

Financial Services to Improve Access to Water and Sanitation in Sub-Saharan Africa

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Achieving the Millennium Development Goals, particularly, reducing child mortality (the fourth), and halving the proportion of people without sustainable access to safe drinking water (the seventh) requires significant improvements in access to safe water and basic sanitation.¹ In Sub-Saharan Africa a water and sanitation crisis looms. Forty-four percent of the population does not have reliable access to safe water, and 63 percent remain un-served by sanitation facilities.² Income poverty is also at a crisis stage. Some 72 percent of the population in Africa lives on less than US\$2 a day and 41 percent suffers from extreme poverty on less than \$1 a day.³ Despite the dire need and consensus on the goals, public funds for water supply and sanitation are drying up.

Private sector financial services could contribute meaningfully to alleviating this crisis if they become available to low-income groups and small-scale pro-

viders of water and sanitation services. Currently, less than 10 percent of the African population has access to financial services, and products are rarely made available for investments in small-scale water supply and sanitation.

Marrying the financial with the water and sanitation sectors to make financial services available to low-income households and small-scale providers of water and sanitation services is a market-driven, market-friendly approach to resolving the credit constraint that is inhibiting the development of water and sanitation infrastructure in Africa. Depending on the situation, this approach (1) promotes the provision of financial services directly to low-income households in order to enable their investment, (2) extends access to water and sanitation services to poor households by making financial instruments available to micro-, small-, and medium-size private operators, and/or (3) targets public funds more effectively to the extreme poor

Key strategies are:

- Closing the information gap that exists between the sectors at the policy and operational levels, and between service users and service suppliers.
- Supporting competition and financial viability in service provision in addressing policy challenges.
- Financial broadening by widening the range of financial products suitable for small-scale water supply and sanitation.
- Financial deepening by increasing the outreach and coverage of financial institutions to small-scale service providers and users.
- Tight targeting of grant funding to the extreme poor and low-potential areas, and separating it from loans.



Photo: Arne Hoel/The World Bank



Key potential benefits are:

- Fulfilling the basic human need for, and human right to, clean water and sanitation.
- Enabling poor households to dedicate more time to economic activity.
- Improving the health status of poor households.
- Closing the “small business finance gap,” thus allowing small and medium-size private operators to expand water supply and sanitation services to those who are currently unserved.

POLICY AND IMPLEMENTATION ISSUES

Implementing this market-driven approach is not a ‘quick fix’ for poverty reduction. The relevant constellation of actors, policies, and circumstances is complex and many enabling conditions need to be introduced or strengthened across the financial, water, and sanitation sectors. Where credit at market conditions can be extended, this approach will fill in existing gaps; where market credit fails due to extreme poverty, the need for grant arrangements will persist. Despite the lack of conditions that would enable a broad-based application of the approach to be successful in the short run, solid gains are possible by implementing targeted pilot measures.

The financial sector. Most countries in Africa suffer from shallow financial systems that provide only limited access to services. The objectives here are financial broadening by widening the range of products, and financial deepening by increasing the outreach of institutions. Customer-friendly procedures, marketing to stimulate demand, and the collection of useful data are foundations that must be developed.

At the macro-level, policies must be put in place that supports market-based competition between institutions. Constraints that prevent financial service providers from offering products in a sustainable way must be removed. On the other hand, prudential rules and regulations, as well as supervisory structures, need to be elaborated, taking into account the particular characteristics of the micro-finance business.

Effective meso-level infrastructure must be in place for the financial system to work well in relevant areas. Key components of such infrastructure are (1) techni-

cal service providers and educational institutions that provide needed training, (2) market research and support for product development, and (3) refinancing facilities to buffer liquidity shortages and term-mismatches of funds.

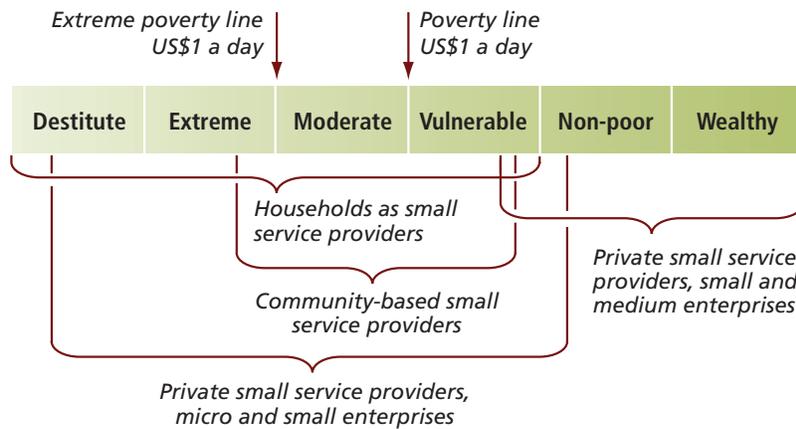
On the micro-level, financial institutions must establish working, responsive relationships with clients outside their traditional clientele, including low-income individuals and less-formal small businesses. To close the small business finance gap in the small-scale water supply and sanitation market, microfinance institutions need to ‘upscale’ to include private operators, while commercial banks should ‘downscale’ to reach low-income clients.

The water supply and sanitation sector is organized by various countries in different ways—centralised or decentralised, with service provision by public utilities or relying on private sector participation, etc. The main challenges in implementing a market-driven approach to closing the gap of financial services for small-scale water supply and sanitation providers are good corporate governance, sufficient autonomy that allows service providers to operate profitably, and the existence of regulatory mechanisms that guarantee quality, transparency, and accountability on the part of the private operators.

The concerns of the poor need to purposefully be addressed. Policy-makers and service providers should not assume that all poor customers represent high-risks and low-returns. They must also recognize that the main utility on its own might not provide end-services to the poor nearly as well as small-scale private operators, and should encourage the adoption of innovative and low-cost technologies. To this end, the creation of pro-poor units within agencies and utilities can be very useful. Restricting water tariffs in order to reach the poor can undermine the approach.

Potential client groups. To determine whether financial services are appropriate instruments for helping poor groups increase access to water supply and sanitation, it is essential to distinguish between the potential client groups. Some are households that provide their own services. Some are small private service providers, including micro and small enterprises. Others are more formal small or medium enterprises. There are also small community-based service providers. Two important differences are the economic status of the client and whether any of

these groups have commercial interests. The figure below classifies economic status along a continuum between *destitute* and *wealthy*, and suggests the type of service provider that tends to be most suited to each.



While this division of service providers by classification of client is a useful conceptual device, it is also very important to account for location because different financial instruments are better suited to urban and peri-urban areas, and to high- and low-potential rural areas.

Common needs. Low income groups are generally financially-illiterate, lack access to relevant financial products, and have limited technical capability. Financial institutions that build working relationships with these groups could overcome the lack of trust and negative reputation of their industry that prevails among those groups, and in so doing expand their client base. The clients, for their part, could establish a positive history and savings track record. All groups would benefit from interventions that support the local production and distribution of appropriate technology.

Households as small self-service providers are those not served by reliable and safe water supply or sanitation services. They tend to belong to low-income groups. The bottom of the economic range of this group mostly does not generate cash income, and so cannot access loans. For those with sufficient income, in urban or rural areas, appropriate financial vehicles and technologies can be made available with good potential for success.

Private small-service providers generate income by selling or transporting water or by providing latrine-cleaning ser-

vices. They operate mostly in urban and peri-urban areas un-served by the utility and typically inhabited by the poor. There are two main categories, whereby degree of formality is much more important than size in distinguishing between them:

Micro or small enterprises usually have low-skill sets, simple organizational structures, and minimal access to organized markets, formal credit, education, or technical training. This group mostly includes the extreme poor, poor, and vulnerable non-poor. Their main constraint is complying with the requirements of the financial sector because of their informality.

High potential nevertheless exists for drawing on financial services (especially micro-loans) in low-income, peri-urban areas for small-scale water supply investments.

Small- and medium-size enterprises resemble firms in a more formal sense. However, their incomplete formalisation and relatively large typical investments imply a higher risk exposure for financial institutions. These operators clearly do not belong to the poor, but can play an important role in serving the poor. This group has high potential as customers of financial institutions, but currently falls in the small-business gap that is served neither by micro-credit institutions nor by commercial banks.

Community-based, small-service providers are found mainly in water supply schemes in rural or peri-urban areas. The poverty levels of community group members range from the destitute to the more vulnerable non-poor. Their management and operational capabilities are low; they do not seek profits. They often lack sufficient legal recognition for consideration for loans, yet their investment needs can be large. If at all, they usually are served by the microfinance industry.

LESSONS

The marriage of the financial with the water supply and sanitation sectors for small-scale infrastructure is a new and complex undertaking that requires innovative approaches. To date, the body of relevant experience in

Africa is quite limited. One valuable pilot project underway is the Kenya Women Finance Trust Ltd. This program provides a one-year loan for a rainwater harvesting tank package that includes a reduced purchase price, delivery, and installation. This program is a collaboration with private-sector water tank producers.

RECOMMENDATIONS FOR PRACTITIONERS

Fostering an enabling environment for collaboration between the financial and the water supply and sanitation sectors is the first step towards putting this approach into practice. Recommendations include:

- Closing the information gap by facilitating exchange and dialogue among the key stakeholders and across the sectors involved.
- The development of appropriate market-friendly policy in the financial, water, and sanitation sectors.
- The development of supervision mechanisms that ensure financial soundness of business practices and the security of savings.
- The development of meso-level networks and professional institutions that serve rural financial intermediaries.
- The establishment of local equipment manufacturing facilities that produce small-scale water supply and sanitation technology.
- Innovation and pilot testing. In the financial sector, this means designing flexible, demand-driven products.

POSSIBLE DONOR INVOLVEMENT

Donor agencies can help support the market-driven approach in Africa through the provision of technical and financial co-operation. To be effective, agencies should work with national decision-makers to prioritize and support the recommendations listed above. Efforts

of financial institutions to broaden their product range and deepen outreach should be supported. Agencies can assist with the piloting of innovative facilities in low-potential areas, and strengthen financial institutions and non-financial institutions (i.e., equipment suppliers) in providing term-lending or leasing arrangements to end-clients. Second-tier institutions that offer refinancing to institutions on the micro-level should be fostered.

In addition, donors must carefully rethink their financing policy in the water supply and sanitation sectors. This new co-operation should aim to refrain from co-financing investments and instead support governments in pursuing the intelligent leveraging of loans by grants. It should also make funding available for small-scale water and sanitation service providers, rather than focusing exclusively on large utilities.

CONCLUSION

Opportunities for local financing mechanisms for water supply and sanitation run dry where the population has no means to repay a loan. In the initial stages of increasing access to financial services, the moderate poor and the vulnerable non-poor will benefit significantly. At the upper end of the extreme poor, households with cash earnings can be reached with appropriate financial vehicles. To reach the destitute and extreme poor, carefully-targeted grant funding might be required.

Thus for each country the following thorny issues will need further discussion:

- The role of private versus public sector in providing water and sanitation, particularly for the poorest.
- The role of large utilities versus small and medium-sized firms in water and sanitation.
- Ways to effectively reach the extreme poor without undermining financial systems development.

¹ This paper draws on studies authored by Brigitte Biesinger and Maren Richter, and on a Position Paper prepared by Alison Lobb, an independent consultant.

² 2006: WHO and UNICEF Joint Monitoring Programme for Water Supply and Sanitation.

³ 2007: World Bank Group (calculated online at <http://iresearch.worldbank.org/PovcalNet/jsp/index.jsp>)

This note was prepared by Julia Rota, Consultant with the Agriculture and Rural Development Department, based on a position paper written by Alison Lobb and published by the German Society for Technical Cooperation (GTZ). The position paper reports on the results of a series of studies undertaken by Brigitte Biesinger and Maren Richter, commissioned by GTZ on behalf of the German Federal Ministry for Economic Cooperation and Development (BMZ).

