



Microfinance for sanitation

Author: Originally compiled by Darren Saywell and updated by Catarina Fonseca in 2006

Quality assurance: John Butterworth and Jim Doherty

Edited and produced as a PDF document: May 2020

Introduction

Micro credit and microfinance are being developed as strategies for infrastructure development, poverty alleviation and income generation. This fact sheet provides a brief overview of microfinance for sanitation.

The success of the microfinance approach in supporting informal micro-enterprises in poor countries has led to it being considered in other areas of development. For example, the use of microfinance intermediaries to supply the credit needed to implement water and sanitation services has become a promising approach to improving service coverage in low income urban, peri-urban and rural communities.

This review examines the progress being made to develop microfinance mechanisms to support sanitation initiatives. It identifies some key factors in the failure and success of these initiatives using examples from around the world.

For additional information on key concepts concerning microfinance, readers are advised to consult the WELL Factsheet on microfinance for water supply services, and the WELL Briefing Note 16 on local financing mechanisms for water.

What is micro-finance

Microcredit is the principle of giving small loans to the very poor to help them generate an income of their own (Wheat, 1997). Microfinance is broader and incorporates savings and insurances as well as credit.

During the last couple of years, microfinance has become an even broader concept. "Building inclusive financial systems for the poor" is increasingly used as the financial institutions that provide financial services to the poor become more diversified and cannot be described as Microfinance institutions (MFIs).

The idea of making small loans to the very poor was first explored in Bangladesh in 1976 when the Grameen Bank was set up by the economist Professor Muhammed Yunus. The strategy of the Grameen Bank was to make up for a lack of borrower collateral to secure loans by creating social collateral through peer pressure support.

The essence of micro-banking is to replace sophisticated credit-evaluation techniques and collateral regulations with lower cost procedures.

A solidarity group of five or so borrowers would agree and mutually guarantee each others loans. This deterred loan defaults and repayment rates stand at greater than 90 per cent. This initiative showed that the poor need not be bad debtors.

Today, microfinance is seen as a crucial poverty alleviation strategy. In 2000, there were 1,580 Micro Finance Initiatives reported world wide, serving over 30 million people including more than 19 million of the poorest (Daley-Harris, 2002). Not all use the Grameen Bank method, other approaches to evaluate future borrowers include individual references, personal guarantees and rotating savings credit associations (ROSCA's) where loans are provided from a communal savings pot.

The generally very positive results from these projects have led to a high level of donor support for microfinance initiatives, and significant amounts of money have been pledged. However, the donor community has also brought with it expectations and requirements which may need clear and specified results in a short time period. This may not always be possible given the time required to build up self sustained microfinance institutions.

Microfinance and sanitation

Potential clients of microfinance for sanitation or sanitation-related services include small scale private providers and households. Microfinance has been used for the construction of household latrines, construction of public toilets, manual latrine-cleaning services and suction truckers which are used to empty pit latrines.

Leveraging household and community resources for sanitation improvements has been reported in countries such as India, Lesotho, Vietnam, Bangladesh, Pakistan and Burkina Faso (Mehta and Knapp, 2004).

Revolving funds for sanitation schemes at village level do not require collateral. Money is saved and borrowed on a rotation basis with no interest to cover the cost of a basic septic tank, for instance. Households often contribute labour.

Examples from around the World

Microfinance for sanitation and sanitation related services can improve access to safe disposal of excreta at smaller and larger scale. These, are illustrated with examples in this section.

Financing urban sanitation in Wogodogo, Burkina Faso

In Wogodogo, a low-income neighbourhood in the capital Ouagadougou, a saving-credit initiative has been set up for household management of domestic waste. The credit was provided by LAGEMYAM, a women's association working for improved sanitation. LAGEMYAM agreed to finance the initial 70% required to start up the credit system.

The interest rate was set to cover mainly administrative costs. Additionally, LAGEMYAM thought that because the population was poor it would be difficult to ask for collateral. The credit was provided based on moral values i.e. the fact that the borrower should be known by the association before having access to the credit.

In a first phase, solid waste collection was organised and 28 households benefited from the loans to construct excreta and waste water infrastructure such as VIP latrines, drainage and soak pits for domestic waste treatment. But only five households reimbursed the credit.

LAGEMYAM and CREPA (an NGO), had assumed that part of the revenue from the solid waste collection would finance the credit system for sanitation. But in reality this did not happen as the population was used to getting sanitation facilities for free and any revenues from solid waste

collection were invested primarily in basic needs such as getting water and food rather than paying back the loan.

During the second phase, 18 additional households constructed more sanitation facilities. The number of reimbursements improved slightly, because project animators from CREPA and the NGO EAST undertook an awareness campaign.

Participatory approaches, with the objective to help the population develop self confidence and commitment, took place in order to improve their attitude vis à vis the credit system. The beneficiaries then realised that if they didn't pay back, the system could not continue to run and the dynamic building sanitation facilities would stop in the neighbourhood. The system runs well now and the rate of reimbursement is more than 80%. (Kouassi-Komlan and Fonseca, 2004)

Microcredit for VIP latrines, Lesotho

This project was initiated in 1980 as part of a wider urban development scheme. The programme provided credit to households for investment in VIP latrines allowing for re-payment over an extended period.

In order to receive credit, households had to first dig a pit and provide a deposit of 30-40% of the total cost. Loans to cover the remaining costs were typically in the range US\$50-300. Although the money came from the Lesotho Government, the Lesotho Bank administered the loan since they had a better record in dealing with loan defaulters.

In 1990, 600 loans had been approved in response to 4500 enquiries, 252 latrines had been built and 81% of individuals had paid up. Close to 1000 VIP latrines were actually built in the target area revealing that about 80% had been built through private initiatives. This highlights the success of the promotion programme and the availability of an affordable and acceptable sanitation option.

Key aspects for the success of the project included (Blackett, 1994):

- Affordable and acceptable latrine design;
- Minimal direct grants or subsidies to householders;
- A comprehensive programme of VIP latrine promotion, health and hygiene education;
- Integration of the project into existing government structures; and
- Strong coordination in policy and planning between different departments promoting improved sanitation

Looking at the credit scheme itself, repayment with interest was supposed to ensure that households accepted full responsibility for sanitation. However, administration costs for the loan were high compared to their size and additional costs like the promotion and management of the scheme were not charged to the borrower. The project was successful at promoting sanitation but it did not create a sustainable microfinance institution.

Unsuccessful microcredit programme, Ghana

The Kumasi Strategic Sanitation Programme is well known for pioneering work on willingness to pay for sanitation in urban areas (Whittington et al, 1992).

The overall goal was to implement a strategy for urban sanitation programmes that could be replicated in other urban centres in Ghana. The guiding principle was the sharing of costs between the project and end users. Loans were made directly to tenant landlords for the installation of

shared sets of latrine units. Repayment was to be made by the landlord over a 2-3 year period to recover their costs. The landlord would either add an amount to the rent or collect a separate fee.

Collection of loan payments in this way has proved problematic. It has led to over billing of tenants and lapses to the regular payment schedule. Landlords sometimes retained funds until all tenants had paid up or used the money as working capital.

As of May 1993, over 40 per cent of the 224 loans disbursed in the 3 pilot areas were in arrears. Collection was further complicated by the fact that the responsibility for debt collection did not lie with a single financial institution but rather a combination of project staff and the community steering committee which added to overall loan administration costs.

Revolving fund for sanitation, Honduras

The Co-operative Housing Foundation (CHF) programme is a national strategy to provide loans for housing improvements in Tegucigalpa, the capital of Honduras. As of 1993, the program had disbursed around US\$4 million dollars to Honduran NGOs for on-lending to some 4000 households. Sanitation was identified as a niche in this market and a UNICEF grant of US\$350,000 was provided to establish a revolving fund for sanitation improvements.

The goal of the CHF programme was to develop NGO capacity to develop their own credit lines from other government departments and eventually the private banking sector. This meant that they first had to establish a track record of making and recovering loans successfully.

Loan agreements were made by beneficiaries directly with the NGO. No collateral was required although the backgrounds of borrowers were closely investigated. Co-signers were used to guarantee payments. Typically the loan would have a duration of 3 years and be paid off in monthly instalments. The average rate of interest was 15% which was low compared with alternative sources of informal finance through money lenders or retail credit.

The NGO's achieved a very high recovery rate of 95% in the early years. Some even developed alternative credit lines as planned. The prospects for integration with the formal sector seem very encouraging.

The success of this scheme can be related to the wide range of options in terms of the type of improvement made, the loan term and the quality of the improvement offered by lenders. Borrowers could tailor their lending package to their individual needs and hence the initiative avoided the 'one size fits all' approach. It was discovered that households were often prepared to choose the high cost option if the incremental increase in property value was considered to be high.

The flexibility of loan terms meant that borrowers and lenders could test the loan system at lower risk to each party. Smaller shorter term loans for sanitation were sometimes paid off early to be replaced by larger longer term agreements for more substantial housing improvements.

Provision of reliable technical advice and help in negotiating construction contracts was a key factor in attracting borrowers with plans to upgrade their sanitation facilities. Low income households often did not have the information necessary to make an informed decision about sanitation provision. A prime function of the loan officer was to monitor construction quality for the customer and use this ability to refuse disbursement to keep contractors in line.

A large subsidy is built into the loan programme i.e. the technical support provided by the CHF, but there is also provision in the financial planning for CHF to get sufficiently close-to-market interest rates from NGOs to preserve the value of the fund's asset base. When the NGO's take over the CHF function, the cost of expert staff will be much lower increasing the potential for sustainability (Co-operative Housing Foundation, 1993)

Recent trends

Sanitation interventions have had relatively low impact considering the scale of the problem i.e. 2.4 billion people without access to adequate sanitation. Very few programmes have reached more than 100,000 people. And even when latrines have been constructed, many are not used or not used as latrines.

The low coverage can be explained partly because sanitation improvements and hygiene education components that go with it, start off as highly subsidised pilot projects and are unable to make the transition from pilot to mainstream programmes due to lack of proper financing plans. Recent trends to improve this situation, related with microfinance, are discussed in this section.

Microfinance and the development of supply chains

Developing effective supply chains for sanitation products and promoting demand has proven more effective than household subsidies. Microfinance can be used for starting up activities required to provide sanitation services such as providing materials for construction, emptying the pits and treating the sludge.

Box 1. Hibir Municipal Sanitary Services

In Addis Ababa, Ethiopia, Business Development Services (an Ethio-German micro and small enterprise development programme) has organised 137 unemployed youth, mostly women, in two groups of cooperatives. Credit for starting up activities has been provided by an MFI and there was an extensive marketing campaign to get clients to buy the cleaning services. The service has a regular income secured with 1,200 clients are paying 3 to 20 birr/month.

The small scale private sector has the ability to tap markets for sanitation or hygiene related products such as soap, toilet construction, toilet parts, toilet cleaning and faecal sludge management. However, starting up activities requires credit. Service providers are able to make a decent profit and as such there is an incentive to create demand and ensure supply.

Opportunities for leveraging resources

Instead of sinking aid into subsidised household latrines, there is a real opportunity for using aid better by developing revolving funds in rural areas for latrines or peri-urban areas for household sewerage connections.

Box 2. Revolving funds at district level in Ghana

In Ghana, 22 Water Boards have formed the Association of Water and Sanitation Development Boards (AWSDB), which have a similar strategy as the community group revolving funds, but at a different scale.

A key strategy of the AWSDBs to mobilise deposits was to establish a pooled reserve fund, which is invested in Treasury Bills and other short-term, low risk, high return investments. The interest earned on the reserve fund represents a large capital base for member boards in each district for their water supply and sanitation activities.

Microfinance and commercial project development can be linked with subsidised activities (mainly done by NGOs) such as sanitation promotion and other technical support for cost-effective solutions and quality control (for instance care with contamination of water sources).

Strategic partnerships to develop scalable solutions

Given the need to build new markets and expand a client base, some MFIs have sought strategic alliances with NGOs and other financial intermediaries. These offer the possibility of complementary skills to reach these markets, with lower running costs for the MFIs since these are supported by the financial intermediaries.

Box 3. Water Partners International

WPI focuses on Strategic Partnerships to help bridge the MFIs and the traditional water sector NGOs. WPI provides financial support to MFIs to conduct pilot projects in the water sector and partners with them to equip them with expertise in the sector. WPI also provides NGOs with operations and credit training (by teaming them up with leading MFI banks in their region) in order for them to launch and manage microfinance operations.

The sanitation microfinance pilot projects with the NGOs in Tamil Nadu in India have reached repayment rates greater than 90% for VIP and cluster latrines in rural areas and urban slums

Source: WPI, 2005.

There are also an increasing number of examples where donors are setting up guarantee funds as an incentive for microfinance institutions to provide loans specifically for sanitation related activities.

Box 4. Garbage collection in Ouagadougou

The Caisse Populaire Ouagadougou in Burkina Faso, has developed a programme for women to collect household garbage. The programme key elements are:

- A guarantee fund has been set up as an incentive for the Caisse Populaire to provide the loans;
- Equipment was provided through the Caisse Populaire, with a 50% subsidy from the Swiss Development Cooperation;
- Special conditions for the loans include the non requirement of collateral and building up the client's credit worthiness based on repayment records

Credit was provided for a period of 18 months and 4 women's cooperatives have benefited. The reimbursement rate has reached 100%.

A clear communication and division of responsibilities between the different partners before setting up the new financing mechanisms and continuous training and monitoring of the beneficiaries have been determinant for the success of the programme.

Source: CREPA/IRC, 2006

Key factors for successful microfinance for sanitation

Successful areas of intervention to guarantee effective microfinance for sanitation are related with both sanitation and financial strategy.

Sanitation strategy

The local market for sanitation facilities needs to be developed. This demand may already exist or can be brought out or generated through an effective promotion scheme.

Sanitation can be seen as part of an overall shelter improvement package. However, microfinance products can be developed specifically to target the small scale private sector given the limitations in existing house improvement loans for sanitation in informal settlements, where tenure issues prevent access to these specific loans.

It is essential to use appropriate and affordable technology. Technical support and help with contracts are attractive and much appreciated characteristics of any sanitation scheme.

It is also advisable to provide a variety of different sanitation options to meet the specific needs of individuals.

Finance strategy

Some general rules gained from microfinance for enterprises apply equally to microfinance for sanitation provision. The credit scheme should be based upon market research of locally based demand, appropriate financial and accounting systems, thorough understanding of the borrower and intermediary capabilities.

Interest rates need to be based on the cost of funds, administration and labour costs, loan loss allowances, margin for inflation and a return on capital. Cost recovery is central to the financing

mechanisms used as in this way a sustainable financial system is achieved. Instead of subsidising directly household sanitation, aid can be used to cover some of these costs.

Loan administration and collection system need to be simple and adapted to the specific needs of the client.

Sources and references

The IRC Financing and Cost Recovery website provides links to other relevant cases studies and organisations involved with microfinance for water and sanitation. <http://www.irc.nl/page/113>

Blackett, Isabel C, 1994, Low-Cost Urban Sanitation in Lesotho, UNDP -World Bank Water and Sanitation Program, Washington DC, USA

Co-operative Housing Foundation, 1993, Supporting Shelter and Community Improvements for Low-Income Families in Central America, Environment and Urbanisation Vol. 5, No1 (April) pp38-51

CREPA/IRC. 2006. Report of the conference on Microfinance for the water and sanitation sector. Dakar, 12-14 December 2005. (forthcoming)

Daley-Harris, S. 2002. Pathways Out of Poverty: Innovations in Microfinance for the Poorest Families. Bloomfield. CT Kumarian Press.

Kouassi-Komlan, Evariste and Catarina Fonseca. 2004. Microfinance for Water and Sanitation in West Africa. 30th WEDC International Conference, Vientiane, Lao PDR. <https://wedc-knowledge.lboro.ac.uk/search.html?q=collection:%22WEDC%20Conference%20Paper%22>

Mehta, Meera and Andreas Knapp. 2004. The Challenge of Financing Sanitation for meeting the Millennium Development Goals. WSP – Water Supply and Sanitation Programme www.wsp.org/publications/af_finsan_mdg.pdf

Water Partners International. 2005. WaterCredit Initiative™. <http://www.water.org/watercredit/>

Whittington, Dale, Lauria, Donald T, Choe Kyeongae, 1993, Household sanitation in Kumasi, Ghana: A Description of Current Practices, Attitudes and Perceptions, World Development, Vol. 21 No 5 pp733-748