CONCEPT NOTE

WASH Financing

Challenges and Solutions

The need for financing

While great progress has been made in increasing WASH access globally, there are still billions of people who need safely managed WASH products and services. iDE believes that markets play a critical role in accelerating WASH uptake. By developing affordable, aspirational WASH products and compelling social marketing campaigns, iDE catalyzes households in the world's poorest locations to invest in WASH solutions and contribute to the development of sustainable, local WASH markets.

Not all customers can afford to pay the full cost of WASH products up front. Many also find it challenging to save up money over time due to the lack of local banking options, pressures to spend savings on family obligations, or unanticipated expenses. Targeted subsidies can increase WASH access for these customers, but subsidy funding is insufficient to meet the challenge. Financing options need to fill the gap. This paper lays out the challenges that organizations like iDE face in expanding access to WASH financing, and outlines opportunities for donors and investors alike to help address these challenges through innovations that bridge funding gaps, unlock working capital, and streamline credit assessments and collections.

Financing challenges

In iDE's experience, working with outside finance partners to expand WASH financing is more challenging than it has been in the past. Some of the primary issues include:

- **Small loans for non-productive assets.** Local lenders are more commercially minded than before and less inclined to give small-value WASH loans that are not explicitly tied to income-generating activities.
- **High capital and transaction costs.** In many countries, local lenders face high interest rates when borrowing from a central bank. This high cost of capital combined with high transaction costs deter MFIs from offering loans for small amounts. With these constraints, lenders struggle to achieve profitability even with a higher volume of small loans.
- **High perceived risk.** In many cases, lenders see WASH loans as an unproven market and fear high default rates, despite growing evidence that these loans carry no more risk than those that have traditionally filled lender portfolios. In Cambodia, for example, iDE has observed that sanitation loans have lower default rates (less than 2%) than the average MFI portfolio. Nevertheless, the Cambodia program has seen partner MFIs declining WASH loans at three times their average decline rate.
- **Repayment schedules.** In many cases, MFI loans have short repayment cycles designed to finance productive assets that can be quickly repaid. For example, loans for agricultural

inputs are often repaid in less than a year. Lenders are becoming more comfortable with the longer repayment terms (often 12-18 months) needed for consumption loans like latrine purchases, but this is not yet the norm.

- **Compliance and monitoring requirements.** Donors, lenders, and NGOs often apply well-intentioned requirements that are not commercially viable for businesses or distribution organizations, such as extensive verification of product quality before loan disbursement. While these restrictions are understandable reactions to previously encountered problems—e.g., households not using the loan for intended purposes, or businesses delivering sub-par quality products—more work needs to be done to address the underlying concerns that led to these requirements, while also ensuring the loan product is commercially viable.
- **Local MFI regulations.** In some specific cases, national governments have imposed interest rate ceilings on MFIs to control household debt, but this may have the unintended effect of deterring lenders from offering small loans. Some donors have offered to provide capital to address these obstacles, but MFIs may be less inclined to take money from international investors if the local currency is volatile or if funds are dollar-denominated and inflation is high.

Opportunities for donors

Donors can play a strategic role in addressing financing bottlenecks and accelerating universal access to WASH by focusing on the opportunities below.

Bridging funding gaps

Kiva.org is a popular financing partner for development projects since it offers interest-free loans and allows for smaller-value, risk tolerant lending. This incentivizes local partners to extend financing for loans that are not income generating (such as for WASH purchases), including to customers without lengthy credit histories. While organizations like Kiva can have a tremendous impact by bringing much needed capital to in-country financing organizations, there is often a significant delay between when the loan is requested and when funds are disbursed to a local partner; in some cases, iDE has waited as long as two months for disbursement. In the meantime, households want a quick decision on whether they have financing to purchase a WASH product. For partners without funding to bridge the time lag while Kiva requests are processed, it can be challenging to keep up with customer demand for financing.

Donors and impact investors can help bridge these gaps by pre-financing loans awaiting Kiva approval through a “float fund.” A float fund would allow local partners to disburse loans while waiting for Kiva funding to be processed. In countries with volatile local currency, investor funds could be held in interest-bearing USD accounts until Kiva money is disbursed, reducing the risk of currency fluctuations.

Unlocking working capital

Funds that go directly to WASH service providers/businesses can finance working capital or installment plans made directly to customers. Traditional lenders often prefer to offer financing to households rather than extend credit so businesses can lend to their customers, even when doing so would enable businesses to deliver WASH products to their customers more quickly.

Lenders unwilling to extend financing for businesses are often also unwilling to underwrite consumer WASH loans themselves, due to their low value or perceived higher risk. Donors have the opportunity to overcome these bottlenecks by making funds available to businesses or to programs that offer financing for WASH products.

Several of iDE's programs have successfully developed lending products and found this to be more efficient than partnering with local lenders.

- Hydrologic, a social enterprise affiliated with iDE Cambodia, produces affordable, aspirational household ceramic water filters for the rural market. Many MFIs are unwilling to offer a loan for the filter amount ($36 USD) given the relatively high transaction costs of administering such a low-value loan. In response, Hydrologic launched an in-house financing arm, which has had success meeting customer financing needs with installment payments. To date, Hydrologic has sold over 500,000 filters, with 90% sold on installment plans. This approach has been successful because Hydrologic is able to leverage capital from funders like Kiva.
- In Ghana, iDE's Sama Sama program initially explored MFI partnerships, and found that MFIs were unwilling to offer a toilet loan for a reasonable interest rate, due to their own high cost of capital. As a result, the program developed its own installment plan to ensure customers would be able to purchase toilets without incurring usurious debt. The installment payments include the principal and loan administration costs, while customers who pay full cash receive a discount. So far, 89% of customers have purchased using an installment loan, which is repaid over 18 months. However, internal funding and Kiva money are insufficient to keep pace with Sama Sama's goal of reaching 300,000 people by late 2019. The program continues to explore additional sources of working capital for both Sama Sama and our private sector partners.

In addition to financing programs to allow customers to pay in installments, donors may consider other approaches. For example, iDE Cambodia is piloting a training for sanitation businesses who are interested in offering credit to their customers. These businesses will be taught how to assess customer credit ratings, collect funds, and track installment payments. While it is too early to assess the approach, iDE is hopeful that it will address many of the financing challenges seen to date, including MFI disinterest in offering low-value loans and hesitancy to fund loans for non-productive purchases.

Streamlining assessment and collection processes

Donor funding can be used to purchase the services of firms that specialize in data collection and mobile money as a way to accelerate access to finance in the poorest locations. For example, lenders may be hesitant to offer small-value WASH product loans because of the high transaction costs associated with assessing creditworthiness and collecting payments (often in-person). Similarly, there are high transaction costs associated with lending to small and informal businesses, and there is significant reluctance to extend credit to customers without existing credit history or formal income streams. Alternative credit assessments can cut down on staff time and costs, while making it easier to determine creditworthiness for small businesses or customers who have informal or irregular income. Mobile money also offers solutions in terms of assessing credit risks and reducing transaction costs for collections.

Assessing creditworthiness

One company, Cignifi, examines customer call and text records along with prepaid phone payment history to determine how likely customers are to respond to financing offers and pay back loans. Using this information, Cignifi reduces customer acquisition costs for lenders by an average of 55%.[1] Other companies, such as Entrepreneurial Finance Lab (EFL), use psychometric surveys adapted to the local country context and language to assess creditworthiness. For example, an EFL survey for business lending will compare an applicant's responses to questions on business skills, attitudes, and ethics to those of similar business owners in the same country and globally.[2] This information allows a lender to assess the entrepreneur's credit risk relative to peers, and has helped lenders reduce default rates by 40%. Safaricom's M-Shwari mobile savings and loan service in Kenya uses mobile phone service data in conjunction with M-PESA mobile money history to determine whether customers are eligible for 30-day microloans.[3]

In addition to streamlining credit assessments, lenders need to consider how to streamline data entry at the branch or head office. The more organizations are able to automate the process from application to approval, the more quickly applications can be approved and disbursed, with cost savings passed onto customers in the form of reduced interest rates and fees. iDE Ghana's Sama Sama program, which offers installment payments for improved toilets in northern Ghana, is building this into their credit assessment. Field loan officers use an app on mobile devices to enter customer information at the time of loan application; this information instantly syncs with Sama Sama's Salesforce customer database, reducing the need for manual data entry at the head office.

The opportunity for donors here is twofold. First, flexible donor funding will be critical for iDE to engage innovative organizations like Cignifi and EFL in testing and scaling their services. Second, and just as importantly, donors bring expertise and cachet that can encourage productive partnerships between WASH sector implementers like iDE and finance specialists like those mentioned above.

Mobile money repayment

Collections are always the most expensive part of finance if lenders have to collect payments in person monthly. In-person collection often delays the loan application process if staff who review loans are out collecting money. As mobile phone adoption grows, mobile money payments can streamline this process, saving staff time and program costs. Currently, 30% of iDE Ghana's Sama Sama toilet installment payments are collected through a mobile money service offered by the telecom MTN. Increasing this to 70 or 80% would dramatically reduce the cost of collections. Additionally, emerging research indicates that repayment rates are higher when lenders offer mobile options, rather than requiring customers to pay at brick and mortar branches or waiting for a collections officer to visit their village.

As Sama Sama has learned, while mobile money is a promising solution, there are still a number of technical challenges that need to be overcome to use it at scale for repayments. Luckily, there are simple, available solutions to these challenges.

- Customers may input an incorrect customer or account number, delaying repayment. This can be resolved by developing a better API between mobile operators and the lender that would prevent mis-keyed payments from going through. Better interfaces would also simplify payments from the customer's perspective, which could make them more likely to use mobile money to repay loans.
- To truly take advantage of the benefits of mobile money, programs need a way to automatically document repayments in existing databases, eliminating the need for staff to manually track and enter repayment amounts. For example, the Sama Sama team is

[1] How does Cignifi work? https://www.youtube.com/watch?time_continue=100&v=AEJs0gw6PKw Accessed October 13, 2017.
[2] EFL FAQ https://www.eflglobal.com/about/faq/ Accessed October 13, 2017.
[3] M-Shwari FAQs https://www.safaricom.co.ke/faqs/faq/273 Accessed October 13, 2017.

integrating these payments into its existing Salesforce system, which allows for real-time reporting on the total loan portfolio, customer payments, payments in arrears, etc.

Other opportunities to use mobile money to streamline collections including having a list of vetted telecom vendors for repayments, rather than accepting funds from any vendor, and bypassing vendors altogether and having customers pay directly from their own mobile wallet.

iDE's experience with telecoms have been mixed, with inconsistent levels of enthusiasm. Donors are well positioned to bring capital that derisks new investments by telecoms that they would otherwise consider a distraction to their main business. In addition to funding, donors can also bring past experience in mobile money solutions to bear on WASH-specific issues. This knowledge sharing will be especially important as organizations like iDE look to scale mobile money payments for new WASH products.

Looking Forward

Donors have an opportunity to address barriers that are hindering the scale-up of WASH financing. By investing in ways to bridge funding gaps, unlock working capital, and streamline credit assessments and collections, donors can leverage innovative approaches to drive toward universal WASH access.

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