

Incentivising the private sector to target low-income customers

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Sanitation businesses can improve services for all urban residents - including the poorest - but this requires carefully designed pricing strategies and measures to reduce risk. This publication outlines WSUP's approach to incentivising the private sector to target low-income customers, and how this is being applied to achieve commercial viability, affordability and equity of FSM service provision in Bangladesh.

Providing at-scale urban WASH services depends on service delivery models which generate ongoing revenues that promote long-term sustainability. Cost recovery alone is insufficient: businesses are motivated to enter the sector by perceived market size and profitability. As a result, many faecal waste collection businesses gravitate towards middle and high-income areas, where market demand and resulting financial margins are assumed to be higher.

This presents a challenge for organisations like WSUP: how can we harness private sector potential to provide improved services at scale, while incentivising businesses to target low-income areas and develop affordable low-income customer services? Below, we set out four lessons from our work supporting SWEEP, a faecal waste collection service operating in Dhaka and Chittagong, and soon to be expanded to Rangpur and Barisal.

1. Reduce the risk of entry

Revenue streams are hard to predict when a business is starting up. The public partner (typically a municipal authority or utility) has a critical role to play in changing the risk structure. One option is to reduce upfront capital costs for vehicle procurement. SWEEP operates through a lease-based agreement: Dhaka Water Supply and Sewerage Authority (DWASA) lease their tanker to the SME (Gulshan Clean & Care, GCC) at a reduced rate; in Chittagong, WSUP purchased a vacuum tanker for the City Corporation, who in turn lease it to the business owner. The costs of using a vehicle is spread across monthly payments and private operators will not have to liquidate assets in case of business failure. This is a key consideration for companies as they contemplate entering a new sector.



2. Include low-income customer targeting as a contractual requirement

The guarantee of public sector support offered by a public-private arrangement can be used as leverage to incentivise equitable service delivery. In Dhaka, GCC was encouraged to serve low-income customers, but this was not initially a condition of the contract. SWEEP Dhaka was able to achieve positive net cash flow in five months on an operations and maintenance basis, largely due to its focus on customers with larger septic tanks such as hotels, who require more time per customer but provide a higher financial margin.

This approach represented GCC's unmediated offering to the market. However, once SWEEP established itself as commercially viable in Dhaka, a clause was introduced to the contract in mid-2017 mandating GCC to ensure that 30% of their customers were lower income. A similar clause was embedded in the agreement with Chittagong Sheba Sangstha (CSS) from the start of the SWEEP Chittagong programme (see Figure 1 overleaf).

Financial modelling demonstrated that a 70-30% mix of high-income/businesses and low-income customers (LICs) would provide sufficient profit to encourage private sector participation; while also delivering an inclusive service for a broad range of customers. In both cities, the SMEs can be fined if they fail to reach the 30% target.

3. Promote preferential pricing to improve the offering to low-income customers

A carefully designed pricing structure can ensure the cost of serving LICs is partly covered by higher prices charged to those with larger pits or septic tanks. In Dhaka, SWEEP customers living in low-income areas are charged a tariff of US\$ 6-7.50 per cubic metre, compared to US\$ 10-15 for middle/high-income (MIC/HIC) and institutional customers; these tariffs correspond to service fees ranging from US\$ 60-75 for small septic tanks, US\$ 150 for medium septic tanks and US\$ 250-1000 for large septic tanks.

Mirroring the pricing strategy in Dhaka, LICs in Chittagong are charged US\$ 6 per cubic metre and high-income/middle-income residential and business customers pay a premium price of US\$ 12 per cubic metre or more (the latter is towards the higher end of what informal manual emptiers currently charge, though this is compromised by poor service quality and reliability). Importantly, the pricing structure is not fixed: customers in Bangladesh expect to negotiate prices – insisting on a set price would result in low uptake. Locking service providers into long-term pricing structures could also compromise their ability to react to economic trends such as inflation.

Figure 1: SWEEP in Dhaka and Chittagong: LICs as proportion of total customers (%). Line represents the introduction of the 30% minimum LIC contract clause in Dhaka

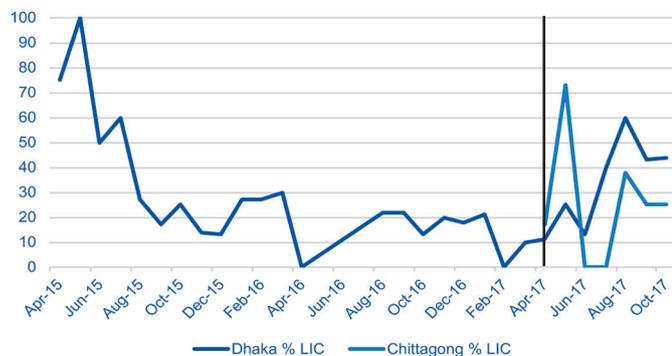
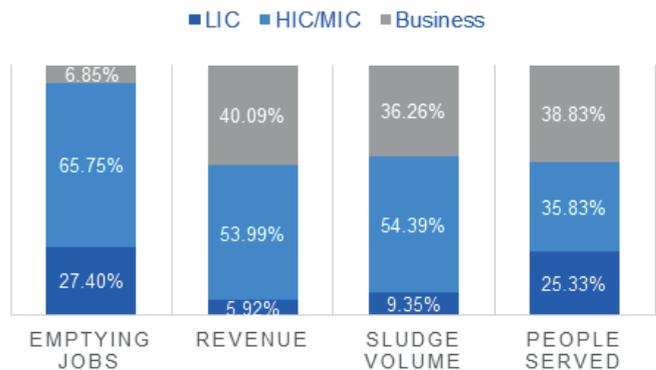


Figure 2: SWEEP Chittagong activity according to customer income bracket, April – October 2017



4. Provide smart support that catalyses citywide change

WSUP staff in Dhaka and Chittagong analysed what incentives or capacity public and private sector actors can and cannot provide, and targeted support accordingly. For example, WSUP identified that the companies delivering SWEEP in both cities required support in financial analysis, business development and marketing campaign strategies.

An equally important role for WSUP and other brokers is to help the public sector understand how to align smart subsidies with incentives (where and how to subsidise); and the value of non-financial support (utilisation of assets and capabilities that could only be granted by public authorities). One example is the Chittagong City Corporation's decision to donate land to WSUP for the construction of new drying beds: in a city where land is at a premium, such in-kind support will reduce transport costs and improve disposal options, significantly impacting sanitation in the city.

Conclusion

SWEEP is breaking new ground as a profitable faecal waste collection service in urban Bangladesh: the businesses in Dhaka and Chittagong became profitable within 5 and 4 months respectively, and did so while maintaining around 30% of their customer base from low-income areas. Key to their success has been a pragmatic approach which recognises the value of middle and high-income customers in establishing and sustaining commercial viability. The targeting of customers according to income brackets provides the foundation of a sophisticated pricing strategy, with a preferential pricing component that reflects the reality of the on-site sanitation market in urban Bangladesh. This positions SWEEP to achieve significant positive social impact.

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