

Conference Issue Paper

East Africa Regional Conference
Accelerating Water Supply and Sanitation for the Urban Poor
29-30 May 2006, Nairobi, Kenya

Role of Local Private Providers to Serve the Urban Poor

1. While municipalities or utilities may have the mandate and responsibility for provision of water supply and sanitation (WSS) services, in many cities and towns in Africa, these formal services are estimated to meet between 10 and 60% of the household demand for drinking water. An additional 5 to 20% buy water from an informal private operator who in turn purchases the water from an operator contracted by the local or national government. And the remaining households? They manage as best they can by paying informal businesses to provide services to them or by supplying themselves.

Understanding who provides water and sanitation services to the poor in practice is critical to the development of sector strategies and policies and sensible MDG roadmaps.

2. The participation of the local private sector (LPS) offers potential advantages to accelerate WSS service provision, particularly to the urban poor. In East Africa, the potential of the LPS involvement has only been made use of in few cases (e.g. Uganda); although an increase in LPS participation is underway in many places (e.g., Tanzania, Rwanda, Kenya...) or is likely to be a result of the path of modernization, decentralization and commercialization that most utilities are undertaking. However, LPS participation through small-scale provider (SSP) in WSS services now constitutes one of the most rapidly growing sectors in urban economies, illustrated through figures describing job creation, rising turnover and increase in customers. The success of the local private/small scale providers (SSP) sector to date, and the opportunity for this part of the market to increase service coverage to the poor is based on evidence that local private providers (i) know how to meet the demand of a variety of customer groups; (ii) consider the poor as a potential market (rather than as a burden); (iii) are willing to invest even in irregular and illegal settlements where legal guarantees are not forthcoming; (iv) are not bound by the same service and quality standards, which are often not suitable for servicing the urban poor taking into account their pressing needs and capacity; and (v) are diverse in nature and able to respond to the diversity of community demand.
3. In practice, the urban poor buy water and sanitation services from formal and informal local private sector actors and they will continue to do so for a decade or more to come. Over the last decade much has been learnt about the characteristics and behaviour of these small-scale, often informal, intermediate, local private sector providers.

In the short and medium term, water and sanitation service delivery to the poor in low-income countries is likely to rely on a multi-stakeholder service delivery strategy that provides options to consumers, and focuses on practical steps that put water in the hands of the poor.

4. The absence of formal utility service in low-income urban areas results both in a high level of illegal connections and a niche market for the local private sector whose response to user demand and ability to manage risks will absorb the risk of expropriation or demolition.

5. Tariff setting by regulators typically draws on information concerning production costs. However in the case of local private sector services this information is not available or used. Tariffs are then frequently fixed at the wrong level, perpetuating sector corruption and making the poor consumers bear the burden. One instrument for effective tariff regulation in the informal sector is competition.

The regulatory challenge is to ensure monopolistic behaviour is reduced and competition is enhanced.

6. Where they exist, subsidies and incentives created to compensate for the lack of profitability when selling water to low-income user groups are invariably channelled through formal institutions. Given that the majority of the poor are not receiving their service from these institutions, these subsidies are not benefiting poor consumers. This again highlights the need to link the SSPs to the formal utilities, to formalise them and to assist them in increasing the scale of their systems.

Output Based Aid mechanisms (OBA) look promising, e.g. subsidies that are passed on to resellers for services delivery in poor neighbourhoods.

7. Developing a dialogue and negotiating with the sheer numbers of individual entrepreneurs involved in service delivery in low-income settlements is impossible. It is necessary to identify interlocutors who can speak on behalf of the providers and fully articulate their needs, constraints and potential. Associations of providers have been established in many countries and recognition of their usefulness is developing. Associations can play a very active role in assisting active authorities resolve blockages. Typically they can help members to define and enforce practical standards, train members in technical and contracting innovations, optimize distribution systems, and establish consensus and solidarity within an otherwise disparate group of entrepreneurs. They can also provide the potential vehicle for constructing facilities beyond the capacity of a single business. Despite these benefits it is also clear that these associations can be used to negative effect and have an adverse impact on the poor. Any organization formed around collective goals finds ways of protecting or improving member interests (e.g. to increase market share, create monopolies, obtain access rights) over the interest of their customers, and in this case the customers are poor. The borderline between a professional association and a cartel is thin.

A key challenge of future work is to understand better the internal dynamics of water providers associations, to develop tools to monitor their orientation and to define precautionary measures and rules that limit the emergence of cartels likely to hamper the development of a fair, pro-poor water market. Self regulation mechanisms need to be increased as long as there is no other regulatory control.

8. The success of informal local private sector activities is due to their capacity to identify local needs, develop commercial niches, and propose solutions. But the constraints surrounding informality also prevent their development. In order to protect their businesses they seek a quiet profile, camouflaged, if possible, to limit the risk of interference. This has proven critical to their survival but limits their potential to move from small to medium sized enterprises and their ability to invest in adequate facilities. The challenge is to incite businesses to shift towards the formal sector and benefit from proper legal protection (having first ensured the legal framework is there to do so). With little evidence of success in this area, it is one of the most significant bottlenecks constraining improved service delivery in slums in peri-urban areas. The argument that formality and collateral lead to access to finance and increases future business prospects is difficult to convey especially when the benefits of informality are more immediate.

Without adequate incentive, formalization is perceived to stifle flexibility and creativity. Fair and transparent conditions need to be agreed upon to convince the informal sector of the benefits of formalization.

9. Few SSPs succeed in negotiating credit with formal banks. For this reason, they finance their investments and their working capital by calling upon the informal financial sector and passing these costs on in the form of higher tariffs to their poor customers. Informal sector borrowing is expensive money (real rates ranging from 2 to 3 % per month). Paradoxically, in Africa, formal banks are keen to identify borrowers in the booming urban services sector. The challenge is to establish sustainable and replicable mechanisms to unlock access to formal market-based finance by making these local private sector providers bankable, by establishing guarantees (such as long contracts and a track record with public institutions) and developing win-win agreements between large formal banks and small businesses in a rapid growth phase. Utilities could play a role in facilitating bankability of the local private sector. The challenge concerns the development of the contract – one of the most promising tools in the quest to finance infrastructure in the water sector.
10. The separation of formal and informal systems for decades has shown its limits and it appears that the development of the technical / physical interface between the two is now a field for innovation. Many African countries have laid the foundations for entering into partnerships with the local private sector and this promising development needs to be supported in a coherent manner and on all levels.

Connecting poor areas to the network or formal supply using appropriate technologies and strategies that meet consumer demand can result in economies of scale and optimize local private sector activity.

11. Creating accountability relationships between local providers and utilities, and giving them a legal status, is a key aspect of the bridge needed to join the utility with the local private sector. The regulatory regime should guide the utilities in this direction.

Much effort is needed to design appropriate contracts, tender procedures and other regulatory mechanisms that adjust to the characteristics of small water providers and accommodate formal public agencies.

12. Understanding the timing and content of the most appropriate package of support Local Private Providers is essential to developing replicable models for scaling up, but the nature of this support is bound to be context specific, and begs the question ‘what works where and when?’ Recent experience in WSS service provision in Africa suggests that one possible framework for understanding the necessary interventions is centered on the capacity and outlook of the utility, and considers the interventions and market support mechanisms at a given point on a reform trajectory.
13. Given its increasing role in delivering services to the urban poor, the local private sector stands as a critical component of the urban water market in developing cities. Unlocking its potential requires a series of targeted actions with a number of actors, on a number of fronts. These need to be aimed at enabling a market that is built on domestic-driven investment and activity and led by consumer demand.

Developing the institutional mechanisms and practical solutions which lead to the integration of the local private sector into city strategies will be critical if MDG roadmaps are to capture the essence of service delivery to the poor.

Imprint: This issue paper was prepared by a collaborative effort of the convenors of the East Africa Regional Conference on Accelerating Water Supply and Sanitation for the Urban Poor: the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), the Water and Sanitation Program (WSP), the Kenyan Ministry for Water and Irrigation (MWI) and the GTZ/MWI Water Sector Reform Program. This material may be copied for research, education or scholarly purpose only. All materials are subject to revision. The views and interpretations of this document are those of the individual authors and/or trainers and do not necessarily reflect the views of WSP, GTZ or the Kenyan Ministry.