sector worth studying.

In Bangladesh, steel is mainly used in the construction industry in the form of rods or bars as a re-infrocing in-fill material in re-inforced cement concrete, it is also used in the form of grills for windocs/doors etc. Some steel is also used in the form of extruded angles for use in trusses in industrial builddings, corrugated iron sheets or galvanized iron sheets are also used as a roofing material in many types of building construction. But in our study we have restricted ourselves mainly to investigating the steel re-inforcement industry and its wholesale trade.

Size of the Market:

Most of the steel re-rolling mills, which produce rods/bars for re-inforcement, are situated at Tejgaon, Pagla, Fatullah, Syampur, Mirpur and Tongi in Dhaka, a number of mills are also located at Chittagong. It is estimated that there are about 200 re-rolling mills in the country but not all of them are necessarily operating at full capacity, as such it is estimated that the annual production of these mills ranges within Taka 300 to Taka 400 crore worth of goods.

The linkage between the steel re-rolling mills and the formal financial institutions is much stronger than that existing between the brick-fileds and the formal financial institutions, due to the fact that many of the steel re-rolling mills were initially set up

STEEL TRADE DISTRIBUTION NETWORK:

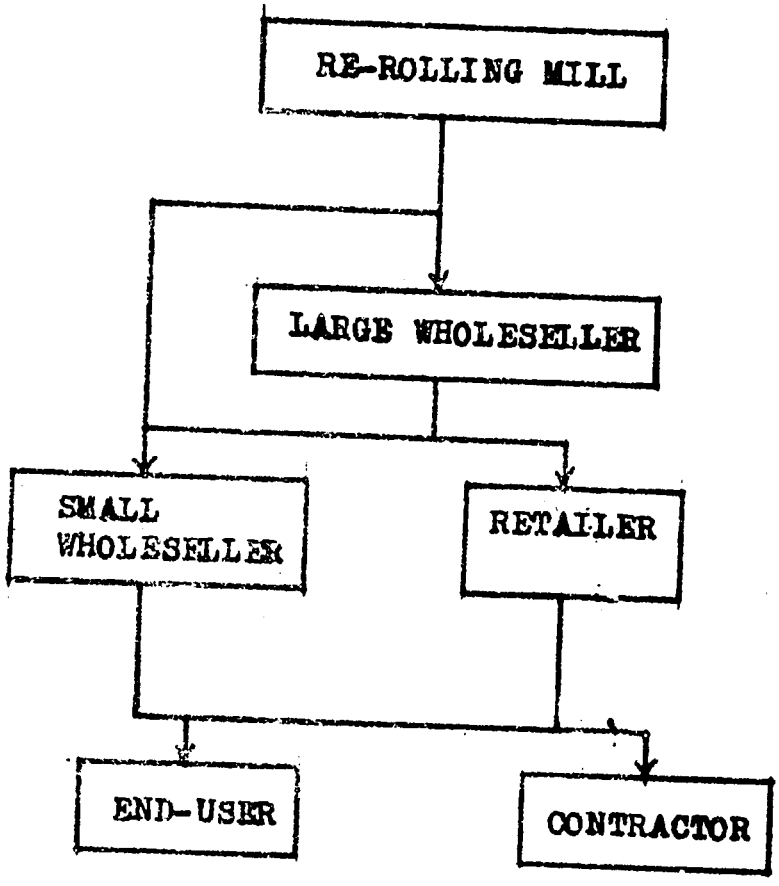

Diagram - III

with financial assistance from such institutions. The re-rolling mills are also involved with the importation of steel scrap as a raw material either directly or indirectly through the shipbreakers and importers & traders. As such they are much better connected with the formal institutions, which gives them better access to the facilities provided by Banks/etc.

But inspite of their better access they still need funds from the informal financial market because the banks only finance them upto a certain point. It is estimated that the re-rolling mills borrow funds to the extent of 15% of the value of their total production, which is a substantial amount. Here again, just as in the brick-making industry, advance purchase of steel rods/bars by the wholesellers from the producers constitutes the major form of informal finance extended to the re-rolling mills.

In most cases, 90% of those studied, they sell their products in advance to the wholesellers, the sale in advance represents between 5% to 20% of the value of their total production. The average general advance sale in a typical case varies between 10% to 15% of the production of the mill.

Nature of Credit Operation:

The organisation of the credit market, involved in financing the re-rolling mills informally, is not at all organised in any systematic manner, that is to say that there are no "identifiable institutions" which can be classified as informal financial institutions which may be approached by the borrowers in times of need. In other words the informal financial market as it exists is a loosely knit network of wholesellers who do not consider themselves to be involved in the "lending" business but in the "wholeselling" business, just as was observed in the brick-making industry.

The re-rolling mills receive the advance payment from the wholeseller 2 months before the date of delivery of the goods. For this

advance payment the buyer receives a price advantage or discount, i.e. for example this year in April when the wholesale market price of rod was Taka 13,200/- per metric ton, the wholesellers who had paid in advance were taking delivery @Tk. 11,950/- per metric ton. Such a price difference represents a difference of 10.46% for a duration of two months, when calculated as a loan the monthly interest turns out to 5.23%. Again it must be emphasized that the "lenders" and "borrowers" both refrain from using the term "interest payment" in the above mentioned transaction.

Thus if the mill owner, instead of selling his product in advance, sold his product after manufacturing then he would have made an extra profit of 10.46%. The mill owners have to sell the rods in advance because of a shortage of operating funds. All the mill owners interviewed expressed their desire not to sell their products in advance and would prefer to sell from ready stock in order to get a better profit margin. Even if we assume an annual volume of 10% of advance sale by the mills, the financial value of such transactions may be valued at about Taka 30 crores.

The level of sophistication is almost the same as that of the informal financial market related to the brick manufacturing industry.

Market Segmentation:

The credit market as it exists vis-a-vis the re-rolling industry is not segmented in terms of political groupings, the relationships between the wholesellers, in this case termed as "lenders" and the re-rolling mill owners is a purely business relationship. The fact that these re-rolling mills are owned by well established businessmen who may have their factory located at Tongi and may have their residence at Dhanmondi and whereas the wholeseller may have his business establishment at Karwan Bazar results in a situation where they (i.e. both the "lender" and the "borrower") have no chance of getting any political gains. The size of the transactions itself is a deterrent

to political biases in such business deals. Whatever relations the lenders and borrowers may have with each are in most cases a direct result of the quality of their transactions.

Identification of Lenders:

All those people who purchase in advance from the re-rolling mills are definitely traders and shopkeepers who are directly connected to the business of supplying steel rods/bars/angles to the market on a wholesale or retail basis. The source of funds of these wholesellers can be from a number of alternative sources besides their own capital.

Categories of Borrowers:

In the opinion of the wholesellers who purchase goods from the mills through advance payments there is no categorisation of the borrowers in any definite form, but rather they prefer to deal more with those mills which keep their commitments regarding the delivery dates as well as maintain the proper quality of their products. Thus the wholeseller would prefer to avoid paying too much advance money to a certain mill while he might be prepared to make an advance payment of twice as much to another mill. Naturally the grading of the mills would vary from wholeseller to wholeseller depending on the nature of experience each wholeseller has with any individual mill, so while one mill may be considered as a "very reliable" mill, another wholeseller may consider that same mill as a "moderately reliable" mill.

Nature of Relationship:

The nature of relationship that exists in general between the various wholesellers and the mill-owners is basically a purely business relationship. But there are two types of relationships, one

in which the wholeseller is the "dominant" party and another in which the mill-owner is the "dominant" party. The large wholesellers are the ones who are usually the dominant party in the transactions between the two sides, whereas the small whole-sellers are dominated by the mill-owners even if they are making advance purchases, in other words this relationship is based on the economic strength of one party in relation to his counterpart.

Sources of Funds:

The cash lending in the steel market is rather uncommon, there were very few reported cases where cash was taken, and even then in those cases the amount did not exceed Taka 1 lac. Of those wholesellers interviewed only about 10% admitted to having borrowed in cash, the rate of interest for such loans averaged about 5% per month. Thus the yearly interest rate turns out to be about 60%, which is quite high. Interestingly enough these loans were taken from business associates and friends for periods not exceeding 2 months duration. The borrowers did not classify the lenders as professional money-lenders because they had lent only in order to "help them, yet without losing their own revenue".

The large wholesellers who can place collateral security with the banks can receive Banks loans, loans are also given on the hypothecations of goods (60% maximum) and on mortgaging of land. Of the cases studied, 70% of the rod/steel dealers were taking loans from a Bank.

The large wholesellers also provide some credit to the smaller wholesellers and retailers as well as to the contractors. The credit provided to the small wholesellers/retailers by them is for a short duration of maximum 7 days and with a small difference in price.

As for to the question whether funds are flowing out of any particular activity to the re-rolling mill industry or rod/steel

wholesale trade, then one must note that as already mentioned some of the borrowers have borrowed from business associates; these business associates would lend to them only because their own business was passing through a "dull" period on account of which they could afford to lend, thus there definitely has been a flow from a less profitable sector to a more profitable sector even if it were temporary.

Uses of Funds:

The credit which the mill-owners receive from the wholesellers is used for productive purposes, such procurement of raw-materials/ etc.

Collateral Security:

There is no system of collateral security for the advance payments, the mills provide a receipt for any payments made, both sides have enough fath in each other.

Level & Structure of Interest Charges:

In the case of advance pruchase the buyer is getting a price advantage of between Taka 100 to Taka 1500 per ton i.e. an average price reduction of say Taka 1250 per ton.

The present market rate being Taka 13,200 per ton, thus resulting in a price difference of 10.46% just for having paid two months in advance. We may calculate this as an interest rate of 5.23% per month, i.e. 62.76% per annum.

The Whole-sale Trade:

Just as there are big whole-sellers with enough capital to pay in advance for their purchasers, there are some big re-rolling mills

which can afford to give credit to the wholesellers. Some of the re-rolling mills studied did provide some credit facility to the wholesellers because they had an excess of ready stock and because selling on credit was more profitable. Normally in a typical case the rods are sold on credit to the wholeseller by the mill owner for a period of 2 to 3 days. There is a price difference of Taka 50 to Taka 200 per ton, depending on the duration and business standing.

In terms of percentage the price difference varies between 0.38% and 1.5%, this difference is due to the credit for 2 or 3 days, which is approximately 15% interest per month, i.e. 160% interest per annum.

It is understood that about 50% of the larger mills provide such short term credits for about 5 to 10 per cent of their total sales. The credit provided to the small wholesellers and retailers by the large wholesellers is for a maximum of 7 days, and with a price increase of Taka 50 to 200 per ton.

Sometimes a wholeseller or retailer may take some goods on credit from a neighbouring trader if he does not have his own ready stock, for such credits there is hardly any price difference and the duration may be of 1 or 2 days. This is done in the interest of good neighbourly relations and on a reciprocal basis.

The small rod retailers and whole-sellers cannot afford to give credit but in some cases they do provide credit to well known customers for a short duration. The quantity of goods given on credit is small and the price difference is very negligible.

CHAPTER FOUR

The Cement Trade:

Cement is a very important raw material for the construction industry, but Bangladesh still has to import more than 50% of its requirements from foreign suppliers, because there are only two cement plants in Bangladesh, namely the Chattak Cement Plant and the Chittagong Clinker Grinding Factory. The total production of these two plants, both of which are owned by the Bangladesh Chemical Industries Corporation (BCIC) and 100% owned by the government, have never exceeded a total of 250,000 tons per annum.

Imports have arrived from a number of countries, namely South Korea, North Korea, Taiwan, Indonesia, Malaysia, Thailand, Phillipines, Burma, Turkey, Iran, and Bulgaria. Some special types of cement have also been imported from Japan.

It is estimated that Bangladesh imports about 850,000 metric tons of ordinary grey portland cement per annum. Since the average C&F Chittagong/Chalna cost per ton of cement is about US $ 40 this represents a substantial drain in foreign exchange for Bangladesh.

The domestic demand for cement is high enough to enable the local producers to sell their full production without giving any kind of credit facility to any dealer, as a matter of fact sales are made by means of permits which can be sold at a premium in the open market. Whatever credit exists in the trading of the local products is limited to the traders and their regular buyers.

The trade of the imported cement is handled in a totally different system right from the beginning of the import process. The import trade is controlled by 5 large private importers and the Trading Corporation of Bangladesh (TCB). Among the 5 private importers, one party is importing about 50% of the total quantity imported by

CEMENT TRADE DISTRIBUTION NETWORK:

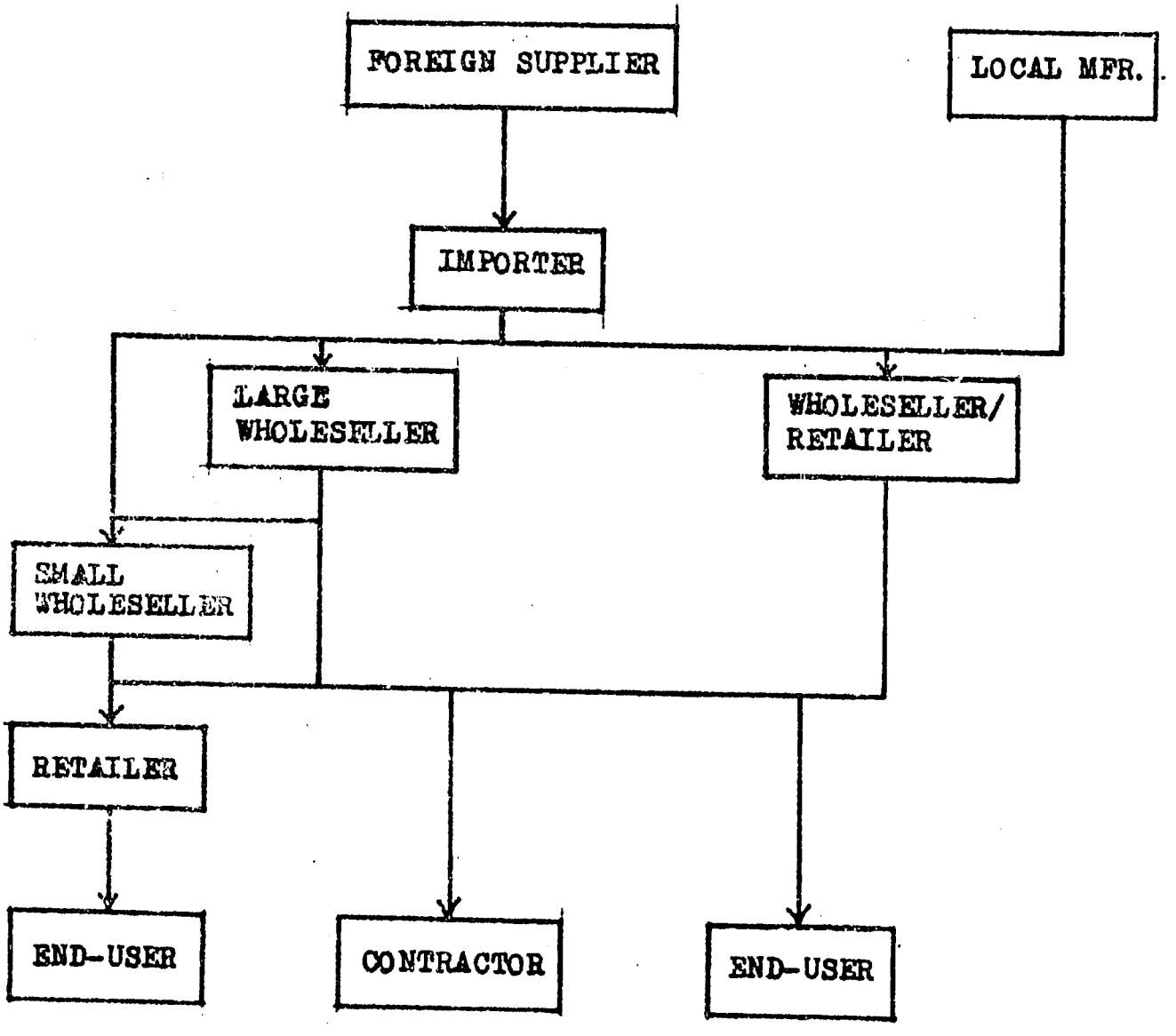

Diagram - IV

all the private importers. This party is dominating the cement import and wholesale trade, especially in the western part of the country as their imports are mostly coming in through Chalna. The remaining four parties are mostly importing through the port of Chittagong and their marketing efforts are mostly concentrated in the eastern part of the country.

The imports of all the five parties are heavily financed by the various banks, both private and government owned banks, as a matter of fact in most cases they are opening letters of credit with a margin of only between 10% to 15%. These importers have however restricted their activities to only importing the goods, or at the most delivery to a few selected large wholesellers/distributors located in key places of the country. These wholesellers and distributors are financially very strong parties, and are financing the importers for clearing the goods from the port for onward distribution. In order to get a clearer picture of the trade please see the diagram depicting the chain from importer to end-user.

In some cases the bank is even financing the clearing of the goods from the port by the importer and thus allowing him to sell the goods to the large wholesellers without taking any advance from them for the purpose of clearing the goods from the port, this facility from the bank allows the importer to make a higher profit.

It is estimated that the importation cost of cement @US$40 per metric ton on C&F Chittagong or Chalna Port basis adds upto a total of about Taka 1,122 million per annum, a market with a size which is a good enough reason to make each importer try to jealously guard his share of the market.

Market Segmentation:

The importer who imports about 50% of the total imports entered cement business about eight years ago in a relatively small way but

gradually succeeded in increasing his share of the market when this importer entered the cement trade no single party was dominating the market and as such the end-users as well as the wholesellers had no specific brand loyalty, importers were importing from the cheapest foreign sources and the endusers were buying whatever was cheapest in the local market. But this importer made a systematic effort to increase his share of the market by entering into those aspects of the trade where the importers were traditionally not involved, for example his own set of lighterage vessel owners was patronised, i.e. vessel owners loyal to him were favoured with regular carrying business from him and so they were expected not to offer their best cooperation to rival importers in terms of carrying charges as well as vessel availability. This importer has also purchased some cargo coasters for inland transportation and is presently in such a dominating position that the vesel owners can be dictated not to carry the cargo of a rival importer unless they are ready to lose their regular business with him. Such obstructions make it very difficult for any new importer to enter the market without losing money. This importer has also developed his own group of wholesellers and distributors whose loyalty is with him and his brand name, this was achieved by initially providing them with goods on credit in order to eliminate his competitors. It was gathered that last year he was owed taka 150 million by his various wholesellers and distributors, this year he has been successful in reducing this credit in the market to about Taka 7.2 million. He had offered his goods for sale on credit to his wholesellers and distributors and succeeded in virtually eliminating his competitors, because of the credit facilities offered by him most of the wholesellers and distributors bought from him and stopped or drastically reduced their business connections with the other importers. He did not offer such credit facilities to wholesellers who also stocked the products of rival companies. Once his competitors were eliminated he gradually started to reduce his credit sales, but by this the brand name of his product became well established in the market and goodwill with

the end-users was strong enough to force the wholesellers and distributors to purchase from him against cash payments and in many cases even through advance payment.

The credit which this importer was giving to his buyers was done by using the funds from the bank. It seems this importer has a bank account with almost every bank in Dhaka and has maintained excellent business relations with each of them in the name of his numerous subsidiary or associated companies enabling him to even pay off the dues of the bank with funds borrowed from another bank.

The other importers also have similar working relationships with their bankers and over the years have gained the trust of their bankers. One such importer has about taka two crores in payment due to him from his cement wholesellers and distributors, these funds have been borrowed from his banker.

Identification of Lenders:

The importers are also financed by the large wholesellers, in some cases, to clear their goods from the port. The group of wholesellers may buy the whole shipload of cargo from the importer at the port (Chalna or Chittagong) at a special price or individual wholesellers may buy certain quantities at certain inland river ports at a slightly higher price.

The big wholesellers are not the only ones to sell on credit, the smaller wholesellers and dealers also sell on credit to their regular buyers such as retailers and contractors. Naturally, as already seen in the other trades these transactions are based on mutual trust due to long-standing relationships.

Categories of Borrowers:

In the cement trade there is a definite categorisation of borrowers, in terms of loyalty of the borrower to the product brandname.

For example, in the case of the "INDOCEMENT" brand of cement imported from Indonesia by the local sole agent and distributed through their own associated distribution company there is a definite categorisation of borrowers, i.e. dealers who are provided with cement on short term credit. In such cases the lenders are more concerned about the long-term credit. In such cases the lenders are more concerned about the long-term goal of protecting their share of the market rather than only making a higher profit. So the "Indocement" sole agent/distributors have developed strong personal and business relationships with a number of wholesellers and dealers on whom they can rely for protection of their share of the market and accordingly these parties are treated as members of their "inner circle".

Nature of Relationship:

The existing relationships in the cement trade are dependent on a number of aspects of the business, namely the brand loyalty, timely repayment of credits and mutual trust. Since the importer/sole agent of any brand of cement is usually given a sales/import target by his foreign supplier which he must fulfill in order to protect his exclusive business relation with the foreign supplier he must open letters of credit at regular intervals. Since there are usually small export price differences of the different foreign suppliers each importer must have a marketing/distribution net work strong enough to resist the pressure from a rival lower priced cement brand. A revolving line of credit with some wholesellers and distributors is one way of tying their hands to the importer's products/specific brand.

Nature of Credit Operations:

The whole system of credit which the importer/large wholesellers operate together is quite well organized, unlike the rod/brick trade, the reason being the strong linkages with the formal financial sec-

tor which has forced them to keep in line with the banks financing them for their letters of credit, etc.

These wholesellers have their own marketing network and have also been supplying cement on credit to their downstream dealers. They are financially quite strong and have amassed large sums of capital through the years and are a key factor in the cement business. The main importers have their own group of such big wholesellers, and both sides maintain relationships faithful to each other for their mutual benefits.

Sources of Funds:

In the cement trade there is a two way flow of funds, on one end from the retailer to the top of the distribution pyramid and on the other end from the importer downwards to the various retailers. Due to their excellent relations with the formal financial institutions the importers are able to borrow in large amounts, they are also able to offer credit to their wholesellers and distributors for short durations with these funds. The importers are supposed to have the financial resources to pay the L/C margin to the banks prior to opening any letter of credit, usually between 10% to 15%. of the L/C value. But whenever the importer does not have sufficient funds of his own for paying the L/C margin he can and may borrow from the large wholeseller. In such cases the wholesellers shall pay in advance for the cement for which the L/C has not as yet been opened, for such a favor the importer will offer the wholeseller a price advantage. Most of the wholesellers have large amounts of capital of their own but they are also receiving advance payments from the smaller wholesellers/dealers/retailers.

Uses of Funds:

As is already evident from the above-given description the funds available to the cement traders is not used for any productive purpo-

ses, even when the purchases are made from the local industries. Funds borrowed informally are used to pay import duties, taxes, labour charges and transportation charges.

Level & Structure of Interest Charges:

Just as in the other trades the system of advance purchases or sales on deferred payment are considered to be a justified method of conducting business and are not in any way considered to be lending or borrowing with interest. But nevertheless there is a hidden interest charge for such transactions. For example when an importer takes an advance payment from a wholeseller, he may have to cede about Taka 2 or 3 per bag of cement, which means a reduction of between 2.2% to 3.3% but in terms of loss of profit to the importer may be calculated as a loss of 50% of the profits.

If an importer opens an L/C for 10,000 metric tons of cement on C&F Chalna Port basis at the rate of US$ 40 per ton then with an L/C margin of 15% he would be investing about Taka 1,12,20,000/- of the bank's money and about Taka 19,80,000/- of his own money. Now since 10,000 metric tons means 200,000 bags of cement, therefore a reduction of Taka 2/- per bag would mean a revenue loss of Taka 400,000/- for the importer who would have made a profit of about Taka 10,00,000/- had he not taken any advance payment. Thus we can see that for the borrower it means a loss of profit from anything between 40% to 60% for taking such advance payments.

Since the import segment of the cement trade is supposed to be the most profitable part of the trade and importers prefer not to reduce their share of investment and profits by avoiding as much as possible the involvement of other partners in it.

The price increases/reductions that a party may have on account of credit facilities taken/given are also quite common in the downstream portions of the cement distribution business. Prices

may differ by about 1% to 3% in the retail and small dealership level. Of the dealers and shopowners studied about 26% received bank loans, an equivalent percent of them used only their own capital.

25% of those who take bank loans also have borrowed from informal sources, and about 50% of these borrowings were with some interest. In none of the cases was there any requirement for collateral security. The loan durations were usually for less than one month.

Almost 90% of the retail and small dealer type of shopowners sell on credit and in more than 50% of the cases where they sold on credit they charged a higher price. The difference in price ranges from between 1 to 3 percent.

The shopowners usually prefer to do business on cash payments but they still have to give the goods on credit to some of their acquaintances whom they can trust for payments on the promised dates. They also have to give credit to contractors because this helps them to have a regular customer, because most people do not build more than one home for themselves but the contractors will keep on coming to them for their supplies if they can satisfy them with certain facilities such as deferred payment. The credit to the contractors usually ranges for payments dealyed from one month to three months. Some contractors also delay payment of their dues for more than three months, the traders try to avoid such contractors.

The basic idea behind the supply of goods on credit is that if a buyer is given some credit then he will come back to his supplier, pay back his dues and again take some goods on credit. Normally partial payment for the goods has to be made before lifting of the goods from the suppliers premises, the cost of transportation of the goods is also the responsibility of the buyer. Now-a-days the suppliers are very cautious in giving goods on credit because almost all of them have some "bad borrowers" who have not paid up their dues even after one year from the due date of repayment.

CHAPTER FIVE

The Sand/Stone Trade:

The trading of stone and sand is mostly done in cash. In some cases delayed payment is made against a work order, the delay may be for a period of 1-2 weeks. Generally no extra charge is made for such a credit, mainly due to the existing good-will between the two parties.

On the other hand the traders at Pagla get credit facilities from the wholesale suppliers of Sylhet, provided there is a long-standing business relationship between the two parties. For such deferred payments the buyer has to pay in cash for 50% of the goods and pay the remaining 50% at a later date, the price for such procurements is higher than that for cash purchases. The credit duration is usually for a period of one month.

The price sur-charge for deferred payments is usually in the range of 5 to 8%, this increased rate on the normal price is fixed and there is no further interest charge if the buyer delays his payment by more than one month but he will loose his good-will with the supplier and may not receive credit so easily in the future.

Most of the good quality sand and stones come from the Sylhet area but sand and stones are also available in the Dinajpur area but those stones and sand do not come to the Dhaka area because of the high cost of transportation.

The transactions in the sand/stone business are also undertaken normally without any collateral security.

CHAPTER SIX

The Contracting Business:

A contractor is a person engaged in the business of constructing or repairing any building, road, factory, dam, etc. or almost anything for somebody else. For this service the contractor is paid a certain portion of the cost of construction in the form of a profit. There are literally hundreds of contractors in Bangladesh spread all over the country, it is virtually impossible to know the exact number because almost everyday some contractor is going out of business and new contractors are also coming up as well. Anyhow it is one of the most important businesses in the country and provides job opportunities to thousands of people.

Most of the contractors are working for the government and its numerous agencies. In order to work for any government organisation the contractor must be enlisted with that organisation or certain other government organisations which permits them to work for the said organisation. The government agencies have categorised the contractors into three broad classes, namely Ist/2nd/3rd Class Contractors. This classification denotes the quality and size of work which a contractor may be permitted to undertake.

The nature of the contracting business is such that almost all contractors must borrow money in order to continue their business. The large contractors are able to meet their full financial requirements fromt the formal financial institutions as well as from their own capital resources. But the smaller contractors usually are unable to receive their full requirements from the banks because they do not have sufficient assets to offer as collateral security for receiving loans and also do not have sufficient cash of their own, thus they have to search out alternative sources of finance in order to survive in this business. They mostly try to procure construction materials and services on deferred payment.

Of the cases studies, all of them procure construction materials on credit. The maximum duration of credit in 50% of the cases was one month and for the rest it was between one and a half month to three months. There is no viable interest charge for procurements on deferred payment, i.e. there is no interest like on a loan from a formal financial institution, for example if a contractor purchases an items on deferred payment and if his payment is due on the Ist of July and if he does not pay until the Ist of August then there is no extra payment to be made by him, had he borrowed from a bank he would be paying an additional amount of interest for one month. But the procurements which the contractors make on deferred payment basis are costlier than those made against cash payments, i.e. the seller charges extra for selling on credit. Usually there is a price difference of Taka 1 or 2 per every hundred taka, i.e. 1% to 2%.

About 60% of the contractors admitted receiving bank loans for their construction project, but then half of these same contractors also said that they still borrow from informal sources as well. In those cases where the borrowings were in cash such borrowings had an interest charge ranging from 2 to 6% per month unless the funds were lent by a close friend or relative without any interest. Very few of the contractors had to borrow from any so-called professional money-lenders. This is because the high rate of interest does not make it financially viable to borrow for periods of 2 or 3 months, the contractors profit margins hardly exceed 20% of the project cost. Money is taken from such money lenders at high interest rates in cases of extreme crisis when other sources of finance are exhausted.

In order to execute a construction contract the contractor needs at least 20% of the estimated cost of the project as working capital if he is to receive "running bill" payments from his client. In those cases where the contractor will receive payment only after completely fulfilling his contract the contractor will need working capital equal to the project cost minus his profit.

Quite often even when the contractor receives a running bill he still cannot collect sufficient working capital to start the work, then he has to borrow. Large contractors have enough finance of their own and can also get a loan from a bank.

The large contractors buy steel rods against cash, since their monthly requirements are quite often as high as one third of a re-rolling mill's monthly production, i.e. in a construction work with an estimated cost of 2 crore the monthly requirement of steel re-inforcement is about 60 tons and an average mill produces about 200 tons per month. So he can easily consume one third of a mill's production and can thereby also control the rod market in the zone where he is working. For cement procurements the large contractors maintain half-yearly or yearly rolling credit facilities. The price of the cement is fixed for the contract period and usually has a credit duration of two weeks, i.e. the supplier is paid his bill by the contractor every two weeks. The large contractors buy bricks in advance in order to get a price advantage, but they are unable to dominate the brick market in Dhaka because the brick-fields in Dhaka are controlled by the wholesellers, the wholesellers in Dhaka have enough capital to control the market.

Anyhow there are numerous problems faced by the contractors in the execution of their projects, especially by the smaller contractors. Delays in payment of the work bill to the contractor causes serious problems because such delays disrupt the line of credit and also causes a loss of good-will of the contractor with his suppliers.

Nowadays there are numerous private sector clients who are in need of the services of contractors for construction of their various projects, which have become more complex and larger in size thereby making it difficult for themselves to construct.

The contractors who work for private sector clients are careful enough not extend credit facilities to them because of the risks involved because of the insecurity of payment of the bills. In these cases mostly the client supplies all the construction materials to the contractor and the contractor bills the client for labour/services on a weekly basis, under this system very little of the contractor's money is blocked in the project.

Another type of contractor is the contractor/developer, who is a relatively newcomer in Bangladesh. These are mostly those people/firms who are constructing housing for sale to the general public. They themselves are undertaking the construction in order to maximize their profits, profits which would have been taken away by an external contractor.

CHAPTER SEVEN

The Urban Housing Situation in Bangladesh:

In this chapter an attempt has been made to shed some light on the urban housing situation in Bangladesh in terms of its historical development as well as past/present and future housing needs.

Historical Development of Urban Housing:

It has been stated both in the Two Year Plan and in The First Five Year Plan that the housing situation in Bangladesh has never been satisfactory. The majority of dwellings are substandard, unsafe and over-crowded and ancillary physical, social and economical facilities and services essential for the development of healthy and harmonious community life are highly inadequate.

The past patterns of community housing development in the urban areas were largely concentrated on providing housing plots and community facilities to upper income groups and houses for the public servants. The exception was a special programme for the refugees. In the private sector, profit being the chief motivation factor, it was always more profitable to build houses for the upper-income groups. As a result there exists a large backlog of low and middle income group housing.

Till the late 50's urban housing in the public sector consisted only of public servants housing and some plot development in Dhaka city (Dhanmondi area) under the then C&W Department. In 1958 a special Housing and Settlement Wing was created under the same department to cater for planned settlements of the refugees. A Statutory Improvement Trust, i.e. EIT, was created in 1953, in the housing sector, which was concerned primarily with the development of land for re-sale and improvement by private interest. In 1952, Government set up a House Building Finance Corporation with power to make direct mortgage loans to homeowners. In 1978, the Housing & Settle-

ment Wing of the Buildings Directorate was elevated to a full-fledged Directorate. Except for the upper income groups, virtually no housing programme had been executed until very recently.

Housing Need/Backlog:

If the present growth rate continues, then by 1989 the urban population of the country will be double that of 1974. This will require construction of 10 lakh new dwellings - on an average 67 thousand dwelling units per year in addition to make up the existing backlog.

The housing situation in the urban areas is not at all satisfactory. The situation is deteriorating due to the rapid influx of rural migrants to the metropolitan areas and large cities.

The estimated requirement of Housing and Housing Backlog in the Municipalities at Dhaka, Chittagong, Khulna and Narayanganj in the year 1974 are shown in the table below:

Table 7.1

Municipalities	Total population	Total No. of Residences	Estimated required houses	Backlog of Houses
Dhaka	13,10,976	1,71,301	2,18,496	47,195
Chittagong	4,16,733	64,848	69,455	4,607
Khulna	4,37,304	63,384	72,884	9,500
Narayanganj	1,76,495	28,963	29,441	478

Sources:
1. Govt. of Bangladesh: Bangladesh Population Census.
2. Office of the Census Commission, Mimeo, 1974.
3. Chaudhury R.H. et al: "Management of Migrants to Urban Regional of Bangladesh" in National Report on Human Settlements, Bangladesh, 1976.

There is a pressing need for housing in Dhaka city both for filling up the past backlog and for present and future requirements.

A recent study by a British Consultant shows the future housing need in Dhaka city as below:

Table 7.2

Year	Housing need	Average need per year
1980-1985	210,000	42,000
1985-1990	245,000	49,000
1990-2000	574,000	57,000

Source: Shankland Cox Partnership. (S.C. Partnership) DMAIUDP. Vol. II Page 137.

As compared to the '74 backlog the present need has increased to 245,000 households, and so far very little consideration has been given to this by the Government. The national resources are currently being used to provide high standard housing for a smaller cross-section of the population instead of directing it for the benefit of the broad majority of the population.

Table 7.3

Housing need in Bangladesh, and its annual rate of increase (1980 - 2000)

Year	Number of houses needed	Rate of increase in percent
1980	1,72,67,999	-
1985	2,01,28,433	3.05
1990	2,28,87,978	2.57
1995	2,58,80,026	2.45
2000	2,92,43,904	2.44

Source: Final year thesis report entitled "Dhakar Grihayoner Sthanik Binnasher Upor Griha Nirman Rin Dan Sangsthar Probhab; 1977-1982" submitted by Asma Khatun to Geography Department, Jahangirnagar University in April 1985.

CHAPTER EIGHT

Housing Finance Institutions:

The housing finance institutions in Bangladesh are an important source of funds in the formal financial sector for the construction of urban dwellings, as such a brief outline of these institutions has been given below.

House Building Finance Corporation:

The Bangladesh House Building Finance Corporation (HBFC) was set-up under the Presidential Order No. 7 of 1973 after repealing the House Building Finance Corporation Act XVIII of 1952. The main affairs of the Corporation are managed by a Board of Directors consisting of six members including the Chairman appointed by the Government. HBFC is under the jurisdiction of the Ministry of Finance. It is the only institution of its kind to provide financial assistance to individuals for the construction of residential houses and appartments in the cities, towns and upazilla head-quarters. The Authorised Capital of the Corporation is Tk. 10.00 crores and Paid Up Capital is Tk. 9.83 crores which has been subscribed by the Government. The main source of its working capital is the sale of debentures to Bangladesh Bank, Bima Corporation and Nationalised Banks. Upto June 30, 1984 it has procured a total sum of Taka 5.25 billions through the sale of debentures.

The Corporation provides house building finance under two different programmes, namely (a) the General Loan Programme and (b) the Multi-storied Loan Programme.

General Loan Programme:

Under this programme, loans are extended for the construction of self contained single unit houses. Initially, the limit of the loan under this programme was Taka 2.55 lakhs. The loan was to be

repaid over a maximum period of 20 years. The margin of investment required to be made by an applicant was 15% of the estimated cost of construction. From April 1983, the limit of the loan under this programme has been increased to Tk. 6.00 lakhs. The rate of interest is 13% per annum upto Tk. 4.00 lakhs and 16% per annum for the additional Tk. 2.00 lakhs with a repayment period of 25 years. The margin of investment has also been reduced to 10% instead of 15%.

Multi-storied Loan Programme:

This programme was started in 1977. The objective being to increase the investment in multi-storied multi-unit buildings to ease the acute housing problem in the urban areas. The loan limits in 1982 were Tk. 6.47 lakhs for 100 square feet and 5.60 lakhs for 800 square feet in each floor (excluding stair-case and balcony) for four-storeid buildings. The loan repayment period was 25 years, with a rate of interest of 10.50%. The margin of investment required was 10% and 2.5% for buildings with floor areas of 1000 square feet and 800 square feet respectively in each floor. Now the maximum repayment period has been revised from 25 years to 30 years. The rate of interest and the margin of investment required remain the same.

The beneficiaries under this programme are private individuals. These individuals include housing developers. Even housing societies borrow in the individual names of members. A developer who wishes to sell the flats constructed can apply for permission to HBFC to transfer the liability to the buyers of the flats. HBFC after examining the capabilities of the buyers may approve the transfer of the mortgaged property to the buyers. Transfer fees are borne by the buyers and transfer is made to the buyers with equal rights over vacant land and space. The septic tank, overhead tank and staircase will remain common and repair and renovation as and when necessary for the common benefit shall be done jointly by all the purchasers. The buyer agrees to repay the proportionate loan due from the seller

to the corporation with the stipulated interest rate. The monthly instalment payable from the proportionate liability transferred will be proportionate to the share of the original instalment.

Suppose the monthly instalment due on a four-storied building is Tk. 4000 and the flats have been sold to four buyers, the monthly instalment due drom each buyer will be Tk. 1000.

Besides the above two categories, the corporation provides loans at a concessional rate of interest of 5% in rural areas for both single and multi-storied apartment houses. The repayment period is 25 years for single storied and 30 years for multi-storied buildings.

The loans under all programmes are secured by the mortgage of land and the proposed building. For this purpose the legal title required is 20 years clear title. In addition to absolute ownership, leased land is also accepted. In the case of leased land, there should be a minimum of 25 years lease.

The Corporation does not grant loans for the purchase of land nor does it grant loans for the purchase of house except in cases where the property is already under mortgage to the institution in which case transfer of liabilities may be allowed.

Applications for loans are dealt with in order of receipt. On this basis it takes about one year, sometimes even more, for an application to be taken up for processing.

The performance of the corporation in the form of loan applications received, loan cases sanctioned, amount involved, amount recovered, percentage of recovery etc. for the years 1981-82 to 1982-83 is given in the Table below:

Table 8.1

Figures in lakh takas

Year	No.of loan application received	No.of loan cases sanctioned	Amount sanctioned	Amount disbursed
(1)	(2)	(3)	(4)	(5)
1981-1982	2753	1939	4845.52	4716.53
1982-1983	2986	2499	7894.84	5782.11

Amount recoverable	Amount recovered	Percentage of recovery	Net profit
(6)	(7)	(8)	(9)
46,10.48	1785.98	38.74	5,91.15
58,88.18	1895.03	32.18	3,49.56

Source: Report of the Martial Law Committee on Organization set up-1984.

Approximately 2500 cases are handled per year. Upto 30 June 1984 the Corporation has sanctioned Taka 6.75 crores with a total disbursement of Taka 5.15 crores, cateogry-wise loaning operation is shown in the Table below:

Table 8.2

Amount in crore taka

Category of loan	No. of cases	Amount of loan sanctioned	Amount of loan disbursed	Housing units
Single Unit House	27,162	288	240	29,346
Multi-storied apartments	6,273	360	265	27,586
Concessional rate (5%) (both single & multi)	918	27	10	1,264
Total	**34,353**	**675**	**515**	**58,196**

Source: Brochure on "Development Finance Institutions in Bangladesh" 1985.

Nationalised Commercial Banks:

The banking system consists of

i) Nationalised Banks
ii) Private Commercial Banks and
iii) Foreign Commercial Banks

The nationalised banks operating are:

(a) Commercial Banks

1. Agrani Bank
2. Janata Bank
3. Rupali Bank
4. Sonali Bank

(b) Specialised Banks

1. Bangladesh Krishi Bank
2. Bangladesh Shilpa Bank

There are ten Private Commercial Banks including Uttara Bank and Pubali Bank which were recently transferred to the Private Sector and eight Foreign Commercial Banks.

The Nationalised Banks are not involved in loaning to the housing sector. Their main interest as Commercial Banks is in turning their available resources several times over in the short-term for trade and commerce for quick profit.

For advances for construction of residential buildings the current directives from the Bangladesh Bank for the Commercial Banks, effective from August 1984 allow upto Tk. 5.00 lakhs per party (including cost of land) minus any loan taken from HBFC. The rate of interest for such loans is 16%. The repayment period is 12 years. Previously the maximum repayment period was 7 years. Banks also grant house building loans to their employees. The maximum in such cases is Tk. 5.00 lakhs inclusive of the amount of advances availed of under staff house building loan scheme. Rate of interest on such additional loans outside the staff house building loan scheme is 16%.

The individual contribution of some of the Nationalised Commercial Banks for house building is as follows:

Table 8.3

(Agrani Bank loans for house building)

Figure in thousands

Year	Amount disbursed in Taka	As a percentage of total loans
1981	83,624	2.04%
1982	20,871	0.43%
1983	37,256	0.54%
1984	38,168	0.36%

The above figures do not include loans for commercial buildings but include loans to the bank staff.

The recovery of loans granted for housing is said to be slow but satisfactory.

Table 8.4

(Sonali Bank, loans for house building)

Figure in thousands

Year	Amount in Takas (sanctioned limit)	As a percentage of total loan
1981	8,172	0.56%
1982	6,492	0.44%
1983	790	0.44%
1984	13,098	0.43%

Note: The above figures include loans for commercial buildings.

A total number of 1674 loans were granted to the bank customers for building construction including housing during the period 1980 to November 1984.

In addition to the loans to customers, they have during the period 1980 to September 1984 also granted 2061 loans totalling Tk.21.8 crore to their staff through their staff housing loan scheme.

Table 8.5

(Uttara Bank, loans for house building)

Year	Amount disbursed	As a percentage of total loans
1976	Tk. 25.60 Lakhs	0.28%
1977	Tk.154.67 Lakhs	1.60%
1978	Tk. 37.05 Lakhs	0.31%
1979	Tk. 1.35 Lakhs	0.01%
1980	Tk. 13.24 Lakhs	0.08%
1981	Tk. 28.75 Lakhs	0.14%
1982	Tk. 9.00 Lakhs	0.04%
1983	Tk. 3.34 Lakhs	0.02%
1984	Tk. 3.65 Lakhs	0.02%

The total number of loans granted by Uttara Bank during the period 1976-1984 was 167.. Since the recovery is satisfactory, the only objection to these loans by the banks would be the blocking of funds for a long-term.

The nationalised commercial banks operate on the following system:

- Repayment capacity is assessed from both the income of the applicant and the anticipated income from the project.
- Loans are released in stages according to the progress of work.

- Repayment falls due after 3 months from the date of disbursement of the full loan or one month from the date of completion of the house, whichever is earlier.

The main features of the housing finance provided by the Commercial Banks are:

The loans are available only to the Bank's good customers, restricting the supply to the upper income group.

- The repayment period of 12 years may be sufficient for persons in the upper income group, because for repayment terms at present commercial banks do not reach the lower-income group for urban housing, a longer period would be required.

- Due to lack of supervision over funds disbursed the businessmen customers are said to be diverting the funds granted for housing for business purposes.

- The banks have a reluctance to tie up their funds on long-term loans.

- The disbursement for housing during the late seventies was high only because of pressure from Government, now it is scaled down and only good customers are encoured.

Islamic Banking:

The Islami Bank Bangladesh Limited (IBBL) is a Private Bank operating with the Islamic sytem of banking, i.e. the bank charges/gives no fixed rate of interest for any amounts of capital given/taken by the bank. Until very recently it was the only bank of its kind operating in Bangladesh, now there are two other such banks which have just come into existence, namely the Islami Ummah Bank and the Al-Baraka Bank.

The IBBL works on the profit/loss sharing system and its lending operations are not classified as "loans" but as "investments". It has the following types of investments in general:

1. Direct Investment : The bank invests capital directly in industrial, agricultural, commercial, transport, real-estate and housing sector projects/business on a short/medium/long term basis.

2. Mudaraba Investment : Investments through self-employed entrepreneurs; persons involved in various crafts or professions are completely financed by the bank for their capital requirements. The profit is shared between the bank and such persons on a pre-determined basis, but if there is any loss the bank alone will bear such losses.

3. Mushareka Investment : Investment on partnership basis, in this case the bank provides capital to various industrial and commercial enterprises by becoming a partner of such enterprises. The rate of profit or loss is determined through mutual negotiations and formalized through a contract.

4. Murabaha Sale : Sale through contract, in this case upon the request of the client, the bank will acquire any goods/commodities for sale to the said client with a small profit on the basis of a pre-determined contract. With this contract are specified the terms and conditions under which the client will fulfill the payment for the purchase, in such cases the bank it-self may even import the item concerned for sale to the client.

5. Bae-i-muazzal Investment : Sale on credit, this system is quite similar to the murabaha sale except that the payment in this case is fulfilled by the client in installments, i.e. it is a form of credit. The bank supplies raw-materials or any other item on credit to the client with a small profit, but the specifications, quantity, delivery date, location and method of delivery are fixed in advance by means of a contract.

6. Bae-i-salam Investment : Advance purchase, in this case the bank makes payments for advance purchase of industrial or agricultural products, in general the bank gives the capital to the industrial/agricultural concern upon signing of the contract where-in the quality/quantity, delivery system etc. are mentioned. The bank will later on sell the product to another party at a small profit

7. Lease/Hire-Purchase Investment : Leasing, in this case the bank rents industrial machinery/transport equipment/ships/housing etc. to its clients under a fixed contract for a certain duration, the bank remains 100% owner of the leased item. Hire-purchase, in this system the bank allows its clients to procure housing/cars/home appliances/etc. through payments in installments, which the

clients can afford to pay. The full cost of the product along with a small profit is recovered by the bank in a predetermined time duration, after recovery of the full capital by the bank the client becomes the full owner of the product.

Through our investigations we gathered that the IBBL has already financed about 30 real-estate or housing projects. The bank has not invested more than Taka 30 Lacs in any single project. The maximum profit that would have been earned by the bank had these projects made a profit was fixed at 30% of their own investment. But as all the 30 projects are turning out to be loss making investments the bank is refraining from making any further investments in this sector.

The IBBL had invested in these projects anticipating recovery of its capital within 2 or 3 years at the maximum. The bank prefers not to go for long-term projects and is flexible enough to negotiate both the percentage of profit for itself as well as the minimum equity investment of the project sponsors, on a project to project basis.

Presently the IBBL is reviewing various aspects of its investments in the real-estate and housing sectors in order to identify and rectify its past mistakes to revive its activities in this sector.

Private Sector Banks:

The private sector banks are involved in financing some aspects of the various activities in the construction sector. The United Commercial Bank Ltd. (UCBL), does not finance any real-estate development projects but is financing a number of contractors who are working on government construction projects. Under the system operated by the UCBL for these loans the contractor gives control to the bank over bill payments that he is to receive from the government

agency, at the same time the contractor must also provide some other security through mortgage of some fixed assets. Then the bank provides some working capital to the contractor to complete the construction, it is also understood that the bank regularly sends staff members to inspect the actual progress of work and to ascertain that the loaned funds are actually being employed in the said project.

The National Credit Limited (NCL), another private sector investment bank, also provides some funds to the construction sector. The NCL has already financed three land development projects, the investment by the bank in these three projects amounts to slightly more than taka three crores. The projects consist of three plots of low land which are being filled up and then sub-divided into smaller plots for sale to the general public as residential plots. The concerned officials of NCL informed us that since the bank was a very new organisation, hardly one year old, it was their policy not to have too much participation in such types of projects for the time being, they considered such real-estate and housing development projects to be medium/long-term investments and presently prefer to finance letters of credit and other short-term business transactions.

The NCL charges 18% interest per annum. It seems that the NCL will finance more projects in the real-estate sector once they have recovered their investments in the above-mentioned projects.

CHAPTER NINE

Multi-ownership Housing:

Through there are a number of different types of building ownership in Dhaka city, the different types of housing have different means of finance for construction. A comparison of five different multi-ownership housing complexes (all located within 2.5 miles from Motijheel Commercial Area, the main commercial centre of Dhaka city), may not be ideal examples for our study but nevertheless shed some light on the financing of housing in urban areas.

There are three types of home ownership found in the five projects, they are co-operative housing, condominiums andprivate ownership.

Table 9.1

Name of the project	Location	Type and ownership	Year of construction completion	Number of stories
Siddeshwari Ispahani Housing (New)	Siddeshwari	Condominium	1980	4
Eastern Housing Siddeshwari	Siddeshwari	Condominium	1982	5
Aziz Co-operative Housing	Purana Paltan	Co-operative	1984 (Incomplete)	8
Hasnabad Housing	Moghbazar	Co-operative	1972	3
Hafizabad Housing	New Eskaton	Private Ownership	1965	3 to 4

Source: M. Arch. Thesis Report entitled "The Sharing Problems of Multi-ownership Flats" by Prof. K. Anam, B.U.E.T., Dhaka, 1984.

Out of these Hafizabad Housing at New Eskaton was private ownership (freehold) of building blocks in a joint (tenancy in common)

ownership of land. All the three or four units of a building block are owned by a single landlord. This form of ownership is just like that of common detached housing properties. The only difference is that the ownerships are not differentiated by putting boundaries around the building blocks. There are ten building blocks in the project with the then different owners accommodating 35 units. The buildings were constructed by the individual landlords. The ground level common facilities such as approach road, children's play area and parking are shared by all. The peripherial boundary walls, provide group privacy and security. The maintenance and management of the project is conducted through a committee formed byt he dwellers. HBFC and Bank loans have been utilised to finance the building construction (all the 3 or 4 units).

The size of the dwelling units vary from 1600 to 1750 sft. The majority of the occupants of the dwelling units are well off businessmen. Most of the units have been let out on rent by the landlords. The monthly rent per unit varies from Tk. 2300 to Tk. 2800. The cost of a unit during 1965 was around Tk.65,000.00.

Hasnabad Co-operative Housing completed the construction during 1972 on a 82 decimal plot. The plot has a long and irregular configuration. There are seven 3 story building blocks accommodating forty-two 900 sft. two-bed room units.

The income level of the dwellers is the lowest (monthly earning Tk. 3,750) compared to that of the four other projects. The rent return from a unit is around Tk. 1800 per month. During 1972 the unit cost was fixed at Tk. 1,50,000. The project was financed totally from member's contributions.

The 9 storied high flat building constructed by Aziz Co-operative Housing Soceity was the first of its kind to be constructed in Dhaka. The ground floor has been kept open for parking. The two building blocks accommodate 32 units. There are provisions for small elevators, one in each block, in the vertical service system of the building blocks. The buildings were laid in the east-west orientation with 42' distance in between. The elevators have not been installed till today.

Table 9.2

(Occupants monthly income/etc.)

Name of the project (year of construction)	Total monthly income	Average monthly expenditure	Average family size including dependent	Size of the unit	Down payment required lakh	Average cost of the unit including decoration	Floor space index	Units/Acre
	Taka	Taka		Sft.		Taka		
I. Siddewwari Ispahani Housing (1980)	Above 4000/-	6000	7.2	1500	-	7,66,000	1.09	31.0
II. Eastern Housing (1982)	14166/-	7916	5.75	1500	2.5	9,50,000	2.23	64.5
III. Hafizabad Housing (1965)	Above 4000/-	7200	10.6	1600 1750	.65	70,000	2.24	54.0
IV. Aziz Co-operative Housing (1984)	Above 4000/-	4333	6.5	1600	.25	6,75,000	3.9	63.8
V. Hasnabad Housing (1972)	3750/-	3000	8.0	900	1.5	1,50,000	1.0	30.74

Source: M. Arch. Thesis Report entitled 'The Sharing Problems of Multi-owned Flats" by Prof. K. Anam, B.U.E.T., Dhaka, 1984.

The building is financed partly by BHFC Loan (Tk. 2,70,000 per unit) and partly by member's financial resources. The cost of the 30 decimal plot was Tk. 16,00,000 in 1979. The buildings are not yet completed i.e. finishing was the responsibility of the buyers.

Table 9.3

(housing delivery schedule)

Project	Year of land procurement (X)	Year of construction	Year of possession by the users (Y)	Time gap between X & Y
I.	1953	1980	1980-81	27
II.	1976	1982	1983-84	7
III.	1965	1965	1965-66	1
IV.	1979	Started in 1981	Part possession 1984	5
V.	1969	1972	1973	

Source: M. Arch. Thesis Report entitled "The Sharing Problems of Multi-ownership Flats" by Prof. K. Anam, 1984.

The last two projects (IV and V) are condominiums, financed by the developers, subsequently sold to the users. The developers allowed certain concessions regarding payment. Part down payment with 10 to 12 quarterly instalments was the best term the developers could offer, please see table below.

Table 9.4

Projects case study	Average cost of the unit	The loan amount 90% of the cost	Amortization period	Interest rate	Monthly repayment	Average rent returns
IV.	800,000/-	720,000/-	30	10½	5,158/-	3,000/
V.	800,000/-	720,000/-	30	10½	5,158/-	3,571/

Source: M. Arch. Thesis report entitled "The Sharing Problems of Multi-ownership Flats" by Prof. K. Anam, B.U.E.T., Dhaka, 1984.

There are not much improvements that could be noted from the other projects. Some difference is observed in the Siddeshwari Ispahani Project which has a little more land area left open because it could not be utilised for building due to the plot size/shape.

The owners/occupants (as shown in Table: 9-2) predominantly belong to the higher income business community. Further-more it is assumed that most of the owners, use the units as their second or third dwelling unit in the city and do not care for the economic returns. The Table: 8/4 shows the gap between the actual rent returns and monthly repayments that may be required if the unit would be financed under the terms and conditions similar to that of HBFC.

These projects were developed to take advantage of locational aspects and were designed to meet the demand of the rich business community and high officials. In most of these projects the households paid large sums as down payments and cleared the total cost of the housing within a very short period. But most common people in the city cannot afford this financing system.

Furthermore, these projects have been found to take a long delivery time, that varies from 4 to 27 years (Table 9.3). The long dealy in housing delivery is considered undesirable in the multi-ownership development.

It should be noted that these expensive projects could in no way generate a desirable housing environment. Moreover it is found that the projects do not earn enough by rent returns to be considered as economically viable yet there is a high demand for such housing. This only supports the age old notion that housing cannot be judged by its economic return alone, it is a predominantly social issue which cannot be evaluated in financial terms alone.

The apparently contradictory aspect of the housing demand has resulted from the pressure on developed land caused by the population growth and the desire to live close to the working place and urban

social services, which reduces transportation cost as well as saves time and energy. Other social factors like, security, status, sense of satisfaction and identify also play an important role in housing demand. These social and psychological factors cannot be evaluated in real terms as they are unqualifiable and subjective. The choice of housing, whether in a flat close to the central areas of the city or far away in a detached cottage, may be primarily guided by economic aspects, but the notion of economic return after the investment has been made becomes secondary in relation to that of various social factors.

Multi-ownership flats may be defined as property held by tenancy in common and the total property comprises more than one dwelling unit accomodated in a vertically repetitive structural system and each unit separated by its floor and roof slabs and walls with common access and services.

It may be observed that under the same title of multi-ownership or tenancy in common some part of the building and land requires exclusive right of use (the dwelling units).

The co-ownership of property thus created will follow the legal formalities applicable in the event of property transfer, that requires all the other co-owners as official witness in the execution of any (dwelling unit) property transfer with concurrent interest which some-times may be very difficult to organize because of absence of co-owners and other complicacies arising due to inheritance of other units.

This non-convertible quality of the co-ownership property makes it least desirable to prospective investors. It may be noted that the section 44 of TPA 1882, has provided certain restrictions on the acquisition of a share of a dwelling unit belonging to an undivided family where stranger transferee will not be entitled to joint possession (or other common or part enjoyment of the unit). The rule implies the preservation of undivided interest in dwelling units

and it does not bar the right of transfer, it simply witholds possession right in case of subdivided transfer by one of the heirs to a "stranger transferee".

The Multi-ownership Housing Organization:

The common service facilities in multi-ownership flats are the properties enjoyed by the co-owners, and that necessitates the need for proper management and maintenance. If the building is small accomodating 4 to 5 units built on a small plot, the problem of management may not arise in a very pressing way. But it may become uncontrollable without a managing body, when large number of co-owners of a big plot of land intend to build the desired flats by themselves. There might be numerous legal problems that might arise during the process of development which might take a long time to resolve through usual process.

A legal institution formed by the co-owners can do the job efficiently in much less time. Thus the need for a formal institution, constituted by the would be flat owners to ensure, proper management of the housing production.

The most common form of these institutions is called the "Co-operative Housing Society".

Co-operative Housing Societies in Bangladesh:

Co-operative Housing Societies in our country do not perform as principal financing institutions that advances loan for housing to their members. Under the Co-operative Societies Act 1940, there were around 76 Co-operative Societies in 1976 registered in Dhaka District. There are no correct statistics that record the total number of flats built and developed. However there are many societies which have successfully completed and plotting projects and some have recently completed building projects as well.

In Bangladesh though the co-operative housing movement started during early 50's, very little real progress has been made to date. According to nature of membership the Co-operatives may be divided into two broad categories. Those which allow membership to a particular government agency or private firm and the societies that accommodate open membership. The open societies usually restrict the membership among the acquainted people. The former types of co-operative socieities have already been formed by the employees of Bangladesh Council of Scientific and Industrial Research, Bangladesh Bank, Agricultural Development Bank, Jahangirnagar University and many others. Most of the members of these co-operatives are from higher middle income group.

Most of the Co-operative Societies formed in Dhaka city are primarily concerned with land procurement, land development and plot distribution. The project sites are chosen in the peripheral zones of the city area, namely at Savar, Kaliakoir, Tongi and Joydebpur etc. perhaps due to excessive land cost and over burdened utility system, non-availability of size able land appropriate for housing neighobourhoods. The societies moved north-wards, to maintain a reasonable limit of affordibility for higher middle income group.

A few societies concentrated their interest in the city procuring small plots and constructing multi-story (8 to 10 story) flats for their members. These societies procured finance mostly from the wealthy members, the members in turn depended partly on their own resources and on Housing Building Finance Corporation loans arranged by the societies acting on behalf of the members. The land bought by the society in the name of the members is used as the mortgage security against the HBFC loan. After completion, the units are distributed among the members as undivided interest shares with the right to occupy a specific unit. The loan liability, taxation and utility services are the occupant's responsibility.

No commercial or Private Banks have so far extended loan to the societies for construction, this is mainly due tot he inadequacies of the societies in presenting proper expertise in management, construction and planning. The other reason might be that the high interest rate and short amortization period required by the banks are not within the means of most of the co-operatives. In absence of strong housing policies of the government and the lack of success of ventures of this nature is understandable.

CHAPTER TEN

Housing Developers:

The services of housing developers are needed by those who cannot undertake the construction of the houses they wish to own but the manner in which some of the housing developers operate has caused some resentment and dissatisfaction. The buyers claim that they have been exploited, others are dissatisfied because the standards are too high for them and cannot afford the cost. The buyers have no access to formal housing finance unless the property is already under mortgage to HBFC in which case HBFC may consider transfer of liabilities to the buyer. But in most cases the flats are constructed with money taken in advance from the prospective buyers.

There are a number of housing development firms, each of them has its own system of taking payments from the buyers of their apartments/flats. A brief description of one project of such a developer may shed some light on the systems employed in general.

The "Home Builders Company Ltd.," a relatively new company in this field has undertaken a project at Mirpur Road near the Science Laboratory, consisting of 37 flats in a single building of 7 storied height situated on a plot of 18 kathas.

Buyers who are interested to purchase a flat have to apply to the developer by filling in the printed application form.

The company will allot apartments to applicants on "first come first served basis". Preference is given to applicants who deposit the full price of the flat during allotment. The company reserves the right to reject any application, allotment or complaint regarding allotment.

The allotment shall be final only after the company receives the earnest money and gives the allotment letter to the client. The company reserves the right to cancel an allotment and refund the earnest money only in case of unforeseen circumstances.

The buyer may pay the price of the flat in instalments as shown in the mode of payment below. The company will apply to the HBFC on behalf of the buyer to avail the construction loan. Approval of the loan shall however depend on the HBFC and the clients eligibility. The client shall have to undertake all the formalities and bear all costs required by the HBFC.

The mode of payment of the price of flats under the instalment scheme is the same for all the buyers. Payment shall be made in five instalments after receiving the allotment letter, the payment schedule is as follows:-

a. The first instalment, inclusive of the earnest money is 40% of the total price of the flat and is payable within three months of signing of the allotment letter.

b. The second instalment which is 15% of the total price of the flat is payable within seven months of signing of the allotment letter.

c. The third instalment which is 15% of the total price of the flat is payable within eleven months of signing of the allotment letter.

d. The fourth instalment which is 15% of the total price of the flat is payable within fifteen months of signing of the allotment letter.

e. The fourth and final instalment is the last 15% of the total price of the flat and is payable within eighteen months of signing of the allotment letter.

Purchasers of flats must adhere to the schedule of payment, to ensure the timely completion of construction. Any delays in payment upto two months shall make the purchaser liable to pay a fine of 50% per annum of the amount of payment delayed. If the payment is delayed more than two months beyond the scheduled time then the allotment shall be cancelled and all instalments refunded except 50% of the earnest money which shall be forfeited by the Company.

Only after payment of the 3rd instalment will the company execute a transfer deed with the client for a proportional part of the land on which the building will be situated. Until after the full payment of all the instalments of the price, the buyer shall not have the right to transfer the allotment letter to a third party. After the buyer has paid all the instalments and taken physical possession of the flat, he shall be able to transfer the same to any third party.

The buyer of the flat shall bear all charges for stamp papers and registration and writing fees of deeds of agreement and transfer.

All buyers must undertake to become members of the "owners co-operative society" which will be formed by the owners of the flats and duly registered under the Co-operative Soceity Act-1940 for the management of the common services and facilities like, stairs, play areas, pump, electricity, water-supply, sewerage, cleaning and painting.

Just as in other countries, the role and function of the housing developers should be regulated by various means to enable them to play an effective role in the construction and delivery of houses/flats to a broader income group. Such intervention, especially of financing institutions by the provision of short-term loans to housing developers and long-term loans to the end-buyers could give a boost to the housing construction industry in general. For example the above-mentioned 37 flats projects shall take at least two years to construct, provided the buyers pay their instalments in time,

if not then the construction will linger on for months or even years as has happened with some projects. This type of intervention should be reinforced by two planning regulations controlling designs and standards and thereby help the housing developers to broaden their present activities and thus let them serve the needs of larger sections of society.

CHAPTER ELEVEN

Conclusions:

From the above review of the role of the informal financial market in the construction sector we can note that the system of lending/borrowing in the various sub-sectors of the construction industry are very much similar in nature and operational modalities.

We may list some of their characteristics as follows:

1. There are no clearly defined "professional money-lenders".
2. There are no individuals or organisations whose main or even secondary business is to lend money either with interest or on a profit sharing basis.
3. There are no government policies or regulations regarding informal financing arrangements.
4. There is a sizeable quantity of idle capital available with "friends & relatives" which are not being used in the most profitable manner from the point of view of both the lender and borrower.
5. The systems of advance purchase or advance sale/purchase on credit are the major forms of informal finance in the construction materials business as well as in the contracting business.
6. The real-estate and housing development businesses have certain peculiarities of their own in the mode of financing which are somewhat different from that of the other sub-sector activities.
7. The construction materials traders and contractors have no strong trade/professional associations to regulate the practice of advance/deferred payments nor do they have any generally agreed upon modalities to fix the prices of their products vis-a-vis the quality/costs of production, etc.

8. The real-estate and housing development business also have no professional association of their own to regulate their business for its proper growth and development as well as for liasing/negotiating with the government for protecting their interests.

10. The larger part of the general public still is of the opinion that charging of interest by any individual is contrary to the ideals of their religion, even though they have accepted the formal financial institutions as a necessary part of modern society.

11. The method of selling/buying goods on credit was much more common in the past than it is today, this is because there has been what is considered a general decline in the moral standards of the people, as such verbal agreements concluded just by a handshake do not have the same validity as in the past, now-a-days people feel insecure without legally valid bindings. Since the IFM transactions are mostly undertaken without any collateral security the borrowers can very easily avoid paying their dues, such instances have seriously hindered the growth and development of the IFM in general. Some suitable mechanism may have to be developed to prevent such irregularities.

Recommendations:

1. The brick industry owners/traders must develop a strong professional association of their own for the proper regulation of this business/industry. This is necessary in order to standardize the quality of the products and to regulate the pricing of the products without which there cannot be any clear cut way to determine the actual "rates of interest for advance purchases/etc.

2. This association must have a proper office and maintain a list of all their members and arrange regular meetings amongst them, to identify and solve various problems, but vis-a-vis the IFM their primary objective should be to weed out the defaulters

by circulating the names of such persons/firms who fail to pay their dues to one supplier and then go to another supplier for further procurement of goods. Such a system will ensure the security of the credit giving supplier.

3. All purchases or transactions of advance/deferred payment should be documented on a standard form developed and printed by this association, it should preferably have some sort of legal validity. This would enable the association to even notify other such associations and formal financial institutions about the defaulting parties.

4. The above listed recommendations are also valid for the steel industry/traders. But the traders must try to reduce the unscrupulous practices of some dealers regarding selling of "underweight quantities".

5. The cement traders should also organize themselves along similar lines. But they should also ensure the proper quality and quantity of the cement in the bags which they sell. Unfortunately the associations alone cannot curtail such cheating by the traders without the support of the government agency to monitor such trading. Moreover the consumers and end-users of such products must also be alert about such problems.

6. The contracting business also needs an association of contractors in order to lobby with the government for accepting their just demands. This professional association should also penalize those contractors who fail to keep their commitments to their suppliers because such defaulters harm the interests of all contractors.

7. The contractors must convince the government not to permit its agencies to float tenders or award contracts when such agencies are not in possession of the funds necessary to execute such works, contractors almost never receive their payments on time and such delays start a chain reaction right upto the doorsteps of the construction materials manufacturer.

8. The formal financial institutions are either unwilling or unable to participate in the financing of the construction industry along the lines prevalent in the IFM, therefore it is suggested that the government encourage the establishment of small cooperative type financial institutions which would be able to get closer to the clients using the IFM. Such small institutions would also be less overloaded with bureaucratic formalities and therefore would be more accessible to the clients.

   It is suggested that the lending and borrowing operations of these institutions should try to emulate the existing systems of advance sales and advance purchases as prevalent in the construction industry. Such an idea is not unrealistic in view of the fact that Islamic Banks in Bangladesh are already executing similar transactions.

9. The real-estate and housing development sub-sector has financing needs which are more complex than that required by the materials and contracting trades.

   In order to provide for a proper housing finance system it is suggested that new institutions be set up which will mobilize new savings from households without depending for its resources on existing savings from other institutions, the credit supply from this institution should focus on the lower income bracket.

SOURCES OF FINANCE:

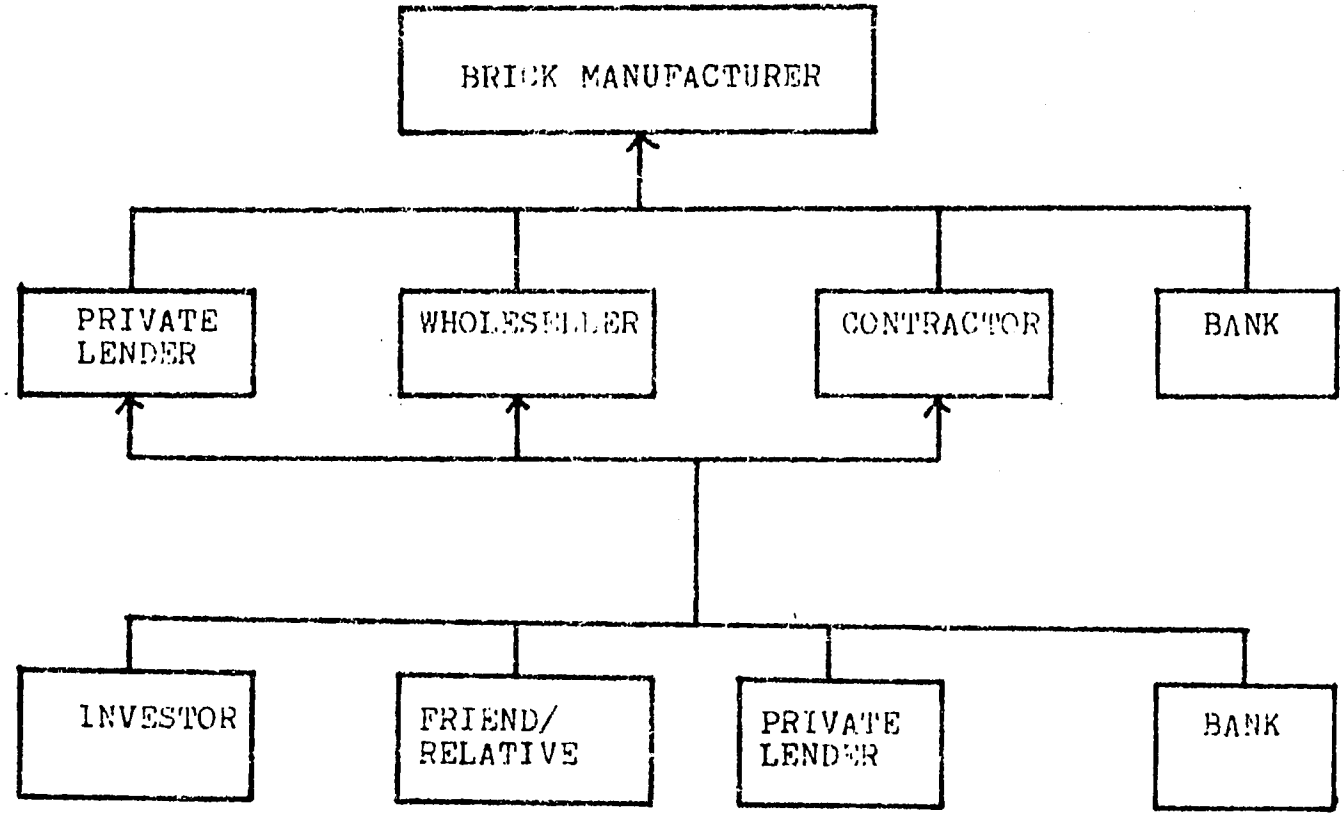

Diagram - I

Number of Brickfields:

The number of coal burning brickfields which are enlisted with the office of the coal controller are given below with their approximate production capacity.

DISTRICT (OLD DISTRICT)	TOTAL NO. OF BRICKFIELDS	PERCENTAGE OF BRICKFIELDS	CAPACITY PER ANNUM
1. Dhaka	325	37.49%	15 Lac
2. Chittagong	70	8.07%	12 "
3. Chittagong H/T	4	0.46%	10 "
4. Comilla	65	7.50%	10 "
5. Sylhet	45	5.19%	10 "
6. Noakhali	35	4.04%	10 "
7. Faridpur	17	1.95%	10 "
8. Barisal	23	2.65%	10 "
9. Patuakhali	1	0.12%	10 "
10. Kushtia	12	1.38%	10 "
11. Khulna	44	5.07%	10 "
12. Jessore	34	3.92%	10 "
13. Dinajpur	23	2.65%	10 "
14. Rangpur	31	3.58%	10 "
15. Rajshahi	32	3.69%	10 "
16. Pabna	51	6.00%	10 "
17. Bogra	42	4.81%	10 "
18. Tangail	7	0.81%	10 "
19. Mymensingh & Jamalpur	6	0.69%	10 "

The above figures are not able to show the complete picture of the brick-making industry because there are a number of coal burning brickfields which are not as yet registered with the office of the coal controller. Moreover the number of brickfields known as Bangla Bhata, a cruder form of brickfield, are believed to equal or even exceed the number of coal burning brickfields in the whole country, these fields burn wood, local coal, furnace oil, scrap-tire, etc. as fuel. Their number may total any number between 500 to 700.

The total number of brickfields which use gas as a fuel in order to burn the bricks is about 50, these are located at Pagla, Demra, Tongi, the average annual production capacity of a gas burning brickfield is 15 lac bricks.

The total number of semi-automatic brickfields producing ceramic bricks is 6. Of these 4 are located at Dhaka and the other 2 are located at Chittagong. Among these fields only the Mirpur Ceramic Works has a capacity of 30 million bricks per annum, and all the others have a production capacity of 15 million per field per annum.

It may be mentioned that the Bangla Bhata type of brickfields usually have an annual production capacity of 4 lac bricks per field.

Brickfield Investment:

In order to start/operate a single-section coal burning brickfield, the approximate capital investment shall be as follows:

- Land	:	Tk. 900,000/-
- Kiln	:	Tk. 100,000/-
- Office/shed	:	Tk. 150,000/-
- Machine/tools	:	Tk. 100,000/-
		Tk.1,250,000/-
- Working Capital	:	Tk. 400,000/-
Total	:	**Tk.1,650,000/-**

Like-wise, in order to start a single-section brickfield a larger investment is required because of the additional machinery and facilities as well as the increased working capital. The investment required is shown as follows:

- Land	:	Tk. 900,000/-
- Kiln/gas connection	:	Tk. 600,000/-
- Pugmill (motorized)	:	Tk. 150,000/-
- Other machines/ equipment	:	Tk. 150,000/-
		Tk. 1,800,000/-
- Working Capital	:	Tk. 800,000/-
Total	:	**Tk. 2,600,000/-**

Production Cost/Profit:

The approximate cost of production for one lack bricks in a coal burning brickfield can be shown as follows:

ITEM	QUANTITY	TOTAL COST (in taka)
-Coal	30 tons	60,000/-
-Earth	10,000 cft.	15,000/-
-Labour	200 persons	12,000/-
-Managers	2 persons	4,000/-
		91,000/-

When one lac green bricks are burned, then 70%, 10%, 15% and 5% come out as 1st class, picket, 2nd class and 3rd class respectively. Thus the quantities coming out for 1st class, picket, 2nd class, and 3rd class are 70,000/-, 10,000/-, 15,000/-, and 5,000/- respectively.

Assuming the price per thousand bricks for each of the above mentioned grades to be as follows:

-Picket	:	Tk. 1150/-
-1st class	:	Tk. 1100/-
-2nd class	:	Tk. 950/-
-3rd class	:	Tk. 620/-

Therefore the total selling price of 1 lac bricks is Taka 105,850/-. And thus the profit to be earned form the production/sale of 1 lac bricks is Taka 14,850/-. So a brickfield with a production capacity of 14 lac bricks can make a profit of approximately Taka 207,900/- per year.

Since the setting-up of brickfields is not financed by the formal financial institutions, the brickfield owners had to invest their own capital at the initial stage. In this connection it may also

be mentioned that the semi-automatic ceramic brick producing projects were set up with financial assistance from the formal development finance organisations such as the BSL/BSRS, but such projects are no longer being financed by them. It may also be noted that most of the brickfields were set up quite some time back and have gradually expanded over a period of time and as such have mostly re-invested profits earned for such purposes.

Case Study of a Brickfield Owner:

Mr. Monir Hossain is one of the partners of M/s. Monir Hossain & Brothers, i.e. a brickfield at Pagla, Dhaka. The field contains one section with the capacity to produce 22 lac bricks this season. According to Mr. Hossain the total requirement of a one section field is about 18 to 20 lac taka. If the field does not sell in advance then taka 20 lacs is required. A minimum of at least taka 18 lacs is required to run a field.

In this case, 40% of the finance is from own funds, the company also received taka 3 lacs, approximately 15%, from the bank as a working capital loan. The shortfall of 45% of the finance had to be met from the IFM in various forms. Mr. Hossain also took taka 1 lac as cash loan from friends/relatives in varying amounts at an average monthly interest rate of 2%. Part of the loan was interest-free. The interest on a loan is known as secured profit on the money invested with the borrower.

Mr. Hossain claimed to have already sold approximately 5 lac bricks in advance at varying rates ranging from taka 1100 to taka 1200 per 1000 bricks, for the season. Thus we can see that this company utilised funds from four sources, i.e. self, bank, cash IFM and advance sale, to start production for the season. It requires about taka 13 to 14 lacs to start a brickfield. The gap in the availability of funds is filled by rolling the cash received from sale of products.

The company does not sell goods on credit except in very few cases to parties with good business standing with whom they have a long relationship. According to Mr. Hossain there is no price difference for such credits, which are in fact delayed payments.

The purchase of clay, fuel and 20% of the labourers' wages are all dealt in cash, but in some cases they get a deferred payment facility for a part of the fuel bill.

Financial Needs/credit Duration:

From the above case study we can understand some of the difficulties that a brickfield entrepreneur has to face in order to procure funds in order to fill the gap of his financial needs, i.e. working capital needs.

If a single section brickfield with a production capacity of 22 lac bricks is to be operated to full capacity then from the figures for the production cost from page 102 we may deduce that one would need to arrange funds @ Tk. 91,000/- per one lac bricks, i.e. taka 20 lacs in order to produce 22 lac bricks. But in reality one does not need the full amount because the funds can be rolled a number of times, i.e.bricks produced are sold and the money used again to buy raw materials/etc. to produce more bricks to sell again. But such rolling may not be possible or desirable all the time, because bricks may not be sold within the designated perod but the production must go on in order to amortize the overhead expenses/etc.

Thus in the case of Mr. Hossain we can see that he had taka 8 lacs of own funds supplemented with 5, 1, and 3 lacs of advance payment, cash loan and bank loan respectively to meet the gap in the working capital requirement.

The rate of interest for the cash loan of taka 1 lac and the bank loan of taka 3 lacs is 2% per month and 18% per annum respectively. The bank loan is repayable not later than one year from the date of borrowing, the informal cash loan is also usually pay-

able not before 3 months and not later than 12 months from the date of borrowing. One may think that the advance payment for bricks may have a system whereby the hidden interest will be charged relative to the credit duration, but such is not the case, there are no additional charges for longer delivery dates. The hidden interest charge which the brickfield owner happens to pay for having received an advance payment is not necessarily guaranteed, in the sense the difference which the lender receives is dependant on the supply/demand status of bricks at the time of delivery, as such prices may not rise as high as may have been anticipated, resulting in a lower than expected "rate of interest". The time of delivery of the bricks for which advance payment is made is decided at the time when such payment is made by mutual consent of both parties concerned and as uch both parties calculate their personal loss/gain for entering into agreement. There is an element of risk for both sides, it is therefore not looked upon as a simple lending/borrowing operation but rather as a business venture, so the notion of implicit interest rates directly proportional to the duration of credit do not seem to fully apply here.

Therefore the average duration of credit and the average implicit interest rates to be calculated here are simply the average of the lowest and highest values obtained.

Total Informal Credit:

The total amount of informal credit extended to the brick-makers in/around Pagla/Munshikhola can be estimated as follows:

$C = ZPY$, where

Y is the total output of the brickfields,

P is the price of bricks at the time advance sale is made,

Z is the proportion of total output sold in advance.

Therefore, taking Y = 60 crore bricks, i.e. 300 fields with an average annual output of 20 lac bricks per field, and taking P = taka 1100 per 1000 bricks, and taking Z = 25%.

Thus the total advance purchase at Pagla/Munshikhola may be estimated at approximately taka 16.50 crores per annum.

Bank Funds for Brickmakers:

Within the brick manufacturing industry funds borrowed from both formal and informal sectors are used for productive purposes. Even though in some other industrial sectors it has been noted that bank credit obtained is diverted to other uses. The peculiarities of this industry do not encourage such a diversion of funds.

Since bank loans are taken mostly in the form of working capital loans and because such loans are available mostly against hypothecation of the brick-field property/assets/goods, i.e. a maximum of 60% of their market value, it would be rather suicidal on the part of the borrower to divert such loans to non-productive purposes and risk seizure of his property for non-payment.

Such diversion of funds even after hypothecation of goods/industries is mostly limited to those industrial units whose setting-up has been financed by banks (with over-invocing by the borrower or sponsor) and also with those industries whose raw materials are mostly imported.

At the most what a brick-field owner may do is to lend out money (at the IFM rate) borrowed from the bank to some other party unable to obtain such a loan, and himself continue to borrow on the IFM for his own uses, such an operation may not be worthwhile in many cases.

The bank loans which are taken by the brick-field owners are working capital loans, i.e. short-term loans with a maximum credit duration of 1 year. Private sector banks' working capital loans though available for the duration of one full year are calculated on a quarterly basis for interest charges, i.e. every 3 months the loan is extended but with a compounding of the interest charges.

The borrower may repay any portion of the loan within the period of one year but by the end of one year he must repay the full amount and again make a request for another loan if he so desires. Borrowers must do this in order to maintain a good working relationship with their bank. Any loan repayment not repaid within the one year time limit is considered delayed repayment and involves additional interest charges as well as "souring" of the lender/borrower relationship to some extent.

The Janata Bank normally gives working capital loans ranging in size from taka 1.5 lac to taka 5 lacs. But in some cases the amount has been higher due to the goodwill of the borrower. The Sonali Bank provides loans ranging from taka 2 lacs to taka 8 lacs.

The Janata Bank (Pagla Branch) has provided about 60 loans this year, whereas the Janata Bank (Fatulla Branch) has provided only 13 loans. In the case of the Pagla Branch the rate of recovery is 100%, but only 50% of the payees are regular. In the case of the Fatulla Branch presently only 40% of the loans have been recovered and it is expected that the remaining portion shall also be recovered. The Sonali Bank (Dapa Branch) made 13 loans, out of which only 3 borrowers are not regular, but in general loan recovery is good. According to the Bank Managers the loan recovery in this sector is better than many other cases.

Interest Charges:

Widely variant interest rates on the same type of transaction are not very likely but the system of advance purchase is not a "pure" lending operation, as such many other factors are involved for both parties, thus such variations are possible as long as they are expedient for the parties in a particular case.

As for the delivery schedule for a specific consignment against an advance payment, it is no doubt mutually agreed upon by both parties and there is at least some form of tentative schedule.

Identification of Lenders:

The working capital requirement of a typical brick-field entrepreneur varies between taka 8 lacs to taka 18 lacs. The proportion of own funds to the proportion of borrowed funds is in the ratio of 40:60. The proportion of funds provided by formal sources to the proportion of funds from informal sources is in the ratio of 25:75.

Of the credit provided by informal sources the proportions provided by the different sources are estimated as follows:

- wholesellers	:	25%
- contractors	:	10 - 15%
- investors	:	5 - 10%
- friends/relatives	:	0 - 10%
- moneylender	:	0 - 10%

The structure of interest rates against different sources is tabulated as follows:

- Banks	:	18 - 20%
- wholeseller	:	55 - 75%
- contractor	:	55 - 75%
- investor	:	37 - 45%
- friends/relatives	:	0 - 30%
- moneylender	:	24 - 72%

Rate of Return for Investors:

In this case investors are those persons who want to lend capital without any fixed interest charges, but they also want a share of the profits, which they expect to be higher than the amount of interest they would receive for depositing that capital with a bank.

These persons are mostly friends/relatives and are mostly content as long as they get a better return from that of a bank. The

profit from their investment is usually 25 to 20% in a period of 8 months, which turns out have an implicit interest rate of 37 to 45% per annum.

Brickfield Market Reputation:

Since there are no fixed interest charges for advance payments therefore a default would cause a loss of income to the "lender". As such the reputation of the brickfield owner is equally important as the reputation of his products. For those makers whose products enjoy a good reputation in the market advance sales are easier to come by because of the better than average/faster salesabiltiy.

Brick Wholesale Trade:

The number of wholesellers and retailer/wholesellers in the Dhaka area is about 250 to 300 numbers.

The average number of bricks bought/sold by such a wholeseller is varying between 5 lac to 10 lac bricks per year, which maybe valued at approximately taka 5.5 to 11 lacs. It is estimated that the 200 wholesellers of the Pagla/Munshikhola area may have a total borrowing in the range of taka 8.25 crore (average advance sales of 7.5 lac bricks, 50% of the capital being own capital). The proportions of own finance/bank credit/IFM credit used in financing brick purchases varies from party to party. Most wholesellers do not or are unable to procure bank loans because such bank loans require collateral security in the form of hypothecation of assets/land. The Sonali Bank (Fatulla Branch) has not given any loans to wholesellers this year. Whereas the Janata Bank Pagla & Fatulla Branches have provided 10 and 2 numbers of loans respectively. Most of the wholesellers have to take recourse to the IFM. But in most cases 50% of the funds are their own capital and the rest are procured from various sources. It is very difficult to assess the actual proportion of capital taken from these different sources.

Case Study of a Brick Wholeseller:

Haji Aowlad Hossain is the proprietor of Haji Aowlad Hossain & Co., a brick wholeselling company at Munshikhola, Pagla. He is one of the larger wholesellers. According to the people of the locality and other traders he has enough capital of his own to own/run a brickfield.

In the interview, he said even though he has ample finance of his own he prefers to run a wholeselling institution because he believes it is easier to run than a brickfield. In the year 1986-'87 he bought 10 lac bricks in advance at the rate of taka 1100 per 1000 bricks. He bought the bricks during the month of October 1986 and started selling them from April 1987 when the price had already risen to taka 1550 per 1000 bricks. In this way he is making a profit of approximately 29% on his capital in six months. His rate of profit will increase as the price of bricks rises in the monsoon season when the brickfields stop production.

Through-out the year he also sells brick which he buys from ready stocks of the brickfields, for these bricks he makes a profit of taka 25 to taka 100 per 1000 bricks. His yearly sale of bricks is approximately 12 lac bricks. He paid an advance of taka 1 lac as rent for his site for the year. He does not sell bricks on credit except to parties with whom he has a very good business relationship. He estimated that 5% of his total sales is on creidt, in very few cases he charges increased rate on goods sold on credit. He does not take any loan from any bank.

Steel Mill Working Capital:

The working capital requirement of a typical re-rolling mill would be approximately taka 40 lacs. Since most of the mill owners already have good working relationships with banks they have much easier access to bank funds than the brickfield owners. As such it maybe said that almost 80% of their working capital needs are

met by the banks, therefore they mostly do not take recourse to the IFM except int he form of advnace sales/etc.

The different sources of credit for the mills are banks, wholesellers (large/small) and contractors. The varying interest (actual/implicit) charges are as follows:

- bank	:	18 - 20% p.a.
- wholeseller	:	62% p.a.
- contractor	:	62% p.a.

The advance purchases would meet a maximum of 20% of the mill's sales output, out of which only 10 to 20% would be taken by contractors, thus 80 to 90% being taken by the wholesellers.

Rod Wholeseller Case Study:

The manager of M/s. Hossain Traders, Naya Bazar, Dhaka was interviewed. This company employs 4 permanent staff. 20% of their financial requirement is met through bank loan, 70% from own funds and the rest 10% from IFM. They do not receive credit from the mills. The company sometimes buys rod in advance from the mills. If they buy in advance the price is cheaper by a thousand taka per ton. The money for advance purchase is normally paid 1 to 1½ months before the delivery date. In some cases the company avails credit facility from the larger stores if the company's own stock is not enough. The duration of this type of credit is for a very short period, for 1 or 2 days. A nominal difference in price is usually charged. According to the manager advance purchases give better profits but quite often the goods are not delivered on time. 20% of the store's goods are sold on credit. There is a difference of taka 200 per ton and the credit facility is extended for a maximum of 15 days in most cases.

The company took some cash loan from the IFM during a crisis period at the interest rate of 3% per month.

The average amount of loan received from a bank by the wholesellers varies between taka 3 to 5 lacs. The various sources of finance along with their proportion and interest charges are tabulated as follows:

-self	: 70%	,	-
-bank	: 20%	,	18 - 20% p.a.
-friend	: 0 - 10%	,	0 - 33% p.a.
-moneylender	: 0 - 10%	,	0 - 72% p.a.

Large Mills:

According to the Re-rolling Mill Owners' Association there are about 200 mills of which about 50 are large mills. The larger mills have an average production capacity of 20 tons per day. The average annual sales of such a large mill is taka 4 crores.

Cement Trade:

The annual importation of cement by the private sector in Bangladesh being about taka 55 crore in value. The bank credit received for this importation would be between taka 44 crore to taka 49 crore. Approximately 50% of the imported amount is given as credit to the wholesellers/distributors by the importers, i.e. near about taka 25 crore per annum.

Such sales on credit to the wholeseller/distributor result in a price difference of taka 2/- on the import cost of taka 90/- per bag, for a credit duration of 20 to 30 days, thus result in an implicit interest rate of between 24% to 36% per annum.

The price paid by the large wholesellers to the importers when they clear goods right from the port is between taka 88/- to taka 90/- per bag.

The premium on price varies between taka 1/- to taka 3/- per bag for credit sales of about 20 to 30 days credit duration by the small wholeseller/dealers tothe retailers & contractors. The price of cement at the wholesale and retail levels for cash payments is about taka 98/- to taka 100/- and taka 100/- to taka 102/- respectively.

The price per bag charged by the importer to the large wholeseller, if no advance payment is taken by the importer, is about taka 90/-. And if advance payment is taken by the importer then the price is taka 88/- per bag, and the goods are made available to the wholeseller from 20 to 30 days of receipt of advance payment. The implicit interest charge may thus vary from 27.64% to 41.47%. Such advance sales constitute about 25% of the total sales of the importers.

The sources of informal credit for the dealers and shopowners are mostly through credit purchases, friends/relatives, and moneylenders. The implicit interest charges for such credit purchases with an enhanced price of 2% to 3% for credit durations of 20 to 30 days comes to about 24.33% & 54.75% on the lower & higher sides respectively. Personal loans from friends/relatives maybe interest free or even as high as 30% to 40% per annum. The moneylenders rate of interest can go as high as 6% per month. The usual working capital requirement of dealers/shopowners varies between taka 2 lacs to taka 4 lacs.

The dealers/shopowners make credit sales to some contractors & customers, these credit sales represent approximately 10% to 15% of their total sales. The price enhancement for such credit sales is between 2% to 3% above the cash sale price, for credit durations of 20 to 30 days. Thus the implicit rate of interest varies between 24.33% to 54.75%.

Market Price of Sand:

The market price of sand if paid for in cash at Meghna Ghat is about taka 700/- to taka 800/- per truck-load.

Multi-storied Loan Program:

People borrowing from the HBFC almost invariably have to invest approximately 15% to 20% of their own funds in the total investment cost. These funds are mostly personal savings, loans from family (father/mother/brother/sister), money gained through sale of rural/ agricultural land, money earned while serving overseas, and off course black money. But the actual proportional quantification of the sources is not possible here.

Housing Societies/Housing Developers:

The housing societies & housing developers have to date implemented projects in Dhaka City totalling approximately taka 50 to 60 crore in value, these buildings were on average delivered within 3 years from the first date of receipt of advance payment. It may also be mentioned that housing societies in general have been more active in the land development sector, i.e. procuring cheaper land and then developing it into a residential area for distribution of plots to their members.

ANNEX B

Study on Urban Informal Financial Market

INDICATIVE TERMS OF REFERENCE

THE CONSTRUCTION SECTOR AND THE INFORMAL FINANCIAL MARKET IN BANGLADESH

Construction is an important activity in Bangladesh. In 1983-84, the sector accounted for about 5.2% of GDP and created employment for 321 thousand persons or 1.15% of the total employment generated by major industries in that year.

The sector can be classified into three broad subsectors, viz., buildings and dwellings, land improvement and other construction. In 1976-77, these three subsectors accounted for about 65%, 20%, and 15% respectively of the total investment in construction activities for that year (amounting to about Tk. 10337 million).

Investment in buildings and dwellings accounts for a major share of total investment in the construction industry. In 1976-77, private sector investment buildings accounted for about 82% of total private sector investment and for about 40% of total investment (public and private) in the industry. Urban buildings accounted for about 65% of total investment in buildings and dwellings and for about 42% of total investment in construction. A focus on activities involving urban building construction could be expected to capture a significant part of the construction industry in Bangladesh with respect to its informal sector financial transactions and thereby provide some insights into the working of the urban informal financial market.

The extent of informal credit absorbed by this sector is not known. Preliminary queries have revealed that a substantial degree of informal financing is involved. A close look at two important sub-activities -- procurement and supply of construction materials

and contracting (for construction) -- is warranted. Those involved in procuring construction materials, both from local and foreign sources, for marketing and distribution, often depend crucially on short-term financing since stocks have to be held and payment for supplies is usually forthcoming on a deferred basis. The working capital credit needs and sources of credit could be investigated. Important local sources/markets for construction materials that could be considered are Pagla for sand, stones and brick, Sylhet for sand and stone, Demra for sand and bricks, Dhaka for cement, bricks and (reinforcement) steel, and Chittagong for cement and (reinforcement) steel.

The informal financial interconnection between the local producers/importers of construction materials and the contracting subsector may be gone into. The contracting sub-sector is often in critical need of short-term financing (because of delayed payments, contractual bases and the like) and part of this could be obtained from informal sources, e.g. from suppliers of materials through purchases on credit basis. The availability of credit and the terms of credit could be assessed.

Methodology

The study will take up an anthropological approach. Informal discussions will be held with a large number of persons involved in the activity -- raw material producers, traders, importers and contractors. A select interview of 25-50 persons could be undertaken.

Additional information could be obtained from banks, real estate agents, and government agencies and sector corporations giving out government sector contracts for construction work. Attempts could also be made to obtain information directly from a few informal sector financiers.

Specific TORs for the study

1) Size and trend of the activity in its various aspects -- import of construction materials (CM), domestic production of CM,

distribution of CM to final users, contracting for construction, and the constructing activity itself;

2) Geographic distribution/concentration of the activity;

3) Operational modalities of each sub-activity; rates of return; scope for improvement of operational methods; various constraints and the extent to which lack of credit poses as a constraint; the incremental return from easing of the supply of credit;

4) Credit needs of the sector, the extent of institutional financing received; the problems of institutional credit delivery;

5) The extent of informal financing; the sources of credit (with a look at possible formal-informal sector linkages in this respect); the terms of credit (explicit or implicit); the beneficial impact of the credit from the borrower's point of view; the oportunity cost of funds from the lender's point of view; the sources of such funds;

6) Government policies/regulations regarding informal financial arrangements;

7) Characterisitcs peculiar to the industry that encourage use of informal finance;

8) The historical trend of informal credit supply in this activity; the scope for expansion of the activity and the corresponding incremental need for credit; whether such credit can be supplied from institutional sources (in that case, the delivery mechanism and administrative costs are to be considered) or whether the informal market should be developed in an appropriate way;

9) Further perspectives of the sector and its relation with other sector; a consideration of equity and efficiency aspects;

10) Concluding remarks, and recommendations.