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Profitability and the poor: Corporate strategies, innovation and sustainability ☆

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Abstract

Based on empirical evidence, the article looks at the implications of private sector participation (PSP) for the delivery of water supply and sanitation to the urban and peri-urban poor in developing countries, with particular reference to Africa and Latin America. More precisely, the article addresses the impact produced by multinational companies' (MNCs) strategies, in light of the pursuit of profitability, on the extension of connections to the pipeline network. It does so by questioning the assumptions that greater private sector efficiency and innovation, together with contract design, will enable the sustainable extension of service coverage to low income dwellers. The strategies of the major water MNCs are considered both in relation to the global expansion of their operations and the adjustment of local strategies to commercial considerations. The latter might result in identifying profitable markets, modifying contractual provisions, attempting to reduce costs and increase income, reducing risks and exiting from non-performing contracts. The evidence reviewed allows for re-assessing the relative roles of the public and private sectors in extending and delivering water services to the poor. First, the most far reaching innovative approaches to extending connections are more likely to come from communities, public authorities and political activity than from MNCs. Secondly, whenever MNCs are liable to exit from non-profitable contracts, the public sector has no other option than to deal with external risks affecting continuity of provision. Finally, market limitations affecting MNCs' ability to serve marginal populations and access cheap capital do not apply to well-organised, politically led public sector undertakings.

Keywords: Water supply and sanitation; Private sector participation; Multinational companies; Corporate strategy; Poverty; Access to pipeline network; Market failure; Public sector; Latin America; Africa

1. Introduction: why private sector?

In the 1990s arguments have been advanced for expecting the international private sector, that is to say multinational companies, to provide a better solution to extending water supply to the poor in developing countries. They refer to the three private sector virtues of efficiency, financial capacity, and proactive management which operates by matching the service supplied with the effective demand of the poor, as concisely summarised by Franceys (1997):

> "Private sector participation is seen to increase efficiency and introduce new sources of finance but above all to require a new emphasis on proactive, performance oriented, commercial management that aims to match the demand of its customers with their willingness to pay realistic charges and tariffs".[1]

☆ *Company names:* The French groups in particular have used various names for both the groups and the water sections since 1990. Throughout this article, for the sake of clarity, the two largest groups will be referred to as 'Suez' and 'Veolia', even when referring to dates before these names were formally used; the next two will be referred to as 'Thames' and 'SAUR'. The principle names associated with these groups are: Suez = Lyonnaise des Eaux; Ondeo. Veolia = Generale des Eaux; Vivendi.

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[1] Richard Franceys: Private Sector Participation In The Water And Sanitation Sector 'Private Waters? – A Bias Towards The Poor' Department For International Development Occasional Paper No 3 1997.

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The leading private companies, notably Suez, have themselves supported this argument by publishing statements of their ability to extend services to the poor in developing countries: see for example Lyonnaise des Eaux (1998) and Suez (2001). A number of private water operations in developing countries are claimed as successful examples of the private sector delivering water to the urban poor.

This paper discusses these arguments and tests the claim that the private sector will deliver better results for the poor by considering the general strategies and practice of the private water companies in relation to the poor in cities in developing countries.

It concludes that

> Expectations of the private sector were flawed by failing to anticipate the impact of commercial strategies on determining the boundaries of expansion, the economics of service, and exit strategies the community-based techniques used by the private companies in extending water services to the poor are not innovations but borrowed from public sector and community initiatives the requirements of profit-maximisation and risk reduction strategies of the private companies define the scope of private expansion at a narrower and less sustainable boundary than the public sector.

2. The case for private water

2.1. Innovation, participation and contract design

From the late 1980s to the early 1990s, the literature promoting PSP in water supply and sanitation insisted on the inadequacy of the public sector in providing good quality services at acceptable costs and achieving universal coverage. One central theme of this argument was that private companies are more innovative and results-oriented, and so could deliver wider coverage more rapidly. Roth (1987, pp. 230–231, 263) attributed poor performance in quantity and quality of water operations in developing countries to poor management of the public sector, and urged the introduction of PSP as a faster solution to the magnitude of the global water crisis:

> “Management in the public sector can often be improved, but the involvement of the private sector can bring quicker results, and the dimensions of the various problems cry for quick results”.

Winpenny (1994, pp. 29–51) recommended the introduction of privatisation and full cost pricing, to solve the problem of increasing needs for finance for capital investment, but also argued that increasing water prices through full cost recovery would, counter-intuitively, be of greater benefit to the poor, because extension of the piped network would give them cheaper water than they had from vendors, and stepped tariffs could provide cross-subsidies:

> “In developing countries the poor … regularly pay prices per unit for their water (from private vendors) many times higher than those paid by wealthier people with their own connections. Any reform that raises charges, improves cost recovery and generates funds for expanding and improving the system promises to be socially progressive, even if charges to piped consumers are raised. The structure of tariffs can further promote distributional goals by offering low “lifeline” rates for minimum levels of consumption”. (Winpenny, 1994, pp. 110–112).

Serageldin (1995, pp. 1–10) also emphasised the inequity of the urban poor having to pay high prices and spend a high proportion of their income in buying water from private street vendors, and added the importance of stakeholder participation as a way of delivering services to informal settlements, citing as an example the Orangi Pilot Project (OPP) in Karachi, Pakistan (Serageldin, 1995, pp. 25–26).

Briscoe and Garn (1995) set out evidence that better results could be achieved by stakeholder participation, new technical approaches to informal settlements, and the case for eliminating subsidies. They referred not only to the Orangi Pilot Project (OPP), but also the extension of service provision to the periphery of São Paulo, Brazil to show “how forcefully poor people demand environmental services, once the primary needs for water supply are fulfilled”. While the OPP case study was centred around community participation in the extension of sewerage services to 600,000 poor people, in São Paulo water and sanitation connections for the favelas exploded between 1980 and 1990. The emergence of democracy in Brazil was seen as the key factor, prior to which SABESP had defined its role narrowly and technocratically: it

> “did not consider provision of services to the *favelas* to be its responsibility, since it was not able to do this according to its prescribed technical standards, and because the *favelas* were not “legal”. Before the legitimization of political activity in Brazil in the early 1980s, SABESP successfully resisted pressures to provide services to the *favelas*”.

However, a smaller municipal water company, COBES, introduced a new technical and institutional approach:

> “On the technical side this [involved] reducing the cost of providing in-house services by using plastic pipe and servicing of narrow roads where access was limited. On the institutional side it meant the community assuming significant responsibility for community relations, and for supervising the work of the contractors… Since COBES had shown how it was, in fact, possible to serve the *favelas*, SABESP had no option but to respond”.

The authors added that “There are many reasons – efficiency, innovation and separation of provider and regulator – suggesting that it is often appropriate to involve the private sector in the provision of these services” and elaborated on the potential of the private sector in mobilising finance for investment too.