CHALLENGE

Globally, the Sustainable Development Goals (2015–2030) are driving efforts to increase water service levels, while ensuring that services are affordable and no vulnerable population is left behind. In concert with global development goals, the United States Agency for International Development (USAID) Rural Evidence and Learning for Water (REAL-Water; 2021–2026) program focuses on identifying ways to expand water access and safety in rural areas of low- and middle-income countries. Rural water supply financing poses special challenges, as the populations are smaller, more dispersed, and poorer than their urban counterparts. This may reduce opportunities for economies of scale and complete cost recovery. As of 2020, the majority of people lacking even basic water services (i.e., water from a protected source requiring no more than 30 minutes to collect) lived in rural areas.

OBJECTIVES

This report aims to provide an overview of financing or funding mechanisms or applications related to water service that are innovative (i.e., not yet commonplace) and promising (i.e., show potential for benefits exceeding the status quo) in rural areas such as small villages.
and dispersed settlements. It highlights categories of novel financial concepts that might offer a greater range of options to government agencies, donors, practitioners, and communities who develop and manage rural water supplies. The concepts may have sufficient merit to warrant further exploration within later stages of REAL-Water or other implementation research programs; however, the REAL-Water consortium does not endorse or relatively rank specific topics or service providers. Financial choices should be weighed relative to one’s local setting and context. We summarize the information to evaluate conditions and trends in rural water financial innovation, leading to overarching recommendations.

FINANCIAL INNOVATIONS

1. VILLAGE SAVINGS FOR WATER

Community-based savings and credit associations offer rural dwellers in low-income settings an opportunity for member-only access to loans, emergency support, and small annual investment returns. With abundant existing savings groups in sub-Saharan Africa and India, the mechanism has been leveraged in some cases to improve financial management of rural water systems.

_THEY OFFER A FRAMEWORK FOR CREATING DEDICATED, AFFORDABLE, AND TRANSPARENT SAVINGS FUNDS TO PAY FOR HIGH-QUALITY MAINTENANCE AND REPAIRS._

Groups may dissolve over time, though, and require periodic external support. Field results from _limited-scale_ water initiatives in several African countries have maintained an above-average reserve fund to support water point maintenance, repairs, or upgrades.
2. DIGITAL FINANCIAL SERVICES

Digital financial services have penetrated many aspects of daily life, including water services.

PREPAID METERING OF AUTOMATED WATER DISPENSING DEVICES AND POSTPAID DIGITAL WATER SERVICE ACCOUNTING PROVIDE BENEFITS FOR BOTH WATER SYSTEM OPERATORS AND CUSTOMERS, IMPROVING FEE COLLECTION CONSISTENCY AS WELL AS CONVENIENCE. THEY MAY LIKESIWE SIMPLIFY SUBSIDY DELIVERY TO VULNERABLE CUSTOMER SEGMENTS.

Converting to digital payment brings some hurdles, such as added transaction fees and costly startup infrastructure. Local training support and social inclusion outreach could benefit digital service expansion. Limited rural deployment is ongoing in Africa, Asia, and Latin America.
3. WATER QUALITY ASSURANCE FUNDS

To reduce the risk of newer markets such as rural water supply testing services, work agreements can be “guaranteed” by external parties, who ensure on-time payment.

CREATING AN ASSURANCE OR RESERVE FUND EFFICIENTLY LEVERSAGES DEVELOPMENT AID AS BACKSTOP FOR MOSTLY SELF-SUFFICIENT LOCAL BUSINESS ARRANGEMENTS.

Should debt arise, the upfront account can be mobilized quickly. One primary example is a novel water quality testing assurance fund that allows larger professional laboratories to provide low-cost, centralized monitoring services to smaller rural water systems. This improves efficiency and incentives for wider-scale testing, but requires some implementation oversight and quality control. Interesting pilot examples come from a few African countries.

Training a customer in Ruiru, Kenya on how to use his phone for making water payments (Source: Joyce Kisiangani, The Aquaya Institute)
4. PERFORMANCE-BASED FUNDING

Repayable water supply investments often risk losses, due to the pervasive challenges of serving low- and middle-income rural settings.

PERFORMANCE-BASED FUNDING IS DESIGNED TO MAXIMIZE ACCOUNTABILITY AND EFFICIENCY OF THE SERVICE PROVIDER.

Its elements generally include: (a) targets and/or ceilings of repayment, (b) an agreed per-unit payment amount for each output and/or outcome (e.g., new household water connection), and (c) independent verification of results prior to payment disbursement. This type of mechanism can accelerate innovation and efficiency if designed well and if service providers are motivated to participate. Encouraging water-related examples have been increasingly deployed in Asia, Africa, and Latin America, although this approach may not offer advantages under all circumstances.

5. DEVELOPMENT IMPACT BOND

One type of performance-based funding is a development impact bond, which moves some risks from service providers and primary donors to a third-party investor, while rewarding water development outcomes. After designing a funding arrangement, the social investor gives the service provider added capital for planned activities. Once outcomes are verified, the primary donor (outcome funder) reimburses the other investor, adding interest or subtracting losses depending on outcome achievement.

WHEN DESIGNED AND EXECUTED SUCCESSFULLY, DEVELOPMENT IMPACT BONDS SHOULD DRIVE EFFICIENCY AND ACCOUNTABILITY, SUPPORTED BY DATA COLLECTION AND PERFORMANCE MANAGEMENT SYSTEMS THAT ALLOW DESIRED OUTCOMES TO BE ACCURATELY MEASURED.

Development impact bonds have yet to be planned for rural water supply, but one is being piloted for rural sanitation in Cambodia.
6. STANDARDIZED LIFE-CYCLE COSTING

Sustaining service delivery for rural water supply depends on accounting for all costs (including operations, repairs, and maintenance) over the assets’ lifespan.

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AS ONE ELEMENT OF ASSET MANAGEMENT, LIFE-CYCLE COSTING TOOLS ALLOW VISUALIZATION, COMPARISON, AND TARGETED FUNDRAISING TO BETTER MATCH ANTICIPATED COSTS.

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Consistent guidance on a life-cycle costing approach has been proposed for rural water supply, consisting of six cost categories, although it is not universally or easily performed by under-resourced service providers. As a result, the practice has seen limited application and data sharing in low- and middle-income countries, such as Vietnam, India, and Ethiopia.

7. BLENDED PUBLIC/PRIVATE FINANCE

Water supply development has traditionally relied on public or aid funding, rather than commercial financing.

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“BLEND” FINANCE REFERS TO LEVERAGING PUBLIC FUNDS (E.G., CONCESSIONAL LOANS OR GRANTS FROM NATIONAL GOVERNMENTS OR DEVELOPMENT BANKS) TO MOBILIZE ADDITIONAL CAPITAL FROM PRIVATE BANKS OR INVESTMENT GROUPS.

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While not nearly as widespread as it is in other sectors (such as energy), this approach is growing in popularity, especially for attractive investment recipients such as well-run urban water utilities. For rural water supply, limited applications have taken root in Madagascar, Benin, and Senegal.

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# Overview of Financial Innovation Pros and Cons

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<thead>
<tr>
<th>Innovations</th>
<th>Pros</th>
<th>Cons</th>
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<tbody>
<tr>
<td>Village savings for water</td>
<td>• Can self-manage for several years with limited external support</td>
<td>• Susceptible to disintegration (i.e., disbanding)</td>
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<td></td>
<td>• Have robust accountability mechanisms</td>
<td>• Must connect with reliable, skilled service providers</td>
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<td></td>
<td>• Build social capital among members to promote collective action</td>
<td>• Integration with water payments may benefit non-members</td>
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<td>Digital financial services</td>
<td>• Dramatically improves fee collection efficiency, especially for prepaid water services</td>
<td>• Customers and operators require local training and troubleshooting support</td>
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<td></td>
<td>• Digital data can be used for analysis or decision-making</td>
<td>• Equipment requires continued maintenance and replacement parts</td>
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<td></td>
<td>• Automates customers’ financial planning</td>
<td>• Poor connectivity could intermittently interfere with payment technologies</td>
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<td>Water quality assurance funds</td>
<td>• Provides long-term support for local capacity building</td>
<td>• Contracts and partnership arrangements take time and legal expertise to set up</td>
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<td></td>
<td>• Offers a cost-efficient approach for donors</td>
<td>• Guarantor requires transparent access to payment information and resources to carry out due diligence</td>
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<td>• When used to support water quality testing, professionalizes monitoring and enables managers to respond more quickly to contamination issues</td>
<td>• Funds may draw down over time, if repayment is inconsistent</td>
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<tr>
<td>Performance-based funding</td>
<td>• Codifies accountability of aid recipients, reducing risk to donors and investors</td>
<td>• New schemes involve upfront design effort, as well as ongoing management and monitoring costs</td>
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<td></td>
<td>• Can accelerate efficiency gains by incentivizing incremental service improvements</td>
<td>• Careful performance verification is needed to ensure borrowers are incentivized to innovate</td>
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<td></td>
<td></td>
<td>• Added labor burden may reduce interest among smaller service providers</td>
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<tr>
<td>Development impact bonds</td>
<td>• Like performance-based funding, may promote innovation, local problem-solving, and adaptation</td>
<td>• Can be complex to design and execute, with high transaction costs</td>
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<tr>
<td></td>
<td>• Involving a third party reduces risks for governments and development partners, who pay only after verifying a successful result</td>
<td>• To date, none have been structured for water services</td>
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<td>• Service providers must have sufficient subject-matter expertise and practical experience in the area of operation</td>
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</tbody>
</table>
## Standardized life-cycle costing

- Allows visualization of the full cost of service delivery, which aids planning and securing funding
- Makes operation and maintenance budgets more realistic and accurate
- Motivates implementers to arrange appropriate savings and investment mechanisms

## Blended public/private finance

- Can unlock private sector resources by reducing risk perceptions
- Transparency requirements of commercial lenders increase financial discipline
- Private financing for the most creditworthy water service providers allows redirection of public funding where subsidies are most needed

- Collecting and analyzing data is resource intensive, and costs must be updated regularly
- Applying a single framework could alienate certain implementers or fail to capture important nuances
- Borrowing terms are initially less favorable than concessional loans
- Most water supply experiences come from middle-income countries and have not been replicated at scale
- Not all rural water service providers can be made creditworthy

# RECOMMENDATIONS

All innovation categories described herein hold promise for advancing rural water supply efforts in low-resource settings. At the same time, financial innovation benefits from continued implementation research, marketing, and coordination to improve performance outcomes. The innovations may render benefits only under favorable conditions, where accountability, transparency, motivation, and reward structures support effective planning and implementation. External support needs may span lengthy time scales. To better facilitate financial innovation that serves rural water consumers in low- and middle-income countries, we offer several recommendations:

**DEVELOPMENT FINANCE INSTITUTIONS** and **GOVERNMENTS** should encourage blending public and private investment in attractive water supply opportunities, while directing concessional lending, grants, and revolving loans to settings where commercial returns are less likely.
DEVELOPMENT FINANCE INSTITUTIONS should build performance incentives into financing and funding schemes if they are likely to translate to practice improvements and tracking is not overly burdensome.

GOVERNMENTS, SERVICE PROVIDERS, AND NONGOVERNMENTAL ORGANIZATIONS should begin establishing networks to better coordinate and pool risks and opportunities for small rural water supplies.

GOVERNMENTS, SERVICE PROVIDERS, AND NONGOVERNMENTAL ORGANIZATIONS should use robust planning to properly assess the lifecycle costs, as well as non-monetary benefits, of new rural water supply schemes.

SERVICE PROVIDERS AND NONGOVERNMENTAL ORGANIZATIONS should ensure they have ongoing mechanisms to share progress with consumers and understand and respond to consumer needs.

SERVICE PROVIDERS, NONGOVERNMENTAL ORGANIZATIONS, AND RESEARCHERS should share data on project or program implementation costs whenever such reporting is feasible.

NONGOVERNMENTAL ORGANIZATIONS should avoid installing new infrastructure in the absence of a clear plan for locally sustained operation and maintenance funding.

NONGOVERNMENTAL ORGANIZATIONS should emphasize building local capacity for rural water system financial management, for example through periodic technical assistance, to help sustain service effectiveness over time.

RESEARCHERS should rigorously evaluate mid-term and long-term results of varied rural water financing programs, to enable learning and innovation over time.
PROFESSIONAL NETWORKS (e.g., the Rural Water Supply Network) should ensure consistent global guidance is communicated to local institutions, and collate local experiences to provide a feedback loop to larger-scale institutions (e.g., regarding funding priorities).

PROFESSIONAL ASSOCIATIONS AND LEARNING INSTITUTIONS should ensure water professionals can access opportunities to gain water supply financial management skills, and ultimately receive recognition and compensation for their services.

ALL PARTIES should consider how water supply programs can be adapted to address potential future risks (e.g., demographic or climate shifts), and invest in approaches resilient to multiple water supply and demand scenarios.

Recommended citation:

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Read the full report

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