



Microfinance for water supply services

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Introduction

Microfinance is topical because it can make an important contribution to the achievement of the Millennium Development Goals (MDGs). Used properly, it can help to reduce income poverty, lessen the vulnerability of the poorest and empower women. For the water sector, it can help the poor to have access to water services.

Microfinance has existed for centuries around the world, including Africa, but 2005, the UN year of microcredit, was instrumental to inform and advocate for microfinance. Mainstream banks such as Citigroup, Deutsche Bank, Credit Suisse, the Brazilian Unibanco and ICICI Indonesia have now found out that the poor, like everyone else, attach great value to being able to save and to face unexpected expenses.

Historically, microfinance has focused on other sectors (such as trade, small scale producers).

What is micro-finance

In most developing countries, financial services such as bank loans, insurance, and pension funds are not accessible by the poor. When some forms of credit are available, these are often limited to either community savings groups or informal money-lenders that charge very high interest rates, reflecting the lack of a formal market.

Microfinance means literally that the amount of finance provided is small, and it has been defined as the provision of diverse financial services to low-income people. However, there is not one agreed definition of the term, which can mean anything from community based revolving funds to the products offered by affluent banks to specific clients (and who are not necessarily the poorest).

The term itself is becoming obsolete and “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 small loans to the very poor was first explored in Bangladesh in 1976, when the Grameen Bank was created. Their strategy was to get around the problem of a lack of borrower guarantee's or collateral, by creating a solidarity group of five or so borrowers who could vouch for each others' loans. Because the borrowers all know each other, there is increased peer pressure to

Microfinance can be essential in providing access to peri-urban households, as it is the case in Cote d'Ivoire where 300 households benefited from the micro credit provided by an NGO to pay the required connection costs to SODECI, the water company.

In three neighbourhoods of Abidjan CREPA Côte d'Ivoire, an NGO, partnered with SODECI, the public water utility, to enable poor households to connect to the network.

With grant funding from UNDP, CREPA first pre-financed the full amount (US\$36 each) of connection fees as a loan for all 300 households. At the same time, CREPA provided a capacity building program aimed at mobilizing household savings to repay the loan and ongoing water bills.

The micro loans were paid back in 17 months. This example is now being replicated in Ouagadougou but the credit is being managed by a microfinance institution

Source: Kouassi-Komlan, E. and T. Gnagne, 2005.

Independent providers

Small-scale providers tend to lack access to credit, which would for example enable them to buy water storage facilities, or to buy and repair water tankers for transport. Borehole operators need finance to drill boreholes or build small water networks. Without such access, most operators rely on family or informal loans, limiting their potential for growth.

PAPME, a microfinance institution (MFI) from Benin, provides credit to clients who borrow money for buying pipes, taps and hoses. Likewise, CMFL, a Ugandan MFI, offers loans for the construction of wells both for households and urban entrepreneurs which resell water. CMFL considers the entrepreneurial activities of independent water providers as a business venture.

In Cambodia, GRET (an international NGO) provides guarantees on commercial loans for piped water systems in rural areas, in case of default of the investor. With a guarantee, the commercial bank can provide medium-term (3-5 year) loans for water supply, with lower collateral

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The Butwal municipality in Nepal, has adopted a cost sharing approach for water supply, whereby 80% of capital costs are paid by the users and 20% is provided as a grant from the municipality. However, the users pay their 80% on an instalment basis (1US\$ per month per household), over a period of time, agreed by the users themselves.

The municipality manages a Drinking Water Management Fund in which the loan paid back by the community is deposited. Transparency in the management of the fund proved to be critical for its sustainability.

Source: WaterAid Nepal, 2005

Limitations of Microfinance in water supply

Because of its success and low default rate, the microfinance sector has become more diverse, with the entrance of several private commercial banks, finance companies, insurance companies, and many NGOs that have become regulated MFIs. Other changes have included modifications



Strategic partnerships to develop scalable solutions

panacea. Microfinance loans will need to be repaid, with interest. If an effective collection system is not in place, their effectiveness is doomed from the start.

Microfinance cannot transform a poorly planned or managed project into a good one. It can, however, help to address some of the different types of constraints of access to finance from households, CBOs, SSIP and municipalities.

Although microfinance may be one means to increase finance to the sector, non-financial measures are many times more critical than merely increasing finance. For instance, the illegal status of some peri-urban areas is a barrier for SSIPs to obtain credit and improve their services. Likewise, the requirement by most utilities for connection costs to be paid in one lump-sum remains a key barrier for increasing coverage to the poorest in urban areas.

Financial allocations need to be linked with empowerment and people's involvement. A few case studies have demonstrated that linking water and sanitation projects with productive activities and social marketing decreases the risk of non reimbursement of loans.

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