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SmartLessons

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Doing More with Less: Leveraging the Private Sector for Rural Water Supply in Benin

Working together, IFC and the World Bank helped develop public-private partnerships (PPPs) to extend the water supply into rural areas of Benin. For the first time in Benin, bankable long-term commercial agreements allowed private operators to raise funding from local commercial banks to undertake the necessary investments. This SmartLesson offers a perspective on what it takes to design and implement sustainable rural water PPP projects, and shares the lessons learned during the project implementation process.

BACKGROUND

In 2006, the government of Benin launched a reform of the water sector that transferred the management of rural water supply schemes from local communities to private operators under lease/affermage contracts to improve accountability and quality of service. A subsequent assessment of the performance of the privately run water systems commissioned in 2010 by the World Bank's Water and Sanitation Program (WSP) noted some improvements but also a number of technical, operational, commercial, financial, and contractual shortcomings that undermined the effectiveness of these arrangements. These included high levels of nonrevenue water, poor financial performance, lack of transparency in the tendering procedures, unclear specification of rights and obligations of the contracting parties, and inability of the private operators to raise funding, resulting in long, unresolved conflicts between operators and contracting municipalities.

To address these challenges, WSP designed a technical assistance program to improve the provision of water in the small towns of Benin through a greater involvement of the private sector, to facilitate access to finance by private operators, and to strengthen the capacity of the public and private sectors. IFC's intervention fit within

that wider program and was executed in partnership with WSP.

In 2012, the government of Benin retained the services of IFC to assist in the design and implementation of robust commercial arrangements and a better risk allocation between municipalities and private operators managing rural water supply schemes. IFC's advisory work was implemented with the financial support of DevCo, a multi-donor facility affiliated with the Private Infrastructure Development Group, which supports infrastructure transactions in the poorest countries by providing funding for expert consultants to prepare projects for private investment. DevCo is funded by IFC, the Department for International Development (DFID) of the United Kingdom, the Austrian Development Agency, the Dutch Ministry of Foreign Affairs, and the Swedish International Development Agency.

The project, designed as a pilot program, complemented WSP's ongoing sector support in the country. Ten pilot rural water supply systems were selected in three different municipalities across the country and grouped into four clusters of two to three systems each. Each of the four clusters was tendered as a separate transaction by the respective municipalities. The tender process led to the award of four eight-year concession agreements for the



Stand post in the village of Illasso, Municipality of Sakete, Department of Plateau, Benin. (Photo by Jane Jamieson)

design, partial financing, rehabilitation, extension, and operation of the 10 rural water systems to three winning bidders.

LESSONS LEARNED

Lesson 1: Offer a “one World Bank Group” solution.

A critical aspect of the success of the project was the “one World Bank” approach that leveraged different parts of the World Bank Group to deliver value to the client. The Water and Sanitation Program’s local presence and incomparable technical and political local knowledge played a pivotal role. mWater—a database platform developed by WSP and containing key information on the performance and the operating assets of 50 piped-water schemes—helped identify potential pilot sites. (mWater led to an initial list of 21 sites; it took additional work to narrow the list to 10 sites.)

WSP’s previous work in the sector and in-country knowledge enabled the project to mobilize the Netherlands Cooperation funding. On numerous occasions, the collaboration and teamwork with WSP helped unlock political gridlock, in particular in providing assistance to the government of Benin to make the necessary decision to move to the implementation phase (bidding process).

As IFC’s Public-Private Partnerships department usually does not provide capacity building to private stakeholders, WSP and IFC’s Sustainable Business Advisory mobilized complementary human and financial resources for trainings and workshops, which were attended by representatives of the municipalities, local investors in the water sector, and local banks.

The combination of the skills and expertise of different operating units of the World Bank Group to deliver a comprehensive assistance program to the Government of Benin for the project was key to its successful implementation. Table 1 summarizes the World Bank Group participation.

Lesson 2: Form commercially viable clusters to increase private sector interest.

Not every rural water system is commercially viable. Indeed, the profitability varies from one site to another according to such factors as: (i) the site topology and location (for example, availability of sufficient underground water to operate the system, presence of alternative sources of water supply); (ii) the buying power and geographical dispersion of the population covered; (iii) the state of repair of the infrastructure; and (iv) related operational and maintenance costs. Moreover, in a context where retail tariffs are higher in rural than in urban areas, it is not viable to increase user charges to compensate for high running cost, lack of scale, and low operating margins.

During the structuring phase of the transaction, the team assessed that some sites would not be attractive on a stand-alone basis, given their low profitability. In some cases, operations were plagued by frequent service disruptions, high water losses, and aging equipment that required frequent repairs. The mitigating strategy involved the formation of commercially viable clusters comprising sites with different levels of profitability to allow for (i) cross-subsidization among the water systems; (ii) rationalization of operating costs through the sharing of resources; and (iii) creation of transaction packages of sufficient scale to attract experienced and financially robust operators.

This approach received support from potential bidders because of the larger scale, and it received support from public authorities whose objective was to give access to improved water services to people served by the least profitable sites. Though forming clusters from sites located in different municipalities has not been tested in this pilot project, it is worth exploring further when it is technically and commercially viable, as it will have the potential for including more sites in clusters.

Lesson 3: Know where the money is going to come from, and engage at a very early stage.

The financial analysis conducted during the structuring phase of the transaction revealed that the rehabilitation of the 10 water systems, the network extensions, and installation of up to 1,071 household connections would require a significant proportion of public subsidies (up to 90 percent of the estimated project cost) to ensure that the private operators undertake the required capital investments while providing affordable water services to the population.

To mobilize public sector contribution, the project approached donors involved in the sector, and the Embassy of the Netherlands expressed interest in supporting the project through the embassy’s existing sector program support. This led to Dutch cooperation to allocate up to \$1 million in grant funding to the project—and to commit to support the national replication if the pilot initia-

Table 1: One World Bank Group Resources for the Project

Benin small-scale piped-water schemes inclusive business support project		World Bank Group		
		World Bank Water and Sanitation Program	IFC Public Private Partnership Advisory	IFC Sustainable Business Advisory
Component 1: Business development support	Contribution to enhanced public private partnership transactions through a pilot project involving several municipalities	X	X	
	Elaboration of a Web-based database (mWater) for performance monitoring and benchmarking	X		
Component 2: PPP financing facility	Sensitization of domestic commercial bank to facilitate private operators' access to debt financing and guarantees	X	X	
	Procurement of the services of an independent expert to assist private operators in the supervision of the execution of construction and rehabilitation work	X		
Component 3: Capacity building	Strengthening of the capacity of the public sector PPP contract supervision and regulation	X		
	Training of SMEs and potential bidders on business skills and tender processes and bid preparation	X	X	X

Source: Authors.

tive should be successful. This allowed for the mobilization of the public subsidies, without which the project would not have been feasible.

The mobilization of funding from public and private sources was possible only because of: (i) early engagement with the donor community and the Dutch technical assistance, once the needs for public contribution were ascertained; and (ii) close collaboration with local commercial banks at the design stage, to ensure their buy-in and provide them with critical information needed to operationalize their support in a timely fashion.

Lesson 4: Get early buy-in, create awareness, and strengthen the capacity of potential bidders.

IFC anticipated that the project would attract mostly local private operators because of the nature and the small scale of it. It was therefore necessary to ensure that existing operators understood the objectives of the project and considered it a business opportunity rather than a threat to their activity. The project implemented various initiatives, including those listed below, to attract suitable candidates and optimize the chances of receiving compliant bids during the tender phase:

- During the due diligence and structuring phase, (i) IFC held information meetings with representatives of the Association of Private Water Operators of Benin to present the project and its benefits and, later in the process, to test the reasonableness of the proposed prequalification criteria; and (ii) in collaboration with IFC's Sustainable Business Advisory department, the PPP advisory team and WSP delivered a business management training to local

entrepreneurs and SME (small and medium enterprise) owners, including potential bidders to the project.

- During the prequalification phase, IFC and WSP organized a two-day training workshop targeting potential operators and reviewing in detail the key elements of public-private partnerships and the project tender process as well as anticipated outcomes.
- During the bidding stage, IFC invited the prequalified bidders to a two-day workshop to (i) present the key issues to consider when preparing a bid submission, using case studies; (ii) review the project tender documents and explain the amend-



Household connection in the village of OUNET, Municipality of Banikoara, Department of Alibori, Benin. (Photo by Fichtner)

ments made after the first round of questions and answers; and (iii) address outstanding comments.

Lesson 5: Strengthen institutional capacity at all times.

The successful implementation of the PPP transaction was largely due to the strong support from the Ministry of Water and the municipalities enrolled in this pilot initiative. This strong commitment is the fruit of several years of WSP's close collaboration with such entities as the Embassy of the Netherlands and GIZ,¹ which were interested in the outcomes of the project. Multiple engagements—through seminars, workshops, hands-on support, and study tours to visit successful rural water PPP projects in Mozambique, Rwanda, and Madagascar—convinced the public actors that the private sectors could be leveraged to improve the provision of water services in rural areas and small towns.

This commitment contributed to the successful launch of the first phase of the reform, with the professionalization of the management of rural water schemes and the conclusion of the first PPP arrangements. Framework contracts were elaborated, and the technical services of the municipalities gained valuable experience in managing tender processes and awarding PPP contracts.

IFC engaged with the municipalities throughout the structuring and tendering of the transactions—to present preliminary findings; review the key elements of the proposed structure; validate the tender documents, prequalification, and evaluation criteria; and discuss performance indicators and aspects of contract managements. These exchanges allowed for knowledge transfer and empowered the municipalities, which took ownership of the project.

Acknowledging the fact that institutional support beyond the signing of concession contracts is critical to ensuring the sustainability of this pilot initiative, WSP is assisting in the creation of a dedicated unit that will regulate the performance of the sector, conduct financial audits, develop and disseminate regulatory procedures for

the municipalities and local governments, and develop benchmarking tools. This assistance will also involve support to the concessionaires during the first year of the contract to minimize any operational and administrative hurdles (mobilization of public subsidies, fund-raising from commercial banks, and so on) that have the potential to undermine the effectiveness of the concession arrangements.

Lesson 6: Sensitize local financial institutions to the benefits of the project.

The ability of private investors to raise financing was critical to the success of the project. Historically, local banks had been reluctant to finance private water operators, as they did not understand the business model or the sector. IFC initiated several working sessions with two local banks to present the project, to understand their requirements for providing funding, to discuss the financial criteria that could be used to select bankable prequalified bidders, and to get their commitment to consider application for project-related bid bonds, performance bonds, and debt financing. One of the banks offered customized financing products to the prequalified bidders as a sign of confidence in the implementation process and the project in general. This approach, which was also used in structuring the Uganda small-scale PPP, has proven very efficient in small-scale infrastructure projects involving investors with limited access to finance.

CONCLUSION

While private sector participation has proven helpful in improving the provision of water services in rural areas and small towns, it would have been challenging to implement this transaction without the extensive upstream work, continual policy dialogue, and institutional support. These elements were necessary to create an enabling environment for the PPP transactions. Countries looking to replicate this project will do well to see that these conditions for success are in place before undertaking such a project.



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¹ GIZ = Deutsche Gesellschaft für Internationale Zusammenarbeit, the German Federal Enterprise for International Cooperation.