



Public Private Partnerships
and the Poor

Series Editor: M. Sohail








Public Private Partnerships *and the Poor*

Interim findings – Part A **Summary and lessons learned**

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2001



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Sohail, M. and Cotton, A. P. (2001)
Public Private Partnership and the Poor
Part A: Summary interim findings and lessons learned
WEDC, Loughborough University, UK.

ISBN Paperback 0 906055 93 8

This document is an output from a project funded by the UK
Department for International Development (DFID)
for the benefit of low-income countries.
The views expressed are not necessarily those of DFID.

Designed and produced at WEDC

Printed by Q3 Print Project Management Ltd, Loughborough

Acknowledgements

The authors gratefully acknowledge the many different people who have willingly contributed their knowledge, opinion and their time to the development of this work.

In particular we wish to thank Mr Ian Curtis, DFID; Dr David Hensen, University of Durban Westville, South Africa; Mr Jeremy Tim, Palmer Development Group, South Africa; Mr Noman Ahmed, NED University of Engineering and Technology, Karachi; Professor Arif Hassan, Urban Resources Centre, Karachi; Ms Barbara Evans and Ms Clarissa Broklehurst, Water and Sanitation programme; Ken Caplan, Business Partners for Development; Mr Roger Brown, Binnie Black and Vteach; S. Cavill (Research Student); WEDC members of staff and Ms Kimberly Clarke for technical editing.

Special thanks to the people from low-income settlements of case locations who have contributed to the research and provided their perspectives on the issue. We feel greatly indebted to them.

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Executive summary

The purpose of this project is to determine workable processes whereby the needs of the poor are promoted in strategies which encourage public-private partnerships (PPP) in the provision of water supply and sanitation services. One of our key objectives is to fill some of the gaps which exist in evidence-based reporting of the facts and issues around the impacts of PPP on poor consumers. This report presents the interim findings of our analysis of both the pre-contract and operational phases of a number of PPP contracts; one of the most important things we have done is to talk to poor consumers and elicit their perceptions. Details of the operational case studies are given in Part B of the report. We have taken a broad view of PPPs and included situations where the public sector is in partnership either with formal private sector companies, or with small scale local entrepreneurs, or with NGOs employed in a private sector capacity.

We have analysed the pre-contract stages of PPPs because this is where the 'rules of the game' are specified and have found the following:

- A key policy issue is that the poor are rarely mentioned at the very outset when the PPP framework is being drawn up; without this, their needs are unlikely to figure in the ensuing contract.
- Poor and vulnerable groups exert little pressure; core issues in PPP development are financial and technical and not those concerning poverty.
- There is a pressing need to develop a base of information about low income groups which is directly usable in the development of PPP arrangements. The process of PPP contract development is tightly time-bound giving little scope to remedy this within the ways of working which are currently the norm.

In PPP operations, the success of the arrangements for governance and the users perceptions of this success depend upon the effectiveness with which relationships can be developed with poor consumers. Projects which had noticeable impacts were based on an understanding of their needs and constraints; technological and financial systems were developed which matched these needs. Successful projects reviewed to date tended to be relatively modest in scope, involving small scale entrepreneurs or NGOs rather than the formal private sector. Measures which are com-

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only used to measure private sector performance, for example reduced leakage, may lead to a more efficient system but they have yet to translate into benefits which are tangible to the consumer groups in question.

Tariff structures have a major impact on the poor. Household cash flow and hence ability to pay for services is highly sensitive to changes in the tariff structure. 'Lifeline' tariff blocks do not necessarily ease the situation from the users perspective.

Imbalances in capacity exist between the partners. Problems occur when small municipalities are required to regulate contracts with the formal private sector; where the private sector partners are small local entrepreneurs, their lack of capacity causes problems for the public partner which has difficulty in offering the necessary support.

We can identify three factors which are generally present in those cases which had a positive impact on poor consumers. These are:

- a shared vision of the PPP which takes account of the needs and preferences of poor consumers;
- effective communication channels between partners; and
- formally agreed roles and responsibilities.





Section 1

Introduction

Purpose of the study

The purpose of this project is to determine workable processes whereby the needs of the poor are promoted in strategies which encourage public-private partnerships (PPP) in the provision of water supply and sanitation services

Why we are doing this work



Many bilateral and multilateral agencies are strongly advocating involvement of the private sector through public-private partnerships as a means of delivering better water and sanitation services. At the same time, these agencies require their programmes to have a clear poverty focus. PPP arrangements are now being implemented and proposed in low-income as well as middle income countries. The number of poor people affected by such arrangements is growing and there is a need to establish the conditions under which they are likely to benefit. This will assist donors to focus their support. Many PPP arrangements concern water supply; given the crucial importance of sanitation in relation to the objectives of many donors; there is an urgent need to explore to what extent sanitation figures in PPP arrangements.

What we have done so far

In our inception report we set out the scope of the work and criteria for selecting case studies which would increase our understanding of how the needs of the poor can be given more prominence in the development and operation of PPP in water supply and sanitation. We have focused on the distribution (and collection) end of the supply chain, close to the final users. This is generally where obstacles to provision for the poor manifest themselves; there tends to be scope for innovation and choice with respect to both the technologies available and the institutional and management arrangements adopted.

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To date, we have carried out a number of activities, which shed light on this. Non location-specific reports and case studies include:

- Inception report;
- literature review;
- analysis of the PPP strategy development phase; and
- analysis of the PPP procurement process;

The following city-based case studies have been completed

- Queenstown, South Africa an international PPP (government with formal private sector);
- Cato Crest, Durban, South Africa an international PPP (government with small entrepreneurs);
- Dolphin Coast, South Africa (government with formal private sector);
- the aborted privatisation process in Karachi, Pakistan intended to be an international PPP (government with formal private sector);
- Orangi, Karachi, Pakistan: sanitation (government with NGO);
- Orangi, Karachi, Pakistan: water supply (government with community groups); and
- Kibera, Nairobi, Kenya (government with small entrepreneurs).

Passing reference is made to work underway in Buenos Aires, Argentina and Jakarta, Indonesia.

We have included case studies where the formal private sector has been involved and also situations involving local entrepreneurs and civil society groups which have been employed in a private sector capacity. Whilst outside the mainstream of formal PPPs, these latter cases may provide useful examples and lessons where the poor have been the focus of partnership arrangements. There may be innovations in the smaller local PPPs, which have the potential to be transferred to larger conventional PPPs.

It is worth noting that the literature review revealed that whilst there exist documents which hypothesise about the effects of private sector involvement on the poor, many of which appear to strike up distinctly *pro-* or *anti-* positions on the wider and contentious issues around privatisation, there remains little direct evidence-based reporting. One of our key objectives is to remedy this situation. This document is neither a discourse about privatisation which advocates views on its desirability or otherwise, nor does it promote particular courses of action on the basis of theory alone. One of the most important things we have done is to go



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and talk to poor consumers to elicit their views. This has been crucial to our investigation of the operational end of how things actually work - as opposed to how they are supposed to work. The evidence we present is based on a review of actual contract documents and on case studies carried out through an extensive programme of site visits and interviews with low-income consumers, public sector agencies, private sector operators and local politicians. The richness of the data is a tribute to our local partners who undertook the field work; their knowledge, experience and understanding of systems and people are central to the findings we present.

What this report is about

The objective of this report is to synthesise the findings of case studies, which have been completed to date. These studies focus on both the contractual processes and operational issues of PPP, including the perceptions of poor consumers. We attempt to draw out lessons learned which:

- report the challenges faced and opportunities created by different forms of PPP in their efforts to improve services for the poor; and
- Identify key issues that are central to promoting the needs of the poor in future PPP.

We emphasise that these are interim findings based on the evidence of the case studies and secondary data collected so far. The final output, which will be supplemented by additional case studies, will include in-depth development of the implications, recommendations for strategic approaches and key guidance points for promoting pro-poor strategies within PPP.

Part A of the report gives a summary of our interim findings and of the lessons learned so far. It is structured as follows

- Introduction
- Background to PPP
- Preparing for PPP: the contractual framework
- Analysis of the operational framework
- Lessons learned from the findings

Part B of the report provides a summary of each case study, along with an analysis and synthesis of the findings.

Who should read this report

We have written this report with a wide readership in mind, including:

- readers with a general professional interest in the water supply and sanitation sector, in procurement and in governance;
- policy makers who are developing strategies for PPP in water supply and sanitation;
- Staff of private sector firms, local government officials, NGOs and CBOs who are involved with the development and implementation of PPP.

Our final output will include shorter documents, which are targeted quite specifically at different audiences

Where to find out more

There is a detailed report on each of the case studies, which includes:

- a full discussion of the processes leading to the PPP;
- descriptions and analysis of roles and responsibilities
- summaries of the interviews with poor consumers and other stakeholders; and
- Sources of further information for the cases.

These detailed reports are available on the project website at <http://www.lboro.ac.uk/wedc/projects/ppp-poor/>

Section 2

Background to PPP

The involvement of the private sector in partnership with government has been advocated as a means of improving the development of sustainable water and sanitation systems. Public Private Partnership (PPP) is used in this report as a general term to cover a wide range of agreements or partnerships made between private sector concerns, public sector utilities, government departments and consumer groups in relation to the delivery of water and sanitation services.

Governments are turning to PPP arrangements for the provision of services for a variety of reasons, which may include:

- lack of capacity of government institutions to deliver a reasonable level of service or to improve service quality;
- financial weakness of public utilities;
- lack of public sector financing capability;
- inability of public institutions to respond to increasing growth in demand through, for example, rapid urbanisation; and
- Problems related to the large numbers of employees in public sector providers and their productivity.

In addition, International Financing Institutions (IFIs) require that certain indebted countries reduce domestic spending as part of structural adjustment programmes; they promote the idea that the private sector is more efficient and effective, and delivers a better quality service.

One of the difficulties in defining the scope of studies concerning private sector involvement in water and sanitation is the sheer diversity of possible partnership arrangements and potential actors. This can range from: complex concession arrangements lasting thirty years which are operated by multi-national companies; shorter duration, simpler forms of management or service contract undertaken by medium sized private enterprises; through to service delivery by small



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scale independent providers who are local entrepreneurs. Note that the different types of formal contracting arrangements are well documented elsewhere.

We have found that it is the more complex contractual relationships, such as concessions and leases, which effectively provide most opportunity for the public sector to make use of the full resources of the private sector. Within the context of our study in water and sanitation, this leads towards hitherto largely unexplored relationships between the formal private sector and groups of consumers who are very poor. Furthermore, relationships may need to be developed with local informal private sector concerns which may be involved in a secondary market for water and which provide the link to poor consumers. The public sector, whether a utility, local government or state government, features in all cases.

We have not investigated relations between two formal commercial providers, nor relations between different public sector authorities. Similarly, totally autonomous forms of provision, for example by community initiatives alone, are not a particular concern of this study.



Section 3

Preparing for PPP: the contractual framework

Introduction

The contractual framework is key to understanding the formation and development of PPP arrangements which involve the formal private sector (PS) in long term lease and concession contracts. We suggest that the process adopted have an important influence on the way in which the operational details of service delivery are worked out. It is these operational details which subsequently impact either positively, negatively, or neutrally, on the poor.

The contractual framework for involvement of the formal private sector can be broken down into four distinct phases as outlined in Table 1. We emphasise that this is how things are currently done, rather than reflecting what may be desirable to promote a more overtly pro-poor approach.

Before discussing the operational aspects of PPPs, in this section we address the ways in which the pre-contractual stage determines how the PPP will affect the poor. Detailed reports analysing phases 1 and 2 have been prepared. We have identified a number of important issues in the stages leading up to the appointment of the Operator and award of the contract. There is a lot at stake in the award of a contract for a duration of 20-30 years and competitive bidding dominates the overall strategy forming process.

This is reflected in the findings of our analysis of the pre-contract award stages of past projects, which are described below.

Policy issue: the poor do not get mentioned. Our key finding is that at the outset, the sponsor/client's objectives and terms of reference do not generally require the needs of the poor to be specifically addressed. This is critical; as the contract development process proceeds it is increasingly harder to bring in changes to the basic terms of reference. Unless provision for poor groups is brought in at the

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Table 3.1. Contractual process in the development of PPP

Phase	Description
1. Development of strategy to involve the private sector:	<p><i>Objective: to develop the overall strategy for the PPP</i></p> <ul style="list-style-type: none"> ■ Responding to factors driving the PPP ■ Development of overall policy to secure PS involvement ■ Define the scale and scope of PS involvement ■ Selection and appointment of advisers ■ Investigation of PPP models and options ■ Selection of preferred option ■ Development of detailed PPP format ■ Planning for regulation
2. Selection of private sector provider	<p><i>Objective: to bring about the award of a contract to a private sector operator</i></p> <ul style="list-style-type: none"> ■ Sourcing of relevant information ■ Drafting of laws and regulations for PS involvement ■ Advisers prepare bid documents including a draft contract ■ Procurement of PSP arrangements ■ Pre-qualification of potential providers ■ Bidding by the potential providers ■ Evaluation of the bids by client and its advisers ■ Negotiations with successful bidder ■ Financial closure ■ Award of contract
3. Operation and regulation	<p><i>Objective: service delivery within the terms and conditions of the contract</i></p> <ul style="list-style-type: none"> ■ Implementation of PPP arrangements: financing of functions, mobilisation, delivery of contracted outputs. ■ Establishment of operational autonomy from government ■ Establishment and implementation of independent regulation ■ Service delivery, operation and development of the system in accordance with agreed performance standards ■ Regulation of PPP arrangements and re-basing prices
4. Termination	<p><i>Objective: satisfactory conclusion of the contract</i></p> <ul style="list-style-type: none"> ■ Rebidding or renegotiation of contract ■ Termination of contract ■ Handover of new assets ■ Evaluation of PPP



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start, it is unlikely to figure at the operational stage. The operator will follow the requirements of the contract; if this does not specifically require him to address the needs of the poor, then he will not do so. The operator is a commercial undertaking, not a development agency and it is not reasonable to expect him to act as one. Commercial reality dominates and services have to be paid for. Whilst changes to operating practice can be negotiated, it is clear that more attention needs to be paid by the sponsor/client and their advisers to creating a policy framework which is more inclusive from the outset given the long term of many concession arrangements. The responsiveness of funding agencies is an important part of PPP procurement; they are sometimes seen as being too distant during the PPP development process, which hampers their ability to promote a pro-poor policy.

Poor and vulnerable groups exert little pressure on the PPP development process, which focuses on the timely appointment of the Operator. Information campaigns are sometimes requested but seldom are they expressly required to ensure access to disadvantaged groups. The poor particularly suffer from “information deficits”, that is, the gap between what is known and what needs to be understood. These deficits are due to both the sequencing of the contract development process and the allocation of insufficient attention and time. Ensuring that more is known about low-income areas before the start of the PPP process is therefore critical, as scant information coupled to a tight time scale and constrained inputs can harm the completion of the full assessment process, particularly for the poor.

Core issues in PPPs are typically technical and financial and not those surrounding poverty. The quest for full cost recovery features prominently; attention is seldom drawn to the ‘public goods’ nature of a more efficient water sector. Wider social and public health objectives are not typically defined or included within contracts. Tackling what are currently perceived to be peripheral issues (for example, duty of care, obligations for universal supply, exclusivity of supply, legality of tenure) could risk sidetracking the competitive bidding and PPP implementation process. We also note that there may be a lack of precision even within the core issues. For example, the terms ‘ability to pay’ and ‘willingness to pay’ are used without definition or detail of the scope of services required for their effective study. There is no standard or accepted practice against which revisions to tariff structures can be made.

Knowledge and understanding of advisers. Terms of Reference mostly appear to be drafted by advisers who are distant from the sponsor/client’s organisation;

their expertise will be determined by the requirement specified by the sponsor/client and normally focus on the core specialities of technology and finance. The inclusion of expert staff who have PPP experience and a workable knowledge of how to improve water and sanitation facilities for low-cost areas are clearly important for pro-poor strategies to be adopted. This lack of understanding on the part of those responsible for developing and negotiating the contracts can lead to the omission of important existing informal arrangements between public utility staff, water vendors and low-income customers.

The time scale for the sponsor/client's advisers to prepare the necessary bidding information is relatively short and they focus on the core technical and financial PPP issues. Tight time constraints inevitably leads to advisers prioritising their workload; consequently, the complex and little understood issues around serving the poor (which are not likely to be part of the terms of reference) are unlikely to receive serious consideration at this stage. The 'time factor' may therefore be a contributing factor for the historic under-representation of services to low-income communities in many concession contract documents.

Drafting of laws and regulations. Time and cost constraints during the procurement phase preclude the opportunity for a whole-scale re-drafting of primary legislation related to the water and sanitation sector. The need to support the PPP process with only minimal changes is an important objective. We are unable to conclude from our contractual analysis whether readily available legal, regulatory or financial instruments could facilitate inclusion of special provisions for the poor.

Bidding by the potential operators. The harsh commercial realities of competitive bidding often mean there is little material change in final service delivery when compared to that set out in the draft contract. Bidders rarely offer improvements over the minimum stipulated requirement and it is not realistic to anticipate that they will propose to extend service coverage into poor areas about which little is known.

Negotiations with successful bidder. In striving to strike the most favourable economic arrangements there is evidence of asymmetry of influence between sponsors/clients and bidders. For complex, long term concessions the market is dominated by relatively few major providers. In some cases government bargaining power is reduced; in order to attract private sector interest, governments may offer terms that present less risk and/or underwrite the risks of the operator. This

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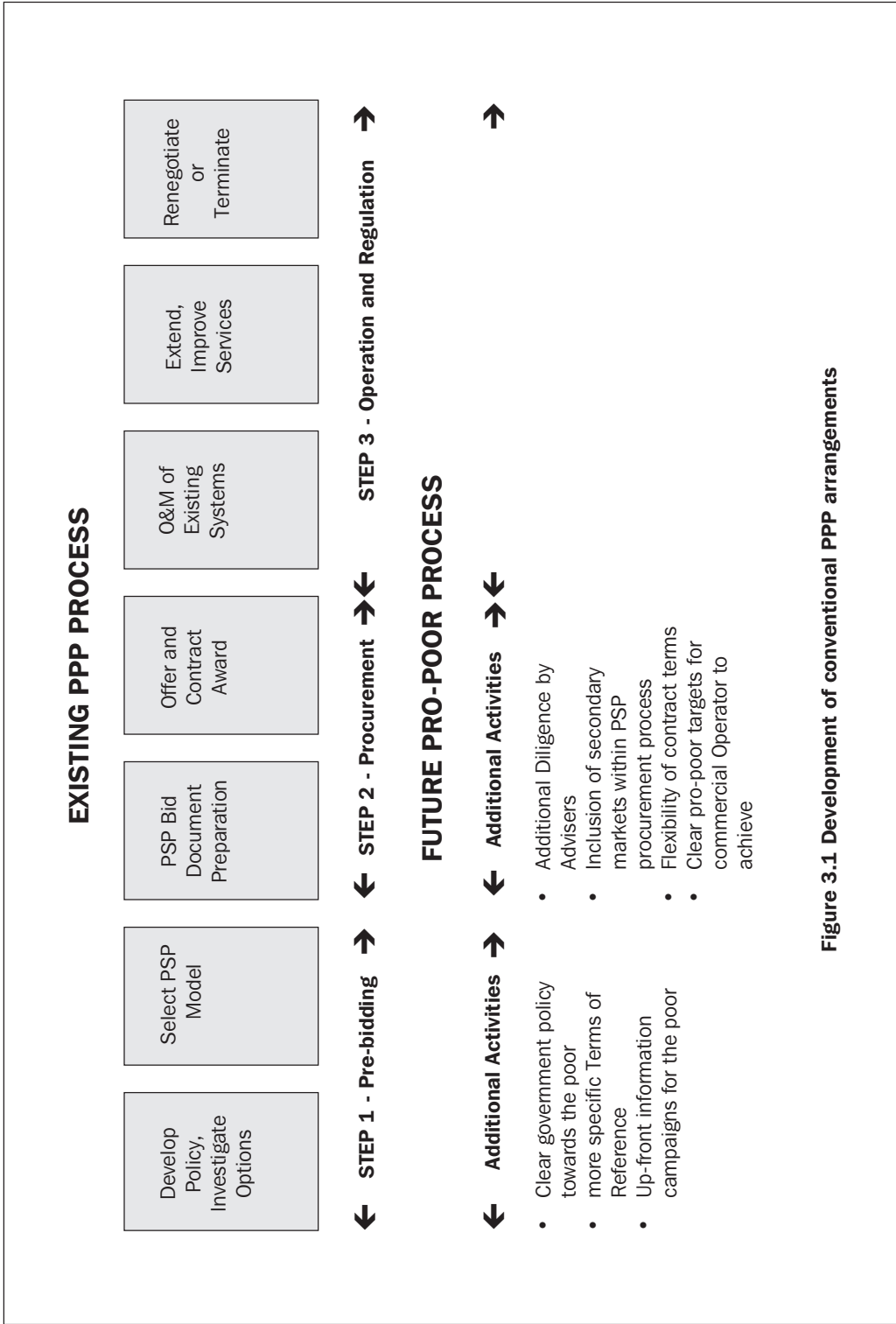


Figure 3.1 Development of conventional PPP arrangements

was illustrated in the case of Karachi, where the proposed contract contained ambiguities, which favoured the private operator; there was no reference to setting out specific service standards to be delivered in the contract.

Flexibility in the contract: PPP contracts in water supply and sanitation often rely upon “command and control” contractual provisions that contrast with other services which appear to grow by adding economic value (and economic self-interest) into their business mentality. In situations where the operator has more control over the level of service and how much to charge, there may be greater scope to determine the extent to which the service coverage is extended to poor groups.

Implications for PPP preparation

Figure 3.1 (adapted from Halcrow Management Sciences) illustrates in general terms the development of conventional PPP arrangements. Based on our analysis of this process, we suggest a number of additional activities in order to promote and mainstream the inclusion of the poor.



Section 4

Analysis of the operational framework

Introduction

In this section, we present the analysis of our findings in relation to operation and regulation of the PPP. Once the contract has been awarded, an operator becomes responsible for some or all aspects of service provision in accordance with the terms and conditions of their contract. The way in which the partnership comes into being and the process of competition used to procure the involvement of the private partner is an important factor. This is described fully in the case studies and is outlined in Part B of this report. As we have seen from our previous analysis, the pre-award stages are crucial in determining the shape of things to come for what is potentially a very long time. We now need to draw on the evidence of how this works in practice regarding the services to which the poor have access. It is worth noting that much of the discussion and many of the findings presented below are equally relevant to public sector service providers.

Governance and relationships with consumers

Public sector utilities and private companies are experienced in service provision to regularised developments occupied by middle and high-income consumers with individual service connections. Public sector utilities rarely have much experience in dealing with service delivery to the poor; operators from the formal private sector appear to have even less. A key feature of extending coverage to the urban poor therefore involves working out new relationships between a diverse range of actors who have little if any experience of one another. This has been one of the most significant operational issues to emerge from the case studies.

The provisions of the contract between public and private partners normally sets out a framework for regulating the performance of the partners; much of the focus is around mechanisms for determining performance standards and the basis for pricing and payment. Inherent in this framework is the means for protecting consumer interests and the mechanisms for redress. There are two different approaches that emerge from the cases.

Indirect links: partnership involves formal private sector. In cases where the operator is from the formal private sector, it is the contractual and hence regulatory link between the operator and the public sector sponsor/client that provides the mechanism for addressing consumers concerns. If consumers are dissatisfied, their mechanism of redress is via the public partner through its control (as the client) over the performance of the operator. There are not necessarily any direct links between the consumers and the operator. The key question is whether or not this type of contractual and regulatory framework has produced a mechanism that is working for poor consumers.

Direct links: partnership does not involve formal private sector. In cases where small local entrepreneurs or civil society groups take on the role of private sector operator, they generally act as an intermediary between the public sector sponsor/client and the consumer. This can involve acting as a retailer of water services. In these circumstances, there tends to be more negotiation of problems and issues at the local level, communicating directly with consumers or their representative groups such as local development associations. There is less recourse to legally binding agreements. The key issue remains the same, namely whether the mechanism works for poor consumers.

Building relationships with low income consumers

In this section we focus on the different ways in which the operator, whether from the formal private sector or not, develops relationships with poor consumers. We also consider the effectiveness, users perceptions and sustainability of these relationships. There are two situations of partnerships which do not involve the formal private sector:

- the informal private sector; and
- civil society organisations.

Formal private sector. In Dolphin Coast, the sponsor/client municipality employs two full time community liaison officers who deal with low income consumers through community liaison committees and local development committees. The reporting line is directly to the municipality. The operator has held meetings with communities, but this does not appear to be formalised. Opinions as to the effectiveness of this are diametrically opposed. The public sector client thinks it is working well, whereas low-income consumers do not share this view and feel that the operator does not assist in any way and that their concerns are not listened to. This may be related to a fundamental dissatisfaction with tariff rates. There are also concerns about lack of consultation in decision making.



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An unusual feature of the Queenstown PPP is that customer management rests with the sponsor/client municipality rather than the operator. Residents can raise issues through their local political councillors; problems can also be brought to the attention of local civic associations. Whilst the operator does not have direct access to consumers, its concern is such that it provides funding for the salaries of the municipal staff dealing with water and sanitation complaints. The operator would prefer to be responsible for customer service, as there is a deep dissatisfaction on the part of poor consumers. This is again related to a fundamental dissatisfaction with tariff rates and with the perceived lack of clarity on roles and responsibilities with the way that the system operates.

Whilst these current systems are sustainable, they are not working at all well

Informal private sector entrepreneurs. In Cato Crest, the water bailiffs, who are responsible for retailing water from the municipality to consumers, fulfil the role of private operator. Their Community Liaison Officer, who assists both residents and bailiffs with any problems they have with the water supply, plays a key role. The bailiffs record consumption according to the meters and calculate the amount payable to Durban Water. Residents had many different avenues for dialogue, including notices; telephone numbers; post boxes; and directly through the bailiffs, the Community Liaison Officer, and development committee members. The roles and responsibilities of both the bailiffs and the consumers are written down in a contractual form. User satisfaction with the service and the operator (the bailiffs) was very high at 71%.

Despite the effectiveness and high consumer satisfaction with the operation, the municipality is concerned about the sustainability of the arrangements primarily because of the support that the bailiffs need. It is management intensive and expensive; the costs simply do not stack up and the system is to be discontinued.

In Kibera, the situation is complex and involves a system of both private vendors who retail water from the municipality, and community based organisations that supply water to their locality. The price of water sold by vendors is highly variable according to the season. To date, the partnership aspect has not been formalised and there appears to be little engagement by the public sector in relation to developing transparent and equitable distribution systems. The relationship between vendor and purchaser is purely commercial without any evidence of mediation in issues of consumer concern. There is a less transparent relationship between officials of the public utility and the vendors.

Civil society organisations. The role played by the NGO in the Karachi sewerage scheme was to facilitate communication between the public sector engineers and the local residents groups, and to provide detailed technical assistance. The public partner paid the NGO for its services. Public sector engineers had no interest in either communicating with low-income groups or in implementing lower cost designs that had been developed by the NGO. This is despite the fact that residents were willing to pay for the capital cost of the local (tertiary) sewers if the cost became affordable. The real success is the work the NGO has done in mobilising and training community members through effective interaction between qualified professionals and low-income communities. The NGO provides technical support, tools and prolonged association that enables communities to construct and maintain their own sewerage systems. It has also provided technical assistance to the public sector partner to develop policies and procedures that facilitate the implementation of lower cost designs. The benefits include: increased credibility of government staff with low-income consumers; joint planning and support; greater efficiency in the use of resources; and more accountability. The NGO had previously developed exceptional experience through community-based pilot projects

This particular case is an important example of building sustainable practices within the public partners and user groups. However, the nature of the work carried out i.e. sewerage construction, did not require the development of systems for day to day operation, as would be the case with the distribution of water. It is also important to note that the work of the NGO in question, namely the Orangi Pilot Project, is widely regarded as being exceptional.

The Awami tanks in Karachi are managed by local volunteers from the community who are the intermediaries between the consumers and the utility as the bulk supplier; these are typically elderly or retired men at the neighbourhood level. They organise community labour to build tanks, identify land for the tanks, ration and timetable supply. The sustainability of these activities depends on the capacity and good will of residents as well as the feasibility of increased interaction between residents.

Users' perceptions. The perspectives of poor consumers interviewed in these case studies on the overall process of PPP development which involves the formal private sector are characterised by a number of concerns. These include: lack of consultation; concern over lack of public control or safeguards; fear of corruption; high tariffs; unemployment; and the assumption that there will be increased burdens on the 'common people' who have no clear idea of the benefits. Involve-

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ment in the processes leading up to change does appear to be critical. Whilst this does not guarantee success, cases in which stakeholder participation was absent or minimal were the least successful in terms of the perception of the poor. Consumers tended to raise objection to the involvement of private companies in their water supply, especially where the company is foreign. Commonly, this is precipitated by increases in tariffs, which are perceived to be making profits for private companies at the consumer's expense.

Partnerships which foster a common vision and shared understanding were more successful; in these situations, non-payment of bills was not an issue. Conversely, situations where widespread stakeholder participation was not initiated were the least successful. Consumers are concerned with the quality of service at the point of delivery; they have little concern with improvements to physical infrastructure in their own right. Performance measures such as reduced leakage may lead to a more efficient system, but they have to translate into benefits which are tangible to the consumer groups in question.

Implications

- Those projects with an explicit focus on poor consumers were particularly successful, with emphasis on developing capacity for training and support for local organisations.
- International private sector companies cannot easily understand the potential sources of support for communities and how these might facilitate communication.
- A key question remains as to how the disparity between the perceptions of the public agency/private sector and the poor can be addressed.
- Private companies have a lot to learn about operating in low-income areas. The core lesson from Durban is the focus on understanding customer circumstances, offering appropriate service levels and focusing on customer outreach. Difficulties are partly overcome by involving local area based groups and structures in the partnership. The learning curve would seem to involve years rather than months. Much depends on continuing relationships between the operator, the public partner, civil society groups and the customers. In this context, it is important to note that the public utilities were not very responsive to low income communities, and hence did not transfer much knowledge on how to work in low income areas to the private operators. There appears little evidence from the cases to suggest that the governance mechanisms arising through the formal contractual procedure are effective in terms of building relations with poor consumers. Partnering with either civil society groups (NGOs and CBOs) or small local entrepreneurs can, in the right circumstances,

help companies along their learning curve while also increasing the capacities of these groups and consumers to engage with PPP arrangements.

- Consumers and civil society groups have a lot to learn about private companies. For poor consumers it can be hard to perceive any differences between the private utility and the pre-existing public utility. A sense of continuity is reinforced when, as in some cases, most of the utility staff is kept on. Consumer relations staff of the operators emphasise the efforts made to inform local groups of the new arrangements and how the company intends to operate. However, given the large populations involved, such information spreads slowly. Where other than formal private sector companies are involved, we can see closer and more effective relationships developing both through local entrepreneurs, and NGOs and CBOs. Actual roles range from interlocutors to local service providers on behalf of the operator.
- The capacity and willingness of the public sector partner to undertake complementary measures in support of low income groups is an important component of any partnership.
- In evaluating the application and appropriateness of particular contracts in a pro-poor context it is important to be very clear about the definition of roles and responsibilities between the public and private partners regarding who does what and who pays for what.

Financial issues and tariffs

Payment problems. Some of the problems faced by low-income households include high arrears, high repayment levels, disconnection of the supply and inability to pay reconnection charges. The introduction of higher charges through both metering and increased standing charges creates additional pressure on the household budget. Low-income people are clearly under most pressure to economise; this has resulted both in less cash being available for other needs and in reduced water consumption. Note that in this section we include connection costs within our discussion of “tariffs”; the key issue is what consumers actually have to pay to get the service.

Tariff structures. One of the most important factors is the tariff structure as this can have a major impact on household cash flow. We have found that the introduction of high fixed charges has been a particular problem for poor consumers and has created real burdens on the urban poor. In Dolphin coast, a new tariff structure was introduced for the PPP; this created a tiered system of service levels and tariffs which includes a ‘lifeline’ tariff of 10 kiloliters. The problem is that for low volume users, which includes most poor consumers, the fixed charges for water and sewerage turn out to be much higher than the metered consumption



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(variable) charges. Consumers are not able to regulate their consumption to achieve lower bills. As a specific measure targeted at the poor, the lifeline block has had hardly any impact. It has also created negative perceptions amongst poor users

Rising tariffs. Water services are historically under-priced and from the perspective of both the public and private partners, the money has to come from somewhere. Increasing the level of cost recovery is often an important objective of PPP and this involves putting up user charges. Where tariffs are too low, this affects the operator's ability to expand supply, which may have a negative impact on the poor who are unserved. Whilst the main problem perceived by low-income users is that they have to pay more, the make-up of the overall tariff can be quite complex. An example of this is changing from a low, flat rate subsidised charge for water only, to a bill that includes fixed and variable charges for both water and sewerage with different tariff blocks. Users are not aware of how the tariffs have been set and are concerned about the transparency of what is going on. In the lowest income groups studied in Queenstown, 50% of households were paying more than 14% of their income for services, excluding electricity. As a consequence of tighter credit control and the absence of alternative financing mechanisms, the level of payment in two of the poorest areas is only about 55%.

Making payment easier: understanding consumers needs. In Cato Crest, Durban, a combination of appropriate technology and cost recovery proved successful; in essence, the public sector and the local operators understood the needs of their low-income consumers. The system of 'ground tanks' enabled the volume of water delivered to each household to be controlled by the local private entrepreneur. This was coupled with a flexible system of prepayment for water supplied; up-front payment could be made in full or in instalments. The system was self-regulating in terms of payment because people were required to pay in advance for the month, in order to receive an agreed volume of water. They knew what they were getting and could budget the cashflow accordingly. For those without 'ground tanks' the earlier system of standposts was available from which water could be purchased directly; the cost of this water was controlled by the public utility.

Willingness to pay. We have observed several different but related perceptions concerning this issue, where those with an inadequate service are prepared to pay more for an improved service. Value for money emerged as an important point from the sewerage project in Karachi. The partnership between an NGO and the Government agency was able to reduce the cost of local sewerage by a factor of almost seven compared with the costs claimed by a different government utility

and its contractors. These high costs were due to high overheads, excess profiteering by contractors, kickbacks to government officials and fees to foreign consultants. By relating technical research and innovation to local reality, the NGO brought the cost down to affordable limits and established that residents were willing to pay the full costs of the local (tertiary level) sewerage.

During the development of the Karachi PPP, consumers indicated a marked lack of willingness to pay increased tariffs which were proposed. This was primarily because they perceived that they would have to pay more without receiving an improved service from a largely discredited public utility.

In Kibera, residents in low income informal settlements paid more for water than did better off households connected to the networked infrastructure who benefited from a subsidised tariff on their supply. The formal tariff structure is clearly neither of concern nor benefit to the poor where they lack access to the municipal supply.

Despite the payment problems experienced by poor consumers for example in Dolphin Coast, some people show a high level of commitment and willingness to pay, to the extent of prioritising their water bills before anything else.

Problems with free water. The Awami tanks in Karachi were not run on a commercial basis; there was no payment for water or recovery of costs within the system. Whilst this has clear advantages for the consumer, there was an important ‘downside’ whereby the communities had little control or bargaining power over a limited and unreliable supply. The lack of cost recovery also meant that the provider utility failed to generate funds needed for further investment in longer-term solutions.

Implications

- Cash flow is critical for poor consumers and is highly sensitive to changes in the tariff structure; this can have a major impact on the poor.
- It is therefore essential to understand household budgets, as both the tariff and the methods of payment will have major impacts.
- Tariff structure planning needs to identify and address impacts which might undermine the security of low-income households through increasing their vulnerability and exposure to risks. Conversely, there is an opportunity to explore alternative financing mechanisms for poor households which minimise the need for large up-front payments.



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Technology

Scope for innovation. There are some interesting examples of simple but innovative technology changes as part of implementation of PPP arrangements. These changes result from a number of factors including:

- analysis of the settlement and its needs;
- taking account of community needs and preferences;
- knowledge of alternatives options and the technical know-how to implement them;
- presence of proven models which can be adopted by local communities; for example, simplified, lower cost designs; and
- willingness to experiment to find innovative alternatives to standard technological approaches.

Levels of service and service differentiation. There are several cases where PPP has led to the introduction of more appropriate and flexible levels of service. This has generally provided lower levels of service at reduced cost for low income people, sometimes in response to public dissatisfaction and the lack of existing municipal investment in infrastructure, as in Cato Crest. Tiered provision was introduced in Durban to meet customer's willingness to pay and demands for water provision. This involved lowering conventionally accepted high levels of service that predominated in the wealthier areas. With increasing unemployment in the case study area (currently 40 – 50%), people who previously had 'level 4' service have reverted back to 'level 2' so that they can pay their bills.

There can be particular problems in informal settlements where the land tenure situation is unresolved; for example, individual house connections carry considerable risk. However, there is evidence that operators will provide some basic level of networked infrastructure in these circumstances

Technology choice. There is scope for local innovation in the choice of technology and adoption of alternative standards (see below). In Cato Crest, the use of ground tanks and the detailed design of the manifold system through which they are fed enabled the volume of water supplied to be controlled. This in turn enabled an appropriate tariff and monthly prepayment system to be developed which was suited to the needs of low-income consumers.

Appropriate technical standards. In the sewerage project in Karachi, the search to find affordable methods of constructing the systems challenged engineering standards and procedures and the conventional manner of implementation of

government agencies and commercial companies. The outcome was an affordable scheme which residents were willing to pay for. Also in Karachi, the Awami tank system for water supply is an example of overcoming an immediate problem by lowering conventional standards.

Technical support is important both for the smaller public sector partners and for local consumer groups who become directly involved in construction and operation. The Awami tanks concept in Karachi is primarily welfare orientated and has been developed and sustained by low-income communities. However, there was a need to support improved tank design and construction to prevent seepage, and to improve operation of the system for drawing water from the tanks. There are long term issues as well; Queenstown is a small municipality and there are local concerns that their technical capacity may be insufficient to adopt the systems that the operator is implementing. This has important implications for eventual re-adoption at the end of the contract and may limit the available options.

Water demand management. In both Queenstown and Dolphin Coast, water demand management measures have been successful to date in reducing unaccounted for water by almost 50%. This is important to the overall efficiency of the operation and also creates an opportunity for redistribution to hitherto unserved areas through increased availability of bulk water.

Implications

- PPPs bring a new operational environment which offers scope for innovation in the use of different technological solutions, the adoption of more locally appropriate engineering standards, and the introduction of differentiated levels of service.
- The private sector has the potential to bring resources and know-how to exploit innovations which use technology as a means to achieve improved service delivery objectives.

Information

The need to communicate effectively. The introduction of PPPs normally change existing roles and responsibilities and these have to be communicated to consumers. If one of the partners (usually the operator) has no working knowledge of the area, then there is a crucial need to find out about consumer's needs. Lack of information regarding the poor in Queenstown meant that although water provision in low-income areas was an explicit part of the contract, there was a lot of confusion locally as to responsibilities, particularly with regard to carrying out repairs. Uncertainty also arose around making payments.



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Asymmetry of information. In several cases, an important issue was that low-income consumers did not know what was going on and appeared to have no effective way of finding out. This is constraining further development of the Awami tanks, as the public utility does not communicate the current operational situation to the community groups. However, there are activists who are now pressing the utility for answers. After 5 years the Kibera scheme is still unfinished; although consumers were involved in construction of the scheme, they have not been informed as to the reason for the delay. Selective communication is perceived to be a form of power.

Creating trust. Communication and information alone are not enough. In Karachi, despite intensive campaigns, it appears that consumers were unsure of what to expect from privatisation since they were not involved in the development process. If user groups and other stakeholders had been integrated into the process then there might not have been such widespread opposition. Another example is Dolphin Coast, where the operator has posted notices to explain tariff increases and how they are calculated, along with newsletters sent with bills and newspaper adverts. Yet consumers report that they feel ‘kept in the dark’.

Finding out about consumers. In Cato Crest, user perspectives were sought and utilised, community management committees were established to create an interface with Durban Water (the public utility) and technology was adapted to suit local needs. Durban Water used notice boards to publicise the cost of water, the opening times of the stand-posts and telephone numbers and post boxes for feedback. Much work was done as part of the preparation for the PPP. As a result, 72% of people felt they had a good relationship with Durban Water. The community liaison officer was key to the success of this relationship.

In Karachi, for both the sewerage scheme and the Awami tank scheme, local groups undertook baseline studies. These included demography, human resources, social data, mapping existing supplies and infrastructure inventories. Most importantly, traditional information channels such as the local elders were also used.

Modes/channels of communication. Although unsuccessful to date, the initial work on the aborted privatisation in Karachi illustrated the wide variety of ways of communicating information. Attempts to develop a broad based consensus on the need for PPP for the Karachi utility included an intensive media campaign, televised debates, seminars, workshops, and question and answer sessions involving a cross section of people and organisations. There were press releases, briefing sessions for journalists and reports on radio and TV. Efforts were made to

ensure that accurate and impartial information was made available in Urdu and English; yet residents were still unsure as to the benefits of the proposed PPP.

There are some obvious mismatches; in Dolphin coast, a telephone 'call line' was set up for queries and reporting faults. In low-income areas this is self-defeating because there are so few public telephones.

Who needs to know what? One of the most important issues highlighted in the pre-contract development phase was the lack of information about poor consumers. On the other hand, in cities such as Karachi, certain groups such as NGOs have a deep understanding of the needs of poor residents; a lot of data is available. Some international agencies also support active urban poverty analyses. The point at issue is whether the information available is in a form which would be of any use to transaction advisers responsible for designing PPP arrangements. To be realistic, they require data for investment planning and financial modelling of cash; a deep understanding of poverty is not their direct concern.

Implications

- There is a pressing need to develop a base of information about low income groups which is directly usable in the development of PPP arrangements. This requires a clearer understanding on the part of both the designers of PPP arrangement and local institutions and organisations about information needs. We hope to explore this further in the propose dstudy on tariffs.
- There is also a clear need to provide information for consumers particularly about proposed roles and responsibilities. Lack of understanding and consensus leads to operational problems and is ultimately disempowering.
- Communication is a vital component of PPPs and investment in this will pay dividends in operational terms. Lack of information does not mean that low-income communities will comply with the partnership; this leads to the risk of non-payment of bills.

Legal issues

Land tenure. Lack of formalised land tenure arrangements is normally a barrier to the extension of networked infrastructure. The regularisation and notification process undertaken by the public sector partner in the informal areas of Karachi was a prerequisite to the successful partnership with a civil society group and the consumers. Similarly in Cato Crest, improvements only took place when the provincial government handed over the land to the public utility. However, this is not always necessary. In Kibera, when improvements to the water supply were delivered, this gave residents the hope that they will eventually be given title to

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the land. Informal settlements may not be explicitly mentioned in PPP contracts, for example with the proposed Karachi privatisation. The operator would have no obligation in these areas even though well over 50% of the city's population reside there.

Non-payment, enforcement and disconnection are dealt with in a variety of ways which depend upon the way in which contractual agreements are drawn up. In the Queenstown concession, customers are now experiencing increasing bills due to the shift from flat rate payment to metered charges and stricter enforcement of credit control. The public sector (municipality) bears the risk of non-payment by households, whereas the operator is guaranteed payment at a rate per volume of water metered at each connection regardless of household payment levels. It is stated on the bill that failure to pay by the due date will result in disconnection. Residents can make arrangements with the municipality to pay off the outstanding debt over a number of months. If no arrangements are made then the electricity and water is disconnected. If there is still no payment then property of the defaulters can be seized. Disconnected households are still charged for the fixed portion of their bill and the reconnection fee has been raised in response to increases in non-payment.

In Cato Crest, these disconnection issues did not arise because the system adopted allowed the volume supplied each day to be controlled; the use of 'ground tanks' involved pre-payment for the water supplied. Residents paid a monthly amount for a water card, which they then gave to the local entrepreneurs (bailiffs) who ensured that their tanks were filled for the next month. This reduced the incidence of bad debt

In Dolphin Coast, non-payment leads to disconnection. The risk of being cut off is greater now that there is a private operator. It was reported that people could generally delay payments in discussion with the municipality.

Legal representation. In Karachi, legal groups were able to exploit legislation to protect the poor from the possible negative consequences of privatisation. There is a role for civil society groups to gain access to legal mechanisms on behalf of the poor and to shape these mechanisms to represent their interests.

Implications

- Disconnection can be very punitive; households may not be able to afford to reconnect and are left without service.
- Lack of tenure not a total barrier to receiving services.

- Roles and responsibilities within the PPP will be defined by local legislation; this needs to advise negotiations with consumer groups.
- Knowledge of legal rights is important for consumers; civil society organisations can play an important role here.

Contractual issues

Recognising poor consumers. Cato Crest highlights the benefits of creating a formal agreement between consumers, the local private sector entrepreneurs and the public utility in the context of a pro-poor policy. Explicit reference is made for the provision of water to low income users and for levels of service for specific groups; there are contractual obligations on all stakeholders in the partnership. Specific provisions for low-income users include:

- clearly defining roles and responsibilities;
- types of provision and level of service;
- financial costs to be borne by users; and
- payment arrangements;

The Dolphin Coast concession contract states that if the concessionaire is unable to meet the requirements of all the customers within the concession area, it shall give preference to the basic water supply and basic sanitation services.

Households responsibility. In Queenstown, responsibilities changed as a result of the stipulations of the PPP contract. Households were unwilling to accept the added responsibility to undertake repairs, partly because they were unaware of the proposed changes in the run up to the PPP.

Negotiation continues after the contract is signed. The need for contracts to be renegotiated during their course came up in Queenstown. It can be difficult to predict how conditions will change and to take account of this in a contracted agreement. The concession contract with the operator was extended to account for both new realities and development challenges. Similarly there have been substantial contractual renegotiations of the overall concessions in Buenos Aires and Jakarta. In Buenos Aires, for low-income consumers the issues to be negotiated were around labour contributions and how the bills would be collected. In Jakarta, both the water companies and low-income communities appear to be open to negotiating new provisioning arrangements. There is clearly scope for improving relations between low income consumers and utilities, and while it clearly does make a difference that the utility is private, it being private does not determine how services will be provided, to whom or even, in practice, at what price.



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Risks. The South African legal system did not allow for delegation of billing and collection to the private sector, at the time the contract was drawn up. This lack of control over customer management presented a significant risk for operators; in general, this is something which advisers could reasonably be expected to foresee and work to put legislation in place as part of the preparation process

Implications

- Operational performance with respect to poor consumers does, as expected, reflect the focus of the contract preparation process which is usually based around the financial concerns of the municipality rather than a concern with the poor.
- Approaches where the concepts of the contract are translated clearly into agreed roles and responsibilities down to the household level have been successful.
- In the forthcoming work we will present a more detailed analysis based on the actual roles and responsibilities for who does what and who pays for what with respect to the potential scope for increasing the pro-poor focus of PPPs.

Regulation, monitoring and complaints

Formal regulatory systems that are normally developed during the pre-operational phases of PPP contracts were notably absent during the preparation for the Karachi privatisation. No provisions were made to check the operation of a monopoly supplier or to impose penalties for sub-standard performance. There were no defined procedures for routine external monitoring of performance.

Lack of capacity on the sponsor/client side for monitoring and reporting proved a problem for the relatively small municipality in Dolphin Coast. They are dependent on consortium of consultants who can cover the legal, technical and financial aspects of the contract. There is a lot at stake as the operator may be fined up to (Rand) R500 000 for infringements and penalties against meeting performance targets. The operator produces an annual report on service levels which it has to make available to customers, publishes monthly summaries and has to develop a five-year plan.

The lack of a suitable interface for poor consumers in Queenstown has created confusion in the operation of the complaints service.

Less formal regulation. In Cato Crest, a lot of attention was paid to developing the relationships between the municipality, the water bailiffs and consumers. Roles and responsibilities were clearly set out, with discussion and negotiation of issues in the local context with consumers. 72% of residents felt that their

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relationship with the sponsor/client, Durban Water, was good. The very recent shift to free water has placed significant strain on the system. Durban Water's link with consumers has been eroded, as the bailiffs are no longer operational. People are unsure of whom to complain to, if indeed they could complain.

Particular problems have arisen in Kibera because the project is still incomplete after five years. Social development consultants were hired to facilitate the flow of information and sustain communication between various participating agencies and communities. There has never been a clear understanding about regulation of the local secondary market in water; this shows how regulation ambiguities in the partnership have the potential to lead to deterioration in the service and increased water prices. Lack of regulation also results in the public sector being deprived of revenue, with only 10% of the water sold by the local entrepreneurs being billed by the City Council.

Effectiveness of regulation. The case studies have shown situations where regulation has not necessarily safeguarded the different interests.

- Poor consumers: in a formally regulated environment such as Queenstown and Dolphin Coast, user perceptions show a deal of dissatisfaction with both the service and the tariffs.
- Public partner: in Kibera, whilst water is being retailed by local vendors, the extent of the billing and the bill collection efficiency by the City Council are both alarmingly low. Whilst consumers are paying for their water, the public partner is not being fully recompensed for the bulk supply.
- Private partner: in Queenstown, the lack of control over customer management is perceived as a significant risk by the operator in terms of their potential to fulfil their obligations.

Implications

- There is lack of capacity on the client side, particularly with smaller municipalities, to monitor and regulate complex contracts.
- More attention needs to be paid to performance measures; where PPP objectives require service improvements for poor consumers, performance indicators need to reflect the quantitative and qualitative nature of the improvements.
- Care needs to be taken when making international comparisons on regulation. There are important distinctions between regulating a contract, which may be the responsibility of a municipality, and regulating a sector through a national body such as happens in the UK.

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- Is regulation a key issue for all poor households? There is a difference between those who are connected to the system and those who are not. The latter have no stake in price regulation as, for example in Kibera, where households pay more for water than if they were connected to the formal network. The “unconnected poor” only become stakeholders in the event that rising tariff revenue leads to coverage being extended into their neighbourhood. Given the right policy environment, we can postulate that a deregulated system which allows greater increases in revenue could lead more rapidly to an expanded consumer base.

Management and administration

Resource costs. Provision to low income groups has proved to be management intensive and this translates into high management costs; consumption of water is low, usually in the lowest tariff block (which may be free) which generates bills for small amounts. Money spent on administration, for example reading meters, maintaining user files, and staff supervision and monitoring, presents a significant risk to the operator. In one area, 55% of bills were unpaid. The implications for the poor may be higher tariffs or higher connection charges which makes the service less affordable. We have already commented on the problems created by high fixed charges for poor consumers (see Section 4.5). In Cato Crest, each bailiff (acting as the private sector operator) was responsible for 200 customers; they were monitored by community development officers through meetings and records, which incurred a high cost to Durban Water. The client believed that more rigorous selection of bailiffs, which focused more on entrepreneurial spirit, would have made the scheme more feasible with regard to management inputs. Alternatively, the incentives to bailiffs may be have been too low.



Section 5

Lessons learned from the findings

In this section we select five key lessons to emerge from our findings so far and attempt to identify some factors which lead to successful outcomes. We will explore these (and other) issues further during the remaining phase of the project in order to develop a set of key guidance points.

Pre-contract phase

Develop policy which recognises the needs of the poor. The policy context for the development of PPPs requires the needs of the poor to be specifically addressed; this is primarily an issue for the client government. If the poor are not mentioned at the outset (as is the case in most of the contract documents reviewed), their needs will not figure in the contractual arrangements and they are unlikely to benefit from increased service coverage. Basically, the client will only get what it asks for. This policy has to be reflected throughout the PPP development process, starting from the objectives set out by the client government agency, through the stipulations of the contract, the regulatory framework and the performance criteria by which the partners will be assessed.

Find out about the needs of the poor. The basic information required to design PPPs which account for the needs of the poor is lacking. There is little time to acquire this information during the very limited period (often only a few months) allotted for contract development. Current actors, including client advisers and private sector operators know very little about the poor and do not have the capacity or methodologies to obtain the required data.

Operational phase

Understand the consumer. Projects which had a noticeable impact on poor consumers were based on an understanding of their needs and constraints; technological and financial systems were developed which matched these needs. The projects tended to be quite small scale and in the cases reviewed so far involved small scale entrepreneurs or NGOs rather than the formal private sector, who have little understanding or experience of working in poor areas. User perceptions regarding formal private sector involvement were generally negative.

Payment structures have a major impact on the poor. Household cash flow and hence ability to pay for services is highly sensitive to changes in the tariff structure (including connection, re-connection and standing charges). ‘Lifeline’ tariff blocks do not necessarily ease the situation from the users perspective. Predictability of payment is important and pre-payment systems are popular. There is a need to review tariff structure planning as there are no consistent practitioner guidelines which are widely accepted.

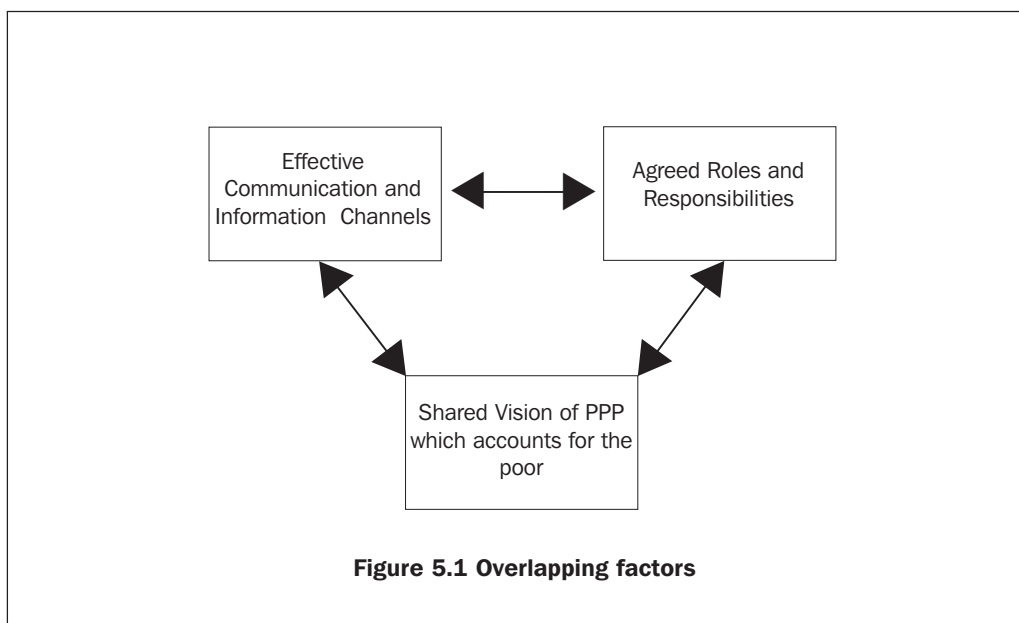
Address imbalances of capacity between partners. Problems occur when small municipalities are required to regulate contracts with the formal private sector; It is the complexity of the contracts which is important rather than their size or scale. Expertise can be bought in, but at a cost; there are perceptions that consumers may be disadvantaged in situations where their voice is represented through the public partner. Where the private sector partners are small local entrepreneurs, their lack of capacity causes problems for the public partner which has difficulty in offering the necessary support. This identifies a serious need for capacity building on the “public” side of the partnership.

Some ingredients of success

We can identify three factors which were generally present in those cases which had a positive impact on poor consumers. Those projects which were most successful in terms of serving the poor were those which:

- Started off with a pro-poor focus at the contract stage and went on to developed a shared vision of PPP with low-income groups
- Clearly defined and formally agreed roles and responsibilities between the PPP and low-income groups
- Maintained effective two-way communication and information channels.

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Different stakeholders in the PPP can have different views on the process. In many instances the rules, role and responsibilities are not communicated. For some PPPs are purely commercial transactions, for some political exercise and for some the water should not involve any profit making element. A shared vision can be developed by different stakeholders to serve the poor while meeting their core organizational objectives.