



Private Sector Initiatives in Slum Upgrading

Judy L. Baker and Kim McClain



URBAN
SECTOR
BOARD

Private Sector Initiatives in Slum Upgrading

Judy L. Baker and Kim McClain



THE WORLD BANK
Washington, D.C.



**URBAN
SECTOR
BOARD**

© 2009 The International Bank for Reconstruction and Development/The World Bank
1818 H Street NW
Washington, DC 20433
Telephone 202-473-1000
Internet: www.worldbank.org
Published May 2009

This volume is a product of the staff of The World Bank. The findings, interpretations, and conclusions expressed in this volume do not necessarily reflect the views of the Executive Directors of The World Bank or the governments they represent.

The World Bank does not guarantee the accuracy of the data included in this work. The boundaries, colors, denominations, and other information shown on any map in this work do not imply any judgment on the part of The World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

Rights and Permissions

The material in this publication is copyrighted. Copying and/or transmitting portions or all of this work without permission may be a violation of applicable law. The International Bank for Reconstruction and Development / The World Bank encourages dissemination of its work and will normally grant permission to reproduce portions of the work promptly.

For permission to photocopy or reprint any part of this work, please send a request with complete information to the Copyright Clearance Center Inc., 222 Rosewood Drive, Danvers, MA 01923, USA; telephone: 978-750-8400; fax: 978-750-4470; Internet: www.copyright.com. All other queries on rights and licenses, including subsidiary rights, should be addressed to the Office of the Publisher, The World Bank, 1818 H Street NW, Washington, DC 20433, USA; fax: 202-522-2422; e-mail: pubrights@worldbank.org.

Cover photos of Accra, Ghana, courtesy of Ashna Singh Mathema.

To order additional copies of this publication, please send an e-mail to the Urban Help Desk, urbanhelp@worldbank.org

Urban publications are available on-line at <http://www.worldbank.org/urban/>.

TABLE OF CONTENTS

Acknowledgements	v
Abstract	vii
I. Introduction and Background	1
The private sector and slum creation	1
Private sector's relationship to slum upgrading programs historically	2
II. Challenges and Opportunities Facing the Private Sector in Engaging with Low-Income Urban Areas	3
Economic environment and the state of the private sector	3
Barriers to private sector engagement	4
Opportunities for private participation in slum upgrading	8
III. Current Approaches to Private Sector Participation in Slum Upgrading	9
Local government's mobilization of private finance	10
Communities as clients	13
Harnessing the private sector's pursuit of high-end markets	15
Direct marketing to the poor	16
Private sector in promoting local economic activity	19
IV. Opportunities for Scaling up Private Sector Engagement in Urban Slums	20
Building trust	20
Facilitating payment	21
Designing and delivering innovative products and services	22
Small-unit high volume sales	22
A role for government, NGOs, and the international community in promoting partnerships	23
References	25
Annex. Case Study Summary Table	29

LIST OF TABLES

Table 1. Types of Private-Public Partnerships	11
---	----

LIST OF BOXES

Box 1. Getting Private Water Utilities into Slums: Metro Manila Water Concessions	12
Box 2. Small Water Providers and OBA Strategies: <i>Aguateros</i> in Paraguay	13
Box 3. Using Profitable Sanitation Technology to Sustain an NGO: the <i>Sulabh</i> Sanitation Movement	20

ACKNOWLEDGEMENTS

This paper was prepared by Judy L. Baker, Lead Economist, Finance, Economics and Urban Department, World Bank and Kim McClain, Consultant, World Bank. The authors wish to thank World Bank staff Dean Cira (peer reviewer), Victor Vergara (peer reviewer), Sandra Cointreau and Tova Solo, as well as participants of a workshop on this topic at the World Bank in May 2008. This study was prepared under the overall guidance of Abha Joshi-Ghani, Urban Sector Manager, Finance, Economics and Urban Department, World Bank.

ABSTRACT

The unmet needs for basic services and housing in rapidly growing slums presents an enormous development challenge. Yet it also presents a significant market opportunity for private entrepreneurs. This paper reviews current experiences of private sector initiatives in slum upgrading activities with an aim to identify challenges, good practice, and opportunities for scaling up such efforts. Approaches such as the mobilization of private sector finance by community groups, direct marketing to the urban poor by microfinance institutions or for incremental housing construction by a cement producer in Mexico, and the use of innovative land-use management techniques such as “transferable development rights” have been effective and viable business models, while delivering much needed services to poor communities. A framework for exploring these experiences is presented in the paper, as well as examples of how the development community can innovate to encourage further private sector participation in slum upgrading activities.

PRIVATE SECTOR INITIATIVES IN SLUM UPGRADING

I. INTRODUCTION AND BACKGROUND

Living conditions in urban slums, characterized by a lack of basic public services and infrastructure, precarious housing, overcrowding and often escalating social problems, remain a major and growing challenge in cities all over the developing world. It is now estimated that one in three city dwellers, a billion people, a sixth of the world's population, live in slums.¹ Governments and the development community have invested significantly in improving the lives of slums dwellers through a range of upgrading programs which typically include infrastructure investments (water and sanitation, waste management, electricity, roads), and in some cases interventions aimed at improving tenure security, social infrastructure, housing quality, access to credit and access to social programs. The immense and growing scale of slums has, however, outpaced the impact these programs alone can have. When considering the scaling up of such efforts to address the growing problem, it is clear that the public sector cannot do it alone and there is much need for alternative approaches. One such approach with enormous potential is the mobilization of additional private sector finance and expertise.

This paper is intended to explore the challenges and opportunities for scaling up private participation in urban upgrading activities and the models through which this can happen. Upgrading is broadly defined in the paper, though some distinction should be made when considering initiatives aimed at physical and social improvements for households and communities, and private sector financing of incremental housing solutions. Section I presents background on the private sector's interactions with slum communities and slum dwellers historically. Section II discusses the challenges and opportunities facing the private sector in engaging with low-income urban communities. Section III explores the current approaches to private sector participation in slum upgrading activities drawing on field experiences, and Section IV outlines some of the lessons from experience and provides a discussion on opportunities for donors and others to work with the private sector in scaling up slum upgrading initiatives.

The private sector and slum creation

Slums are the spontaneous response of the poor to their own needs for shelter in cities. They are essentially a private phenomenon, which responds to market incentives and distortions without extensive government interference. Slums form part of the informal economy, and they house many of the informal economy's actors. Slums thrive and grow because a significant amount of economic activity contributes to the provision of basic shelter, water, food, energy, and other goods to slum dwellers. Slum dwellers are often entrepreneurs themselves, but their demand also attracts other informal entrepreneurs. For example, so-called "illegal land developers" ignore zoning codes, minimum service requirements for residential subdivisions (and in some cases even the property rights of the land holder), to sell small un-serviced plots on vacant land, often at the urban periphery, to the urban poor and new migrants. While not a legal business, the process by which these illegal subdivisions allocate land, like in many other types of slums, is entirely market-based with prices that respond to the level of land security, location, proximity to transport and

¹ United Nations Population Fund (UNFPA), *State of the World Population 2007: Unleashing the Potential of Urban Growth*, 2007, p. 16.

employment, and the size and quality of the plot itself.² In slums that have not received assistance from Non-Governmental Organizations (NGOs) or the government, the informal private sector has likely been the exclusive means for development, highlighting the market system on which slums rely - the basis for envisioning an expanded role for the formal private sector.

The formal private sector has played a role in slum creation as well as the role of injured party, defendant of property rights, or passive landlord. Private landowners may even be complicit with the "land invasions" and "informal land developers" that establish slums on their property because it opens the opportunity to charge rent to inhabitants while legally reserving the right to evict squatters when better opportunities for commercial development arise.³

In general, the private sector's attitude toward slums has ranged from indifferent to quietly supportive, primarily because slums house the informal economy which provides goods, services, and labor at low costs.⁴ The relationship between slum dwellers and business interests has, however, been strained and even contentious at times.⁵ Slum creation accelerates with migration and can encroach upon land that is wanted for commercial development. The many negative externalities associated with slums, such as crime, disease, and poverty, can also spill out of the slums into the larger city, affecting businesses directly and the city's image.⁶ The private sector's interests regarding slums are not clear cut or homogenous, thus understanding them within the local context is important to approaching and negotiating programs with the private sector.

Private sector's relationship to slum upgrading programs historically

Almost 50 years of experience in improving housing and living standards for the urban poor has taught the development community that neither the government nor the private sector alone can provide the poor with the basic requirements for healthy urban living. The pendulum has swung in different countries and at different times between leaving provision of shelter entirely to the private sector, through neglect of slums, the eviction of squatters, or unassisted resettlement, and making expensive but often inadequate government investments in public housing, sites and services, and upgrading of slum communities.⁷ A trend in the 1980s towards supporting institutional development, improving regulatory environments and building municipal planning capacity recognized the impact of

² See, United Nations Human Settlements Programme (UN-Habitat), *The Challenge of Slums: Global Report on Human Settlements 2003*, Sterling, VA: Earthscan, 2003, pp. 105-106 and Erhard Berner, "Learning from informal markets: Innovative approaches to land and housing provision," *Development in Practice* 11:2/3, May 2001, pp. 297-302, for a discussion of illegal sub-divisions and other mechanisms by which slum dwellers purchase or rent their plots.

³ The case of urban slums in Tegucigalpa is one where ownership is contested between the local government and a number of wealthy landowners who have to varying extents extorted rent out of squatters and ultimately sought payment for the land after it had been developed ("100 millones de lempiras podría obtener Siri Zúñiga por negligencia de Alcaldía en pleito de tierras ejidales," *Revistazo.com* 6, Jan. 2003, <http://www.revistazo.com/ene-03/index.htm>). See also Erhard Berner, pp. 297-302, for a more general discussion of landowners' participation in slum creation.

⁴ United Nations Human Settlements Programme (UN-Habitat), pp. 67-8.

⁵ Harassment and eviction of slum dwellers by authorities can result from the pressure of business interests to open up land for development (Julia Vilorio-Williams, *Urban Community Upgrading: Lessons from the Past—Prospects for the Future*, Washington, DC: World Bank Institute, 2006, pp. 2, 9-10).

⁶ United Nations Human Settlements Programme (UN-Habitat), pp. 65, see p. 78 (footnote 74) for examples of slum dweller "relocation" for Olympics games.

⁷ United Nations Human Settlements Programme (UN-Habitat), pp. 128-31.

government policy together with the limits of government finance.⁸ As one example, in Zimbabwe in the mid-1980s, the World Bank focused on encouraging private sector building societies to finance affordable housing, though economic downturn in the mid-1990s reversed much of the progress and the long-term effect was limited.⁹

Government policy reform programs have also played a role in the privatization of public utilities, which can signify a transfer of responsibility for many slum upgrading elements to the private sector. While privatization has the potential to shake corruption and inefficiency out of entrenched public utilities, a lack of sufficient regulation can also eliminate cross-subsidization and operations in low-margin markets. Ultimately, the impact that privatization has had on service provision to slums is not well documented, and the evidence that is available suggests widely disparate experiences.¹⁰

While intentions for slum upgrading have been good and much has been learned about the dynamics of slums, the private sector's role has not figured prominently in many discussions. A considerable amount of work, both investigative and programmatic, has yet to be done to fully realize the opportunities that involving the private sector can have for slum upgrading activities.

II. CHALLENGES AND OPPORTUNITIES FACING THE PRIVATE SECTOR IN ENGAGING WITH LOW-INCOME URBAN AREAS

The wide array of relationships the private sector has had to slum upgrading and the many innovative mechanisms that have been piloted to encourage these can be described as a *mélange* of diverse responses to the many different contexts in which slums exist. There are a number of challenges and opportunities in working in low-income areas which have been addressed in many different ways. This section covers the environment for private sector activity, some of the key barriers facing the private sector, as well as the opportunities for both private sector and slums to benefit from engagement.

Economic environment and the state of the private sector

The state of the economy will have a tremendous impact on how the private sector can be mobilized for slum upgrading. A booming economy may attract private finance towards higher yield investments which are not typically in slums. It may also provide opportunities, however, to harness the demand for high-end real estate development to cross-subsidize affordable housing, as through Transfer of Development Rights (TDRs).¹¹ To the extent that economic growth is effectively converted into greater tax revenue, it can also improve the chances that municipal governments will be able to attract private finance for slum upgrading projects.

The economy will also influence the profile of slums and slum dwellers. The size, shape, and growth of slums depends not only on housing and land markets but also on migration to

⁸ United Nations Human Settlements Programme (UN-Habitat), *The Challenge of Slums: Global Report on Human Settlements 2003*, Sterling, VA: Earthscan, 2003, pp. 136-8, 141.

⁹ Edward Ramsamy, "The World Bank & Urban Programmes in Zimbabwe: A Critical Appraisal," *Review of African Political Economy* 33: 109, pp. 515-523.

¹⁰ United Nations Human Settlements Programme (UN-Habitat), pp. 44-5, 137.

¹¹ A building boom in the 1980s in Bangkok created the development pressure needed to make land sharing agreements appealing to owners of squatted land (Shlomo Angel and Somsook Boonyabancha, p. 110). Conversely, the fall in property values in Mumbai after 1997 adversely impacted the viability of the government's TDR scheme for slum upgrading (Vinit Mukhija, p. 801).

cities, the informal sector, and unemployment rates, which are in turn shaped by economic growth. The levels of poverty within a slum are critical to the strategies employed to involve the private sector, and the economic state of the city will largely determine the opportunities for income available to slum dwellers.¹² This is by far the largest factor in spontaneous slum upgrading carried out by the residents themselves, and so it will certainly impact how interested slum dwellers are in cooperating with the private sector for improvements.

The state of the private sector itself is also critical. In many countries, the formal private sector is relatively small and may have limited capacity, and even more limited resources, and is often highly risk averse making it easier to focus investment opportunities with the wealthy. The depth and capacity of the formal financial sector to mobilize capital is an even greater problem. While the informal sector is also a private source of slum upgrading activities, it may not bring to the slums the benefits of economies of scale, investment capital, long run corporate accountability, and integration of the slum into the greater city that are normally pursued with private sector partnerships. The formal private sector may be severely limited in its demand for investment opportunities and as such will not respond as enthusiastically as hoped to opportunities in slums.¹³

Barriers to private sector engagement

The private sector faces a number of barriers and disincentives to targeting the low-income market or engaging with efforts to upgrade slums. Often the choice not to pursue low-income clients or entry into slum markets is a very rational one considering the business, political, and economic structure and environment. Businesses are often ill-prepared to service the low-income market, and their lack of experience with poor clients makes them even more wary of exploring profit-making opportunities in the slums.

Traditional Business Models. The corporate culture in many developing countries does not foster collaboration with or service to the lower-income segment of the population.¹⁴ The predominant business model tends to pursue low volume, high profit margin markets as the key to business success. Low volumes are believed to imply fewer administrative costs, but they must be accompanied with substantial profit margins. High profit margins are more acceptable to consumers at higher income levels. Corporations also often have trouble with pricing structures that stray from a basic unit-pricing scheme, making the transition to differential pricing, which can make servicing low-income clients profitable, more difficult. Internal corporate policies also can get in the way of servicing poor clients. The most common policy to impact slum dwellers is the collateral requirement for loans. Since most slum dwellers do not hold title to their land (and therefore cannot claim secure ownership of any improvements on that land such as a house or workshop), they can present very little collateral and as such are not eligible for loans with formal sector lenders.

Investment Climate. Businesses also respond to national and local business environments, including the financial sector, business laws and regulations, transaction costs, and industry standards, that are often too conservative, costly and idealistic to meet the realities of poor consumers. Laws regarding business contracts, quality standards, labor

¹² See United Nations Human Settlements Programme (UN-Habitat), pp. 96-104 for an overview of economic and employment conditions of slum dwellers.

¹³ See David S. Olinger, pp. 5-8, for a discussion of the range of characteristics of formal and informal private sectors.

¹⁴ See discussion of the assumptions held by MNCs about the poor in C.K. Prahalad, *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits*, New Jersey: Wharton School Publishing, 2005, p. 8-9.

benefits and wages, building codes, and bookkeeping regulations, among others, increase the cost of doing business in a country and restrict the range of products that can be offered. Poor people's effective demand is often for housing and services that are considered sub-standard by law, thus blocking the formal private sector from providing these products without a special waiver. This is particularly problematic with regard to building codes and the poor's preference for lower-risk, progressive construction of housing.¹⁵ Companies that install infrastructure must present evidence that customers have the right to make changes to the land, which is normally enshrined only in a legal land title. Zoning laws can further restrict how land can be developed by legally barring companies from residential infrastructure installations despite the existence of a community of residential consumers and regardless of the legal title held on the land.¹⁶

In the financial sector, overly conservative reserve requirements restrict the supply of funds for lending, driving up interest rates, and banking laws often mirror corporate policies by requiring high levels of collateral for all lending.¹⁷ The regulatory burden on commercial banks, coupled with their unfamiliarity with informal populations, can result in what is called a "financial exclusion" affecting low-income groups and their potential opportunities.¹⁸

Regulation of utility prices can also discourage utility companies from investing in the more costly infrastructure required to service slum communities when there is no possibility of charging more to recover the higher costs. Particularly when investment is scarce, business-owners rationally choose to pursue the low-hanging fruit of wealthier markets where business regulations are less of a barrier.

Governments may also have the ability to unilaterally change the terms of contracts with businesses, such as for service provision or as part of public-private partnerships, which can lead to a reluctance of companies to bid on government contracts without substantial measures to mitigate political risk. Lastly, companies are acutely aware of the risk of social unrest in response to changes in service provision, such as the decline of subsidies, the transition from a flat fee to metering, and the removal of illegal service connections.¹⁹ The government's support of companies in these transitions is critical to success and to maintaining the companies' image. Conversely, the government can act opportunistically and prefer the political benefits of siding with the people. While the political environment is more critical in private sector provision of public goods, the government's understanding and support of the private sector and market mechanisms will influence the general public's opinion of businesses and profit-making, and thus shape the relationships companies can build with people.²⁰

Public good investments. One of the more fundamental economic problems facing the private sector in contributing to slum upgrading is the fact that many of the goods required by the poor are either purely public goods or goods with strong positive externalities that

¹⁵ John F. C. Turner, *Housing by People: Towards autonomy in building environments*, New York: Pantheon Books, 1977.

¹⁶ *Housing: Enabling Markets to Work*, World Bank, Apr. 1993, pp. 24, 28-30.

¹⁷ David L. Painter, "Scaling up Slum Improvement: Engaging Slum Dwellers and the Private Sector to Finance a Better Future," *TGCI Development Innovation*, June 2006, p. 16.

¹⁸ Solo, T. *Between financial Exclusion and Community Development*, 2009, World Bank Institute and Cities Alliance.

¹⁹ See Tillmann Sachs and Robert LK Tiong, "The impact of political risks on public-private partnership (PPP) opportunities in Asia," 2005, <http://www2.ntu.edu.sg/ResearchPaper/ODR/2006/Impact%20of%20political%20risks%20on%20PPPs%20-%20CEE.pdf>.

²⁰ See C.K. Prahalad's discussion of the Indian government's relationship with the private sector, p. 6-7.

create minimal private demand. Streets and pathways, public lighting, rainwater channels, public parks, and public security are pure public goods that, once supplied, are available to anyone in the neighborhood. Potable water, sewerage, solid waste collection and disposal, electricity, healthcare and public education are goods that can be sold privately to varying degrees, however, denying them to people who are unwilling or unable to pay is not socially desirable because of the positive impact these goods have on the entire community. It is also, to varying degrees, difficult and costly to restrict these services, once installed, to only those who are paying. In both cases, the incentive to free-ride can be strong, making cost-recovery for the company uncertain. In fact, in some slums, the absence of a formal service provider leads slum dwellers to make illegal connections to nearby electricity, cable television and water networks. Many companies may further interpret poor people's low income as increasing their propensity to free-ride, though there is little evidence to support this suspicion, and private companies are often not willing to risk making an investment when they may not be able to collect payment for their services.²¹

Public goods are often considered the responsibility of the state, with resources to pay for these goods available through taxation. States, however, often do not have the capacity to provide all goods deemed to have positive social benefits, the starting point of this work. States do, however, create a political environment around these public and social goods that shape the private sector's willingness to get involved in providing them. States may claim that water, housing, health, and education, among other goods, are basic rights of all citizens, thus making them political issues. When the quantity, quality or price of any of these goods is not in-line with what society considers acceptable, politicians have the incentive to intervene in the market, in the best case, with subsidies and other incentives, and in the worst case (for business), with price controls.²² In India and Brazil, for example, housing is considered a basic right of all citizens enshrined in the constitution, and politicians have consistently used the provision of free and highly-subsidized low-income housing to win votes.²³ This can then serve as a deterrent to people's willingness to pay for housing.

Property rights and land titling. There has been extensive study of the need for recognized and defensible property rights to attract private sector investment.²⁴ There is a body of literature that considers land titling in slums the most critical intervention that governments can do to spur private investment in slums. Certainly lack of permanent legal title is one of the defining elements of most slums, and it undeniably shapes private investment in housing and neighborhood upgrading, by both households and businesses.²⁵ The proportion of households with access to secure tenure is in fact the only indicator for the MDG related to improving the lives of people living in slums.²⁶ There is, however, a considerable gray area between holding a legal title and absolute precariousness, and there is also considerable debate about the true influence of land tenure on willingness to invest.

²¹ Richard Franceys and Almud Weitz, "Public-Private Community Partnerships in Infrastructure for the Poor," *Journal of International Development* 15, 2003, p. 1084.

²² Patricia Clarke Annez, "Urban Infrastructure Finance from Private Operators: What Have We Learned from Recent Experience?" World Bank Policy Research Working Paper 4045, Nov. 2006, pp. 10-12.

²³ For Brazil see Jessica Budds, Paulo Teixeira and SEHAB, "Ensuring the right to the city: pro-poor housing, urban development and tenure legalization in Sao Paulo, Brazil," *Environment and Urbanization* 17, 2005, p. 96. For India, see Sundar Burra, "Towards a pro-poor framework for slum upgrading in Mumbai, India," *Environment and Urbanization* 17, 2005, p. 72.

²⁴ See United Nations Human Settlements Programme (UN-Habitat), pp. 167-72.

²⁵ C.K. Prahalad connects the lack of land titles to the poor's preference for holding wealth in durable household items as opposed to immovable land and housing improvements. C.K. Prahalad, p. 12.

²⁶ "A complete listing of the goals, targets, and indicators for MDGs," World Bank, http://devdata.worldbank.org/gmis/mdg/list_of_goals.htm.

As most governments have come to recognize the existence of slums and accept them as marginal poor neighborhoods rather than illegal squatter settlements that need to be cleared, slum dwellers have gained differing and fluctuating levels of security of tenure.²⁷ This security may be informal, but it may be strengthened by pro-poor policies, land being public and without competing owners, historical longevity of the community, low demand for land development and correspondingly low land prices, or other factors that help guarantee that slum dwellers won't be evicted. Some governments also establish semi-formal lease or registration systems, whereby slum dwellers, particularly on public land, make renters' or settlers' arrangements with the government that give temporary legal right to occupy. Street addressing within slums has also been used to give a semblance of official location and recognition to individual homes in slums and normalize the slums as integrated neighborhoods.²⁸

The importance of land titling and the extent to which it is a barrier to private sector involvement is a hotly contested issue. Some development professionals believe that it requires excessive time and effort that is only fruitful with significant political will, making it a distraction from the more direct issues of infrastructure and health that slum dwellers more desperately need. On the other side of the debate, the only long term, sustainable strategy is to ensure people have legal title to their land so that private investment can happen spontaneously. A common middle ground is that both land titling and slum upgrading can progress simultaneously, but that neither should be made to wait for the other.

Crime and Violence. Crime, violence, and the control of slums by organized gangs or "slum lords" who use illegal methods to extort money from residents, can be major deterrents for the private sector. While crime and violence is not specific to slums, it is closely linked to inequality and exclusion, particularly evident in low-income urban areas. The World Bank's "Doing Business Surveys" show that crime retards entrepreneurial activity in every region.²⁹ In Latin America, more than 50 percent of firms surveyed judged crime to be a serious obstacle to conducting business. In Sub-Saharan Africa and East Asia, more than 25 percent or more said the same. The impact of crime varies by country. In Nigeria, the Investment Climate Survey shows 37 percent of respondents identify crime as a major or severe constraint on their operations, in Zambia 50 percent, and in Kenya 70 percent. In Guatemala, an extraordinary 80 percent of surveyed firms said that crime is a major or severe constraint. A study in Dhaka, Bangladesh found that a major constraint cited by service providers for delivering services to the urban poor was the role of "mastaans" which are individuals who provide services to slum residents by circumventing the system. They use illegal methods, organize in gangs/groups, and often use extortion and violence.³⁰ Other main constraints included the lack of government policy and evictions of slum residents.

Culture. A final barrier to private sector engagement with the poor is the lack of knowledge and understanding between the two groups. The culture gap between the formal private sector and the urban poor can be significant, making private businesses wary of attracting poor clients and poor people distrustful of private businesses' intentions. Many

²⁷ For a full discussion of types of slum formation and tenure, see United Nations Human Settlements Programme, pp. 79-88.

²⁸ Catherine Farvacque-Vitkovic, Lucien Godin, Hugues Leroux, Florence Verdet, and Roberto Chavez, *Street Addressing and the Management of Cities, Directions in Development*, Washington, DC: World Bank, 2005, pp. 36-39.

²⁹ World Bank, 2005, "A Better Investment Climate for Everyone",

³⁰ World Bank, 2007, "Dhaka: Improving Living Conditions for the Urban Poor", Report No. 35824-BD.

formal businesses do not see low-income customers interested and able to pay for the services they provide. They may fear the crime they hear reported in the slums and believe that they would risk damage or loss of property. The formal business sector historically has had limited experience with poor clients which impacts its ability to gauge risk, measure demand, and perceive the tastes and desires of the market. In some countries, class stereotypes limit formal business-owners from seeing poor people as a potential market altogether.³¹ The misunderstanding and distrust can go both ways as poor people may perceive formal businesses as exploitative, greedy, and unfair to both customers and workers alike.³² This may mean that businesses have to invest in building trust with their potential clients in poor neighborhoods before fully perceiving the benefits of entering these markets.

Opportunities for private participation in slum upgrading

Despite the considerable barriers mentioned above, there is a growing awareness of the potential for both slums and businesses to benefit greatly from the engagement of the private sector. The poor, who make up the bottom or base of the economic pyramid (BOP) with less than \$3000 in annual income (2002 PPP), total over 4 billion in numbers and over \$5 trillion in purchasing power. Hernando de Soto's theory of property rights also proposes that the poor have considerable "dead capital", \$1.2 trillion of it, according to a 2003 study, in the form of untitled land (slum properties themselves) and unregistered businesses that can be mobilized through titling and business registration. There is also increasing recognition of the considerable resources generated through remittances that are often channeled into housing and education. In 2005, \$167 billion in remittances were officially recorded entering developing countries, and as much as 50% more may have been transferred informally.³³ If organized and leveraged correctly, the poor's purchasing power can represent a significant market capable of enticing the private sector into producing goods and services that improve living conditions in slums.

Much of the poor's purchasing power currently fuels the informal economy and thus represents an un-captured market for the formal private sector. The informal economy produces an estimated average of 30% of official GDP in Asia, 40% in Eastern Europe, and 43% in both Africa and Latin America and the Caribbean making it a substantial proportion of the market.³⁴ While the informal economy represents an important complement to the formal economy in providing services to the poor, informality can bring with it higher costs of production related to smaller scale, lower quality goods, unsafe and unsanitary practices, exploitative pricing strategies, inconsistency, and other quality and price differentials that disadvantage the poor. This "poverty penalty", as it has been termed, hurts the poor and makes a clear case for encouraging the formal private sector to extend services to the poor. And the fact that the poor do regularly pay a price premium provides evidence that there is real demand and ability and willingness to pay.³⁵

While spontaneous private sector initiatives that benefit the urban poor will continue to happen, there is still a need for public and donor funding and assistance. More importantly, the potential for donor funding to mobilize even greater amounts of private capital is an

³¹ C.K. Prahalad, pp. 8-10, 20-1.

³² Government and charitable organizations have often gone along with the "dominant logic [that]...the private sector [is]...exploitative of the poor" (C.K. Prahalad, pp. 6-7, 9).

³³ *The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid*, World Resources Institute, 2007, p. 16.

³⁴ Attributed to Friedrich Schneider (2005); quoted from *The Next 4 Billion*, p. 16.

³⁵ C.K. Prahalad, p. 11-12.

opportunity that must be recognized. Some programs to encourage investment by local capital markets and slum households themselves have mobilized upwards of 7 times the program budget in private investment.³⁶ The multiplier effect created by allowing poor people to contribute their own investment and offering a profit-making opportunity to private investors is a critical force for scaling up slum upgrading efforts.

There is much to be gained not only from private sector finance and investment, but also from private sector expertise in efficient management of projects. The private sector has much greater experience in cost-minimization and the effective use of human resources, among many other strategies for efficiency. Formal private economic activity in slums also creates opportunities for wage labor and small local businesses to provide inputs, which lowers unemployment and creates demand for entrepreneurs. The presence and participation of the formal sector in slums can help to integrate communities into the broader economy of the city and reverse the marginalization of slum dwellers.³⁷

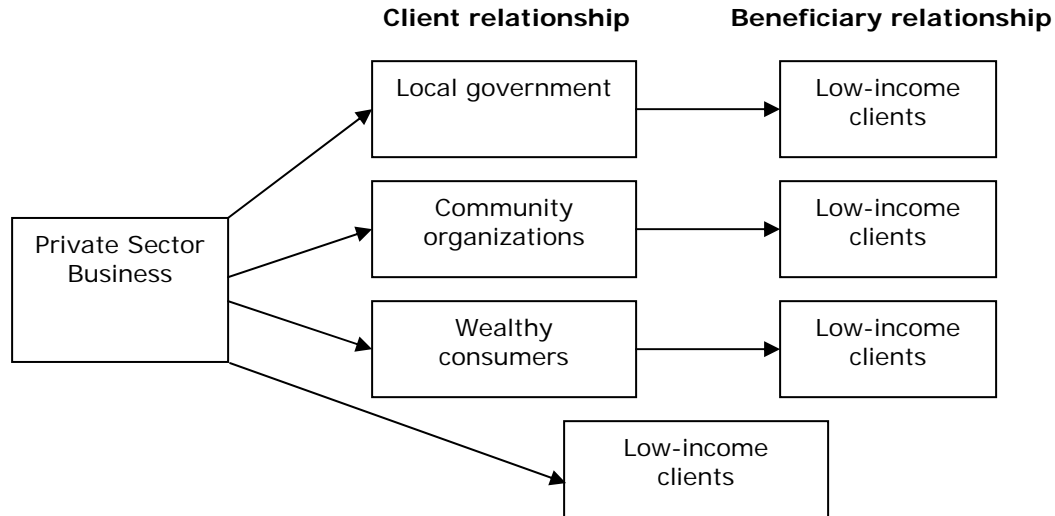
III. CURRENT APPROACHES TO PRIVATE SECTOR PARTICIPATION IN SLUM UPGRADING

The private sector's role in slum upgrading can take many forms. An attempt to categorize these roles can be done along the lines of who the private sector engages as a client and how that leads to benefits for the poor. These client interactions are categorized as private sector engagement with: i) local government; ii) community organizations; iii) wealthy consumers; and iv) directly with the poor. Naturally individual projects and ventures may contain multiple relationships and contracts linking the private sector to the poor, altogether creating a diversity of options for mobilizing private investment. All of these mechanisms direct private investment towards the urban poor and the slum communities they live in and can result in a wide range of impacts, including increased and more efficient service provision, permanent infrastructure, innovative solutions to unique problems of poverty, greater choice for poor consumers, integration of slums into the formal sector and larger city, and social assistance to the poorest slum dwellers.

In the following section, examples of the private sector's involvement in slum upgrading are presented according to the kind of business relationship the private sector engaged in, as a way to understand where new projects may involve the private sector. The private sector must perceive a profitable transaction with all of its clients, and so understanding how those relationships and contracts have been developed to promote improved welfare for the poor is key to effectively identifying opportunities for private investments in slum upgrading. Beyond the four main categories of client interactions mentioned above, are further links, including patron-beneficiary relationships, political accountability relationships, regulatory relationships, and donor accountability relationships which connect each of these clients to poor people themselves and can shape private sector's incentives, investments, service quality, and other business decisions. This multiplicity of potential connections creates a diverse universe of potential private-public-individual partnerships, a selection of which is presented below.

³⁶ David L. Painter, p. 11.

³⁷ C.K. Prahalad describes the poor's integration into the formal market economy as providing opportunities for acquiring a formal identity, p. 107.



Local government's mobilization of private finance

Decentralization has increasingly empowered local government to act independently on matters of local development, including efforts to upgrade slums. Resource and capacity constraints, however, remain major challenges and create demand for finance and expertise in the operation and implementation of public works and services. While often bundled with public-private partnership projects that impact the city at large, there are a number of examples where such activities are also financing slum upgrading and service provision to poor areas. Donors such as USAID have created finance facilities, such as the Community Water and Sanitation Facility (CWSF), which provide gap funding and credit guarantees to help municipalities access commercial finance for slum infrastructure and service expansion projects.³⁸

Interest has also been growing in municipal bonds as a means to mobilize private domestic capital for public projects. In India, the Ahmedabad Municipal Corporation issued the first municipal bond in 1998 without a central government guarantee for the purpose of financing a city-wide water and sanitation project that included many slum areas and the Slum Networking Project "Parivartan." In 2005, municipal governments around Bangalore built on Ahmedabad's success with a bond issue called the Greater Bangalore Water and Sanitation Pooled Facility that combined the commitments of eight city governments. In both cases, the success of the bond sales depended on the municipal governments having previously demonstrated a revenue surplus and received a sufficiently high credit-rating to ensure an interest rate in line with the government's projections of future ability to pay, among other conditions. The ability of municipal governments to mobilize domestic capital greatly enhances the scale at which municipal governments can engage in development. Ahmedabad's four municipal bond issues raised \$89.5 million between 1998 and 2006. The Greater Bangalore Facility raised over \$23 million with the assistance of a \$780,000 partial credit guarantee from USAID, essentially mobilizing over \$29 in domestic capital for every dollar donated.³⁹

³⁸ "Community Water and Sanitation Facility: A Cities Alliance Initiative," Factsheet from the Fourth World Water Forum, Mexico City, March 2006.

³⁹ David L. Painter, pp. 19-20.

The private sector can also be brought into project implementation and service delivery through contracts and partnerships with local government. Municipal governments that lack the capacity to expand public services can pursue a range of public-private partnerships. The following Table 1 lays out the basic characteristics of the main types of public-private partnerships for infrastructure.

Table 1. Types of Private-Public Partnerships

Option	Asset ownership	Operations and maintenance	Capital investment	Commercial risk	Duration
Service contract	Public	Public and private	Public	Public	1-2 years
Management contract	Public	Private	Public	Public	3-5 years
Lease	Public	Private	Public	Shared	8-15 years
Concession	Public	Private	Private	Private	25-30 years
BOT/BOO*	Private and public	Private	Private	Private	20-30 years
Divesture	Private, or private and public	Private	Private	Private	Indefinite (may be limited by license)

* Build-operate-transfer/build-operate-own

Source: "Selecting an Option for Private Sector Participation," World Bank Toolkit, 1997.

The experience with public-private-partnerships in urban slums has mainly been through components of larger projects that may include an entire utility (water, sewerage, electricity, transport) within a certain city or region. Municipal governments may hire a private company to extend the water and sanitation network to new parts of the city, including slum communities (a service contract), or they may include in a concession the commitment to extend service to certain slum communities, which obliges the private company to recover the costs of service provision and initial investment from their customers, including the slum dwellers. Pilot projects to extend service to poor communities in Jakarta as part of two separate water concessions have had some success, although moving beyond the pilot phase has been difficult. In Port Vila, Vanuatu, a concession contract successfully extended free potable water service to poor areas through cross subsidies from wealthier areas. In Manila, the concessionaires Mayniland Water Services and Manila Water Company use a variety of internal programs and partnerships with NGOs, community organizations and small entrepreneurs to increase water distribution to slums.⁴⁰ Municipalities have discovered that involving the private sector in public utilities and works is not without its problems, but as cities continue to consider public-private partnerships as ways to improve public services, service expansion to slums can be brought to the negotiating table and integrated into PPP contracts.⁴¹ (Box 1)

⁴⁰ See Almud Weitz and Richard Franceys eds., *Beyond Boundaries: Extending Services to the Urban Poor*, Asian Development Bank, August 2002, http://www.adb.org/documents/books/beyond_boundaries/beyond_boundaries.pdf, pp. 50-61 for further description of these public-private partnerships, and the full publication for a broader selection of examples.

⁴¹ See Almud Weitz and Richard Franceys eds., *Beyond Boundaries: Extending Services to the Urban Poor* for examples of problems with pro-poor concessions. See Meera Mehta, "Balancing Commercial Viability with the Needs of the Poor in the Development of Urban Water Supply and Sewerage Projects," *Project Notes 14*, USAID Indo-US Financial Institutions Reform and Expansion Project—Debt Market Component FIRE(D), January 1999,

Box 1. Getting Private Water Utilities into Slums: Metro Manila Water Concessions

Metro Manila's water authority was privatized in 1997 with the intention of solving problems of inefficiency and financial shortfalls. Two 25-year concession contracts were signed, one with Manila Water Company (composed of Ayala and International Water) to cover the eastern zone of the city and a second with Maynilad Water Services (Benpres and Ondeo) to cover the western zone. Both concessionaires are required to expand service coverage to 77-87% by 2001 and 95-98% by 2021. To achieve this, both companies have had to devise strategies to profitably extend water services to slums.

Although the concession agreement allows for the installation of one public standpipe per 475 people in depressed areas, both companies have worked to establish other types of connections that bring water closer to people's homes and ensure greater revenue for the companies. Manila Water has introduced group taps for 2-5 households to share a single connection registration and water bill. The company has also introduced community-managed water connections in which a community association is responsible for a master meter and installs and manages a distribution network to blocks or individuals. Manila Water also permits private companies to buy water for resale through private distribution networks, which the contractor must take responsibility for maintaining.

Maynilad has actively sought out partnerships with NGOs to extend individual household connections, preferred by customers in all income groups, to slums. Its Bayan Tubig (Water for the Community) program waives the land-title requirement in slums and integrates payment of the connection fee into the first 6, 12, or 24 monthly water bills. NGOs, such as the Swiss chapter of Médecins San Frontières and the local LINGAP Foundation in Malabon, get communities involved to support ownership of the program through information, education and community campaigns and assistance to the poorest families through microfinance. Maynilad additionally will contract with community-based associations to provide billing and collection services, which further localizes value creation in household water provision.

The companies have enhanced their image and have decreased non-revenue water through formalizing water provision arrangements in slums where many people had been receiving water through illegal connections and public standpipes. Through their contract with the local government and their partnerships with NGOs and community associations, these two private water utilities are promoting access to safe, reliable potable water in the poorest areas in Metro Manila.

*From Almud Weitz and Richard Franceys eds., Beyond Boundaries: Extending Services to the Urban Poor, Asian Development Bank, August 2002, http://www.adb.org/documents/books/beyond_boundaries/beyond_boundaries.pdf, pp. 56-60. See also, Richard Franceys and Almud Weitz, "Public-Private Community Partnerships in Infrastructure for the Poor," *Journal of International Development* 15, 2003, p. 1092-1094.*

Output-based aid (OBA) is a growing trend in structuring subsidies to the private sector so as to ensure that performance targets, particularly those related to service provision to the poor, are met. OBA links the payment of subsidies to the demonstration of specific service delivery or outputs, such as the connection of a set number of new customers to the electrical grid or water distribution network. Private providers must therefore shoulder their own risk of non-performance and provide their own finance upfront (in most cases) to meet the performance targets.⁴² OBA has been particularly effective in extending water connections to slums through one-time network extension and connection fee subsidies, such as is being done in Manaus (Brazil), Jakarta, Manila, Mozambique, Surabaya (Indonesia), and Ethiopia.⁴³ As with concessions and other public-private partnerships and

<http://www.niua.org/indiarurbaninfo/fire-D/ProjectNo.14.pdf>, for issues related to integrating service provision to the poor into commercially viable projects.

⁴² "Output-based aid: Supporting infrastructure delivery through explicit and performance-based subsidies," *OBA Approaches* Note Number 5, March 2005, http://www.gpoba.org/documents/OBAApproaches_What_is_OBA.pdf, and the GPOBA website: www.gpoba.org.

⁴³ *GPOBA Activities* (updated Feb. 22, 2008), <http://www.gpoba.org/activities/index.asp>.

contracts, sufficient attention must be paid to mitigating payment risk on the part of the government and to designing efficient and credible monitoring and administration systems. (Box 2)

Box 2. Small Water Providers and OBA Strategies: *Aguateros* in Paraguay

Like most Latin American countries, Paraguay's potable water is provided principally by public water utilities—ESSAP in urban areas and SENASA in rural areas—however, a total of 17% of residential water connections are installed and serviced by approximately 400 independent small-scale water providers. These *Aguateros* provide potable water to close to 500,000 mostly poor residents of the peri-urban communities around Asunción and other cities through independent wells and distribution networks servicing 300 to 3,000 households each. *Aguateros* are capitalist entrepreneurs that invest their own funds or borrow from commercial banks to take advantage of the growth in peri-urban neighborhoods by setting up profitable water systems. They have adapted their revenue-raising techniques to match the payment abilities of their clients through market-rate financing of connection fees and initial flat-fee monthly tariffs before later installing meters.

A working relationship between *Aguateros*, some though not all of whom operate informally, and the government has been negotiated over the 20 years since *Aguateros* began doing business. The public utilities have regulatory power over any water providers, and they review all *Aguateros'* bi-annual water quality certifications. They are also increasingly exerting control over tariffs and fees charged to users in response to some *Aguateros'* acting monopolistically and abusing users. The *Aguateros* have also organized an association to represent their interests, improve their own image, and better negotiate with the government.

In 2002, working with the World Bank's Global Partnership on Output-Based Aid, SENASA initiated a pilot OBA program to take advantage of *Aguateros'* and small construction companies' entrepreneurialism to provide potable water to four rural villages. Builder-operator consortiums bid for a contract that offered a per-connection subsidy contingent on completion of a borehole, disinfection system, elevated or pressurized ground storage tank, and distribution system with working household connections in each of four communities. SENASA negotiated the terms with local water users associations to ensure agreement on users' connection charges (beyond the subsidy) and tariffs. The response from the communities has been very positive, particularly due to the speed with which the projects were brought to completion, supporting the hope that partnerships between SENASA and *Aguateros* can continue to extend access to water to small towns and peri-urban communities.

The success that small-scale private water providers have had in formalizing their business and engaging with government regulatory agencies effectively deepened the private water sector, and this created the competitive conditions necessary for the success of output-based aid.

From "Aguateros: Small Scale Water Entrepreneurs," Upgrading Urban Communities: A Resource Framework, Section: Case Examples, The World Bank Group, <http://web.mit.edu/urbanupgrading/upgrading/case-examples/ce-py-agu.html> and Franz Drees-Gross et al., "Output-Based Aid in Water: Lessons in Implementation from a Pilot in Paraguay," OBAApproaches Note Number 7, May 2005, <http://www.gpoba.org/docs/OBAApproachesParaguaywater.pdf>.

Communities as clients

When slum dwellers are locally organized into community organizations or town councils, and particularly when they can ally themselves with local NGOs, there is an opportunity for their collective organization to attract the attention of the private sector and convince them of their potential as a client. Like local governments, local community-based organizations (CBOs) and NGOs can organize and partner with the private sector to acquire goods and services that can then be enjoyed by all slum dwellers. The Community-Led Infrastructure Finance Facility (CLIFF) bases its model on the idea that local community organizations are

capable of attracting private finance for their slum upgrading activities in the same way municipal governments can. The CLIFF provides grants for technical assistance, capital, knowledge-sharing, and management costs in addition to facilitating credit guarantees for local organizations that are soliciting private and public finance in order to scale up local solutions to the problems in slums. The Indian Alliance, a local NGO, has been able to get financing for housing projects for slum dwellers from domestic banks with only a 10% guarantee from CLIFF (down from an over 100% guarantee 10 years ago).⁴⁴ UN-Habitat has piloted a similar finance facility, the Slum Upgrading Facility (SUF), which looks to organize public, private, and community stakeholders to encourage involvement of all sectors in enabling community organizations to carry out bankable slum upgrading projects.⁴⁵

Communities can also organize to acquire other services from the private providers who may be unprepared to market their services to individual consumers in slum neighborhoods. In Port Vila, Vanuatu, a private company provides solid waste collection services to many areas of the city and recently began collecting from numerous centrally located points in the peri-urban village of Mele. The company began service in response to the village's collective request for a contract and continues to deal with the village collectively through a health management committee that selects the pick-up sites, collects donations, and pays the company.⁴⁶ Community water boards are also a common way for poor neighborhoods to convince water utilities to provide service, as the community assumes the responsibility for collecting fees from users (often by applying flat fees per house, apartment, or business instead of metering charges which requires greater capital investment) and paying the monthly bill.⁴⁷

In microfinance for housing, effective NGO microlenders can mobilize the credit histories of their member/borrowers in order to access commercial lines of credit and therefore expand their pool of funding. Genesis Empresarial, a Guatemalan NGO working in rural microenterprise and housing lending for the poor, is an example of an NGO that has gained access to credit lines from commercial banks, which they then extend to their clients on a cost-recovery and even profitable basis.⁴⁸ Microfinance loans for housing can speed up the self-construction process, improving client's standard of living and constructing rooms that can be rented out for additional income.

Lastly, when pursuing title to their land, often the only viable option for poor slum dwellers is to negotiate collectively, particularly when land must be purchased from and financed by the private sector. One such example is Terra Nova, a Brazilian for-profit company that regularizes land that has been illegally occupied by negotiating a fair price between the owners and residents, buying the land, making improvements on it, and then immediately reselling it to the residents at the collectively negotiated price. The organized collective

⁴⁴ Ian Morris, Financial Services Coordinator, Homeless International, telephone interview, March 28, 2008.

⁴⁵ Ruth McLeod, "SUF Local Finance Facilities: what they are, why they are important, and how they work," UN-Habitat Slum Upgrading Facility (SUF) Working Paper 8, April 2008.

⁴⁶ Almud Weitz and Richard Franceys eds., *Beyond Boundaries*, pp. 42-43.

⁴⁷ Juntas Administradoras de Agua (administrative water boards) are the most common mechanism for charging for water and maintaining distribution systems that provide through household connections in poor slums and rural villages in Honduras (Author's experience). Water boards are also used in poor slums in Manila (Richard Franceys and Almud Weitz, "Public-Private Community Partnerships...", p. 1093).

⁴⁸ Ivo Imparato and Jeff Ruster, *Slum Upgrading and Participation: Lessons from Latin America*, Washington, DC: World Bank, 2003, p. 284.

bargaining keeps owners and the company in check from pricing the land above what the residents can pay.⁴⁹

Harnessing the private sector's pursuit of high-end markets

Traditionally private businesses have focused on the higher-income market for the bulk of their profits because of the high profit margins this market permits and the higher perceived potential for growth. This profit-seeking tendency naturally lends itself towards higher-income consumers though can be harnessed to extend benefits to the poor through government regulatory instruments and even activism with higher-income consumers. One approach is through tariff structures which are designed to create cross-subsidization from high-income consumers to the poor. This is often seen where water and sanitation utilities have been integrated with the private sector. Tariffs can be set by zones, to benefit poor slums, or by consumption levels, which set lower rates for a basic level of consumption (often termed a lifeline block) and then increasing rates for higher levels of consumption.⁵⁰ This type of price setting allows producers to lower the price for those who won't buy at higher prices and, therefore, expand sales without losing the revenue from higher prices applied to those who are willing to pay more. The privatization of public utilities has its own difficulties, but integrating such cross-subsidization of service expansion to the urban poor in the contract conditions private companies' pursuit of the high-income market on its extension into the low-income market as well.

Innovative land-use management techniques have also used this approach to engage private developers in low-income housing and slum upgrading. In US cities, mixed housing development regulations have been used to oblige developers to produce and offer a certain number of units within each newly developed neighborhood at prices that are affordable to low-income households. In addition to producing housing for poor families, it also has the added benefit of avoiding exclusively low-income neighborhoods by integrating different levels of housing within one new development.⁵¹ In the developing world, the creation of "Transferable Development Rights" (TDRs) has brought developers into the low-income market in much the same way. In Mumbai, developers were offered an increase in the permitted floor-surface-index (FSI) if they agreed to produce a given number of low-income units. In cases of slums, the government would require the developer to provide serviced housing *in situ* for all families in the slum. The slum could and would be densified, but would allow the developer to take any remaining FSI and use it to develop market-rate apartments or commercial units on the same site, or transfer the FSI as TDRs to another location or sell them to another developer for use elsewhere in the city.⁵² Developers responded not to the opportunity to upgrade slums or produce low-income housing but to the opportunity to pursue more high-income development.

Even in cases where government was not involved, slum communities have come to similar arrangements with developers that owned the land where slums were situated but faced long court battles to evict slum dwellers. In an arrangement called "land-sharing",

⁴⁹ See "FIABCI Premia Cohapar e Terra Nova, Do Parana," *FIABCI Brasil Informa*, Apr. 19, 2005, www.fiabci.com.br/Noticias.asp?CodNoticia=582, and www.grupoterranova.com.br.

⁵⁰ "Establishing Pricing Policy," *Water and Sanitation for All: A Practitioners Companion*, <http://web.mit.edu/urbanupgrading/waterandsanitation/funding/estab-price-policy.html>.

⁵¹ For a complete discussion of mixed-income housing in the US see Alastair Smith, "Mixed Income Housing Developments: Promise and Reality," NeighborWorks Program, Joint Center for Housing Studies of Harvard University, Neighborhood Reinvestment Corporation, October 2002, http://www.jchs.harvard.edu/publications/W02-10_Smith.pdf.

⁵² Vinit Mukhija, "Enabling Slum Redevelopment in Mumbai: Policy Paradox in Practice," *Housing Studies* 16:6, 2001, pp.791-806.

communities agree to voluntarily vacate part of the land for commercial development in return for receiving rights to occupy, and in some cases even housing and basic services, on the less commercially-viable part of the land. Examples include Thailand, the Philippines, Cambodia and India.⁵³

While corporate social responsibility is not necessarily the private sector's most sustainable solution to the problems of urban poverty, it is worth mentioning that companies are increasingly recognizing the marketing power of philanthropy, particularly among higher-income consumers. Just as "green products" are taking over the high-end marketplace, socially responsible practices, such as fair wages and giving back to local communities, are increasingly publicized to attract greater brand loyalty from higher-income consumers. Activism directed at companies and their preferred consumers can bring awareness to the needs of the poorest people in slums and contribute to greater corporate responsibility and philanthropy for housing, health, and education services for the poorest of slum dwellers.

Direct marketing to the poor

While the urban poor undoubtedly struggle daily with limited resources, they do rely on the cash economy to purchase most of what they need to survive. The formal private sector often discounts the profitability of marketing to the poor, but the growth of the informal sector, which does target primarily the poor, is evidence of the buying power of slum dwellers. There are numerous examples of private sector innovation and market expansion directed towards what is increasingly referred to as the "bottom of the pyramid." Many of these are also examples of private sector engagement improving the quality of life in urban slums.

The private sector is particularly suited to housing markets, a principal private good in slums. Non-profit microfinance institutions are converting into for-profit lenders,⁵⁴ and private commercial banks are beginning to show interest in extending lines of credit to housing microfinance lenders.⁵⁵ Loans are made available for progressive housing construction, substitutes are made for collateral requirements including a shift away from mortgage finance in favor of other forms of guarantees such as group lending, and loans are bundled with savings and insurance services to help mitigate risks for both the bank and the poor household.⁵⁶

Studies of housing microfinance programs such as Genesis Empresarial (Guatemala), MiBanco (Peru), and Patrimonio Hoy (Mexico) demonstrate some important lessons; i) the programs can be profitable and operate on a large-scale; ii) partnerships between suppliers of building materials and lenders can be key to building volume and improving quality of construction; and iii) the public sector can support housing microfinance by providing

⁵³ Shlomo Angel and Somsook Boonyabanha, "Land Sharing as an Alternative to Eviction: The Bangkok Experience," *Third World Policy Review* 10:2, 1988, pp. 107-127.

⁵⁴ Many microfinance institutions have entered the field of housing microfinance: "Cases in point include Banco Sol in Bolivia, Banco Solidario in Ecuador, Mibanco in Peru, Banco Ademi in Dominican Republic, Calpia in Honduras and Genesis Empresarial in Guatemala." (Bruce Ferguson, "Housing microfinance—a key to improving habitat and the sustainability of microfinance institutions," *Small Enterprise Development* 14:1, March 2003, pp. 26-7)

⁵⁵ PROA, an NGO working with Aymara and Quechua populations in El Alto Barrio, receives funding for its shelter lending program from Mutual La Paz, a traditional mortgage lender. Loans are for home improvement, water and sewer line connections, titling, and new constructions built by small contractors (David S. Olinger, "The Role of the Private Sector in Delivering Low Income Housing in Developed and Developing Countries," International Housing Coalition, paper prepared for the World Urban Forum III, Vancouver, Canada, June 2006, pp. 23-24). Genesis Empresarial has also received a commercial line of credit from local commercial banks for housing microfinance (Ivo Imparato and Jeff Ruster, p. 284 and www.genesisempresarial.com).

⁵⁶ David L. Painter, pp. 11-18.

liquidity to the system, and by allowing institutions to set loan terms and operate programs on a commercial basis.⁵⁷

Financial services are critical to the urban poor who are more integrated into the cash economy than the rural poor and yet face many of the same barriers to accessing financial institutions. Carrying cash after payday or to make a large payment also puts people at risk of robbery.⁵⁸ In the Philippines, Smart Communications and Globe Telecom have created cell-phone based financial services that allow users to pay for goods, transfer money and cross-border remittances, purchase airtime, pay utility bills, and perform other financial transactions with the use of text-messages. Globe Telecom's systems do not even require the user to open a formal bank account; rather it allows transactions through partnered retail locations in addition to banks. The South African Bank of Athens has created a virtual bank called "Wizzit" that gives its customers a debit card and facilitates a number of transactions through secure mobile phone systems and existing worldwide ATM networks.⁵⁹ In Guatemala, two leading commercial banks have opened new branches in peri-urban and rural municipalities to seek new clients with touch screen automatic teller machines that offer menus in indigenous languages and picture options.⁶⁰

Cemex, the leading Mexican cement producer, has gotten even more directly involved in housing construction by targeting its Patrimonio Hoy program to low- and middle-income families that are building their homes one room at a time. Cemex allows households to sign on to a 70-week program in which they make weekly payments in return for scheduled deliveries of cement at key intervals in the construction process. The price is locked in the day the household signs up, and technical assistance is available as part of the club fee charged to all program members. The credit provided for the purchase of cement, plus the technical assistance and storage that is provided to decrease loss of materials, have allowed families to add an additional room in 60% less time and with 35% less expense and of higher technical quality. Patrimonio Hoy has been an entirely commercial venture and gained a strong foothold in the lower- to middle-income construction market. Its success has led Cemex to extend it to the other countries where the company has operations.⁶¹

Health and hygiene are also areas that the private sector has introduced products to be marketed to the poor. The poor often buy in small quantities as they have little cash available and are hesitant to commit too much money to any single purchase when their incomes are unpredictable. Sachet packaging of soap, shampoo, and laundry detergent and single dose sales of common painkillers, fever, and cold medications are giving poor people easy access to these products that were recently considered luxuries.⁶² The lack of health facilities in slums has inspired the development of franchises of pharmacies that provide medical consults with physicians, blood pressure checks, and other health services along with medicines and health products, like condoms, clean syringes and insecticide-treated bednets, in and around slum neighborhoods. Franchisees get the benefit of brand recognition and are obliged to undergo quality audits to ensure a consistent level of service. The poor have easier access to basic medical advice, and pharmacy doctors and nurses can

⁵⁷ Gwinner, Goldberg, Solo and Didoni, 2005, "From Financial Exclusion to Inclusion, Increasing the Availability of Credit to the Urban poor in Latin America.", En Breve Number 98, World Bank.

⁵⁸ *The Next 4 Billion*, p. 97.

⁵⁹ *The Next 4 Billion*, pp. 102, 104.

⁶⁰ Gwinner, *ibid.*

⁶¹ See "Combining Profit and Social Development," *Global Envision*, May 27, 2003, www.globalenvision.org/library/5/484 [accessed Feb. 15, 2008], or Ricardo Sandoval, "Block by Block," *Stanford Social Innovation Review*, Summer 2005.

⁶² C.K. Prahalad, pp. 16-18.

help recognize when clients should seek further care. CFWshops in Kenya and Mi Farmacita Nacional in Mexico are both successful examples of this model.⁶³

As discussed earlier, many of the most basic goods needed to make slums livable are public goods or goods with strong externalities that make individuals less likely to pay their full cost. The private sector does not have strong incentives to produce these goods because they cannot be sure that they will be able to recover their costs from consumers. New innovations in payment for services, however, are helping to alleviate these fears and mobilize private capital and business towards the slums. The Aquacard, a debit card used to turn on a water spigot, can be used by residents to purchase water from a shared faucet without the markup of a local water vendor. The water provider receives payments immediately through agreement with the bank where the water debit accounts are held. Residents get the benefit of access to water and prepayment that eliminates any risk of future unexpected debt, and the water provider has 100% collection of user fees. The *Sulabh* Sanitation Movement provides bathroom and washhouse facilities in slums in India under a similar prepaid system whereby residents can purchase monthly family passes and visitors can pay-per-use.⁶⁴ As described in the section on communities as clients, collective responsibility for payment at the community level is also a way to relieve private sector providers of the burden of revenue collection and further induce them to enter markets (Box 3).

The challenges of service provision to urban slums have inspired a wide range of small-scale solutions by private entrepreneurs whose business models are tailored to fit the unique structure of costs and demand found in particular slum communities. While formal private sector providers may have the advantages of scale and management experience, small-scale providers have the advantages of flexibility in product and process, and in-depth knowledge of specific local contexts. In water, small-scale providers include owners of water tankers, drillers of boreholes, and private vendors who distribute water from a standing tank, utility connection, or a well through control of a standpipe or through a local distribution network that is privately installed.⁶⁵ Small-scale providers in communities without access to the electrical utility grid have used diesel generators to provide energy to locally built networks and even to charge 12-volt batteries for a fee.⁶⁶ Entrepreneurs have also provided sanitation services through the emptying of pit latrines, a process that was studied by UN-Habitat in 1996, leading to the introduction of Vacutug, an improved version of private providers' waste-container pushcarts that includes a diesel engine powered vacuum and a 500 liter tank.⁶⁷ While each individual venture is usually small, the total

⁶³ *The Next 4 Billion*, p. 35, 39-40.

⁶⁴ Almud Weitz and Richard Franceys eds., *Beyond Boundaries*, pp. 40-41.

⁶⁵ In Cebu, small-scale providers manage small household distribution networks from their own private wells in areas not reached by the public utility. In Delhi, tricycle services can be hired to transport water from a public standpipe to the home. In Dhaka, 9,100 households are provided minimal water through an illegal distribution network that draws water without charge from the public utility network. In Ho Chi Minh City, almost 20% of residents get their water from small providers who resell water from their private connection, operate water tankers, manage small pipe networks, sell bottled water, or in one case, provide well water through a partnership with the public water utility. (Arthur C. McIntosh, *Asian Water Supplies—Reaching the Poor*, Asian Development Bank, London: IWA Publishing, 2003, http://www.adb.org/Documents/Books/Asian_Water_Supplies/asian_water_supplies.pdf)

⁶⁶ Yemen has achieved high levels of rural electrification through private networks powered by diesel generators. In parts of Africa, 12-volt batteries are a popular energy source and private generator owners charge to re-charge batteries. (David Ehrhardt, "Impact of Market Structure on Service Options for the Poor," for the conference Infrastructure for Development: Private Solutions and the Poor, May 31 – June 1, 2000, London, UK, http://www.castalia.fr/SITE_Default/x-files/1863.pdf)

⁶⁷ Graham Alabaster and Iole Issaias, "Removing human waste—the Vacutug solution," *Habitat Debate: Water and Sanitation for Cities* 9:3, September 2003, p. 17.

capital invested in slums by small-scale providers is not: in Manila, one small-scale water provider invested \$350,000 in five years to deliver water to 25,000 households; the small-scale providers in Ho Chi Minh City have invested \$80,000 in providing water to 400 household connections.⁶⁸

Small-scale private service providers (SPSPs) have developed a variety of solutions to the needs of slum dwellers for water, sanitation, electricity, telecommunications, transport, and solid waste.⁶⁹ They are often better positioned than central utilities to deliver decentralized services, as they are usually managed by local entrepreneurs who are close to end-users, and are typically more flexible in the use of technology based on locally available resources.⁷⁰ They can sometimes be the first to introduce and test the pro-poor potential of technological advances, such as internet, computer, and cellular technology.⁷¹ Their knowledge of the market, flexibility to try out innovative technologies and business models, and existent capital investment in slums, make small-scale providers an important part of the private sector which has enormous potential in the provision of basic services.⁷² Some of the challenges related to SPSPs are concerns about quality, safety, and affordability as many operate outside the formal sector. Policies such as legitimizing such businesses, providing a “light” regulatory framework, partnering with utilities, and facilitating the development of associations of providers to help with technical assistance and quality, can help.⁷³ (Box 2)

Private sector in promoting local economic activity

Many of the strategies companies use to target the low-income market require bringing services closer to where people live and selling them in small quantities at higher volumes. These strategies require manpower within the slums, giving them an added benefit within slum communities—the creation of jobs and income generating opportunities. As companies expand to enter the low-income market, their labor forces must increase, but perhaps most important are the jobs and entrepreneurial opportunities that appear within the slums, and for which slum dwellers are best prepared. Patrimonio Hoy employs local promoters who receive commission for each new group of members that signs onto the program. Franchise pharmacies give slum dwellers with street-front property a lucrative business opportunity. Sulabh washhouses require full-time attendants. In slums where unemployment is truly high, these new sources of income for the poor cannot be overlooked as part of the benefit of private sector engagement.

⁶⁸ Herve Conan, “Scope and scale of Small Scale Independent Private Water Providers in 8 Asian Cities,” <http://www.adb.org/Documents/Events/2003/3WWF/conan.pdf>, p. 5.

⁶⁹ On solid waste, see Cointreau, S. and Coad, A. 2000, “Private Sector Participation in Municipal Solid Waste Management.”, SKAT, St. Gallen, Switzerland, http://rru.worldbank.org/Documents/Toolkits/waste_fulltoolkit.pdf

⁷⁰ Baker, Judy, 2009, forthcoming, “Opportunities and Challenges for Small-Scale Private Service Providers in Electricity and Water Supply: Evidence from Bangladesh, Cambodia, Kenya and the Philippines.”

⁷¹ Private internet cafes and village telephone operators are often the first to connect residents to information technology, and their services by necessity often include training and promotion of the various uses of these technologies in order to attract and keep their clients. Small-scale providers and poor consumers alike are generally “more willing to adopt new technologies because they have nothing to forget.” (C.K. Prahalad, p. 16)

⁷² For a discussion of how to engage small-scale providers, see Marianne Kjellen and Gordon McGranahan, “Informal Water Vendors and the Urban Poor,” IIED Human Settlements Discussion Paper Series, March 2006, <http://www.iied.org/pubs/pdfs/10529IIED.pdf>, pp. 19-23.

⁷³ Baker, 2009.

**Box 3. Using Profitable Sanitation Technology to Sustain an NGO:
The *Sulabh* Sanitation Movement**

In the 1970s, the Sulabh International Social Service Organization began to look at sanitation in the slums through the dual lenses of the health of families and neighborhoods and the dignity of “scavengers” who empty pit latrines and “floating” populations, like pavement dwellers and rickshaw pullers, who do not have regular access to toilet facilities. Its founder, Dr. Bindeshwar Pathak noticed that poor sanitation coverage in India was largely the result of insufficient awareness and motivation to address the problem and a lack of affordable sanitation technology. Aware that sewerage systems are complex and expensive to install, particularly in slums, and wanting to eliminate the demeaning job of scavengers of removing waste by hand, Dr. Pathak designed a two-pit, pour flush, water-sealed toilet system that treats waste on-site without odor. The toilets are cheap, costing \$10 to \$1000 depending on capacity (from individual household to community facilities). Their low odor and flushing capacity—they require only 2 liters of water to flush—make them culturally appropriate and creates demand from both private household and communities alike.

The *Sulabh* toilet technology has given *Sulabh* International a sustainable way to extend sanitation and other services into slum communities and public areas where pavement dwellers live. Households can purchase toilets that take up minimal space on their lots and require minimal maintenance. Community toilet complexes provide a variety of services including separate men and women’s toilet and bathing facilities, clothes washing areas, housing for 24 hour caretakers, and in some cases community meeting halls. Because there is both private and collective demand for the toilets, *Sulabh* International has been able to become a self-sustaining NGO through the proceeds from the sale of private units, and the collection of pay-per-use and monthly pass fees from users of community and public units. The NGO is able to reinvest its income in programs to promote sanitation and hygiene awareness and to retrain scavengers (whose waste collection services are no longer needed where *Sulabh* toilets are installed) in other income-generating activities. In this way, their sanitation program actually creates funds, rather than draining them.

The *Sulabh* Sanitation Movement has installed more than 1.2 million *Sulabh* toilets in private homes and has built and maintains over 7,500 community and public toilet complexes. It estimates that it reaches over 10 million people with sustainable sanitation services in India each day. This is a critical example of how the focus on a product design and a business plan specific to the low-income market can create scalable, sustainable, and socially beneficial ventures in slums.

From Bindeshwar Pathak, “Toilets for all,” *Habitat Debate* 9:3, United Nations Human Settlements Programme, Sept. 2003, p. 13; Bindeshwar Pathak, “Sanitation is the key to healthy cities—a profile of Sulabh International,” *Environment and Urbanization* 11:1, Apr. 1999, <http://eau.sagepub.com/cgi/reprint/11/1/221.pdf>; and the Sulabh International Social Service Organization website, Profile, Aims and Objectives, <http://www.sulabhinternational.org/pg01.htm>.

IV. OPPORTUNITIES FOR SCALING UP PRIVATE SECTOR ENGAGEMENT IN URBAN SLUMS

There are a number of innovative approaches to slum upgrading activities which have relied on the private sector, as discussed in the previous section, which offer much potential for scaling up. In exploring such opportunities, a few lessons from experience emerge that can be critical to the success of such ventures. These can be classified into four approaches that are particularly promising for attracting the private sector to urban slums: building trust, small-unit high-volume sales, facilitating payment, and new products and marketing. Also included is a discussion on roles for Governments, NGOs, and the international community.

Building trust

Key barriers to the formal private sector’s entrance into the low-income market have been the lack of knowledge and understanding of how people live in the slums and a lack of trust

in poor people to be good clients. This is particularly true when significant investment in the community is required and with direct lending to poor families. Despite the many informal financial arrangements used by the poor, they have little documented financial history. Workers in the informal economy are paid in cash, receipts even for rent payments are rare, and loan sharks are not willing or reliable sources of credit records. Formal sector lenders and companies planning large investments must therefore find other ways to measure financial risk of their low-income clients. Some poor households do have access to some verification of their financial reliability, and companies can broaden their list of accepted documents to include utility receipts, payment ledgers for furniture and small appliances bought on credit, and series of deposit slips for dedicated savings accounts.⁷⁴ When none of these are available, evidence of consistent payment can be created by enrolling potential borrowers into a dedicated savings program and requiring a set number of consistent deposits before a loan will be disbursed. This has the added benefit of establishing a small amount of collateral that can be held for the duration of the loan.

Companies that are planning a large investment, such as the installation of a water main, sewage line or street lighting, can use similar strategies to decrease the risk of overestimation of demand. Community members can be asked to make deposits into a trust fund towards payment of the installation costs of the new utility. If sufficient funds are not deposited, refunds to community members can be made from the trust and the project cancelled; if there is sufficient demand, as expressed by deposits to the fund, then the company has already collected all or part of the cost of installation and can proceed with greater confidence.

These and other mechanisms that initiate slum dwellers into relationships with formal sector businesses through evidence of their ability and willingness to pay also serve additional functions. They encourage reciprocal trust by community members of formal business, and they begin a feeling of group membership and loyalty to the company that encourages word-of-mouth marketing and future projects for slum dwellers. In fact, companies have had success with membership clubs in slums that confer relevant benefits and hold members accountable to making payments and following through with efforts to improve their own lives and well-being.⁷⁵

Facilitating payment

One of the private sector's greatest concerns is that the poor will not respect the contract to pay for services and goods they receive. There are three main mechanisms that can facilitate payment and reduce risk: client grouping (even up to the community level), pre-payment, and auto-pay technology. Client grouping is the treatment of a group of individual buyers as one collective buyer. Although the income of the poor can be quite volatile, collective incomes of groups are more stable thus allowing individuals within groups to cover the payments of others if necessary in the short run. This shifts some of the risk of non-payment to the group itself and creates peer pressure on the individuals to pay their part (this being the basis for group lending, as introduced by the Grameen Bank). This client grouping can be taken up to the community level as well. The community leadership or a community-based organization takes responsibility for collecting payment from individuals, which both lowers the administrative cost and the risk assumed by the private company. This strategy has worked within highly organized slums to bring piped water

⁷⁴ Appliance retailers targeting low-income markets, such as Elektra in Mexico and Casas Bahia in Brazil, have integrated membership programs that include records of in-store credit history. (C.K. Prahalad, pp. 115-116)

⁷⁵ Cemex has used their builders' club to gain brand loyalty and to encourage members to continue building and to improve the technical quality of their building.

(individuals pay a flat fee and a community water board pays the monthly quota and manages water distribution), sewerage, solid waste collection, and other services.

Strategies at the individual level can also be used to adjust to the poor's payment abilities and preferences. Their inconsistent income flows can make monthly payments difficult, as it does not allow for immediate shifts to a lower usage to decrease payments, and it presents the continuous risk of falling into debt and owing late fees and penalties. Poor people often prefer prepayment and pay-per-use for services, which allow them much greater control over their budgets. Technologies that allow for auto-payment for services, such as the Aquacard, lower the risk of late or non-payment to both businesses and poor clients.⁷⁶

Designing and delivering innovative products and services

The best opportunity for the private sector to engage profitably with the urban poor is with innovative products that are specifically designed to meet the needs of the poor, at prices they can afford, and delivered in ways that fit their lifestyles.⁷⁷ Financial services is one area where new products appropriate to the scale of poor people's wealth, earning potential, cash flow, insurance needs and level of risk are critical to reaching the poor market. The Kuyasa Fund, which provides housing microfinance in Cape Town, has integrated a non-payment risk life insurance plan into its loans that protects the family from falling under the burden of debt if the borrower dies.⁷⁸ Poor people's preferences in housing is an area that has been studied in depth; permanent housing is valued as much for its shelter services as for its asset value as a financial safety net. Traditional mortgage contracts are not a product that will appeal to urban families that seek security in their housing more than comfortable living standards.⁷⁹

The use of technical assistance packages attached to membership programs can be quite effective, as Cemex has done by giving home construction training to its club members, on how to best utilize their cement products for home building to maximize benefits. Social marketing has played an important role in promoting the consumption of hygiene products and preventive health interventions, and its techniques and lessons learned can be applied to commercial marketing of other social goods as well.⁸⁰

Small-unit high volume sales

The predominant business model in low-income areas relies on small unit profits at high volumes. In order to meet slum dwellers' demand while still ensuring a sufficient profit, the basic economics of the BOP market are based on "small unit packages, low margin per unit, high volume and high return on capital employed."⁸¹ Profit margins will be small, so the goods will need to be distributed broadly and sold to a large number of clients with high frequency. Packaging innovations for consumer goods that allow for single-use sized quantities to be sold individually have helped bring brand-name food, medicine, and hygiene

⁷⁶ For an overview of payment strategies see "Setting up Payment Systems," *Water and Sanitation for All: A Practitioners Companion*, <http://web.mit.edu/urbanupgrading/waterandsanitation/funding/setup-pay-sys.html>.

⁷⁷ C.K. Prahalad presents "Twelve Principles of Innovation for BOP Markets," pp. 25-7.

⁷⁸ Regina Campa Sole and Laura Moser, "Scaling up Housing Microfinance for Slum Upgrading," *Housing Finance International*, December 2006, p. 13.

⁷⁹ John F. C. Turner.

⁸⁰ For an in-depth case study on Hindustan Lever Limited's partnership with health social marketing interventions to extend the soap market, see Mindy Murch and Kate Reeder, "Selling Health: Hindustan Lever Limited and the Soap Market," in C.K. Prahalad, pp. 207-239.

⁸¹ C.K. Prahalad, p. 24.

products into slums without compromising quality controls, safety, or the marketing benefits of packaging.⁸² In finance, micro-credit is one innovation that has allowed the poor to purchase financial services in the quantities they can afford. Technological innovation can support making micro-credit profitable. One example is SKS Microfinance in India which has developed “modern, efficient back-office systems [including simple loan management software] to lower transaction costs substantially so that micro-loans could be handled profitably and at scale.” Today SKS, through an open line of credit with India’s largest private sector bank, ICICI Bank, has lent more than \$57 million to more than 200,000 women.⁸³

Well-functioning distribution networks are also a key factor in reaching urban slum dwellers. Businesses have had success with using and supporting the development of local vendor-client networks made up of slum dwellers themselves. For some goods, local sub-offices may need to be built and local people employed directly. For other goods, independent local distributors such as shop owners and mobile salespeople can be used to expand a new product into the slum neighborhood. Local promoters can serve as agents for companies offering services, and local entrepreneurs can even become franchisees. The use of local residents and preexisting networks also contributes to the local economy and social cohesion. Companies that integrate the resources of the community into their business plan perceive lower costs and can potentially avoid losses to crime and vandalism as the community is more likely to protect the assets of a company it sees as part of the community fabric.

A role for government, NGOs, and the international community in promoting partnerships

The private sector can be encouraged and assisted by partnerships with both government agencies and NGOs. Government can fulfill the dual role of liberalizing the markets that affect the urban poor (i.e., adjusting building and land use regulations to fit the needs for affordable housing, ensuring a regulatory framework that permits the delivery of services by small-scale providers, etc.) and supporting private sector’s interest in the urban poor with assistance that helps to subsidize and/or mitigate the commercial risk of entering the low-income sector. Where the government is the holder of property rights, it has discretion over stabilizing and legalizing land tenure to slum dwellers. While in most cases the existence of urban slums is directly correlated to the government’s inability to provide infrastructure, basic services, and planning capacity to a large number of urban residents, governments can still obstruct the private sector’s involvement in service provision and development by claiming exclusive rights to service provision or by using free public housing or services to gain political favor.⁸⁴

NGOs are also critical partners with the private sector, both as consumer advocates on the part of slum dwellers, and as sources of expertise on slum dwellers’ needs, ability and willingness to pay, and risk profiles. This can be particularly important when the private sector is entering a new market. From the perspective of the poor, the advocacy is particularly important in contexts where the private sector does not recognize the long-term potential of low-income clients and the poor do not have the business and technical knowledge required to effectively negotiate reasonable terms and prices.⁸⁵ NGOs also can

⁸² For further discussion of small unit sales and the poor’s spending and consumption preferences, see C.K. Prahalad, pp. 16-20.

⁸³ *The Next 4 Billion*, p. 99.

⁸⁴ C.K. Prahalad, pp. 6-7.

⁸⁵ Ian Morris, telephone interview, March 28, 2008.

provide businesses a medium by which to initially enter a given market or community, as NGOs have experience in organizing and engaging poor individuals and communities as a whole for projects in ways that can be useful for doing business in these same communities. NGOs often have gained the trust of local communities, which can provide an important bridge for companies wanting to build a relationship with people and leaders in these new markets.⁸⁶

There are many roles that donors and multilateral institutions can play in encouraging broader private sector participation in slum upgrading activities. This includes support to policy reforms which improve macroeconomic stability as well as the overall business environment and support to smaller firms through financial services and business development services, loans and guarantees to the private sector, and technical assistance to build capacity.⁸⁷ There is also scope for fostering private sector involvement in slums through financial instruments that reduce risk. This may include a guarantee instrument, which would provide some assurance to private sector investors in the event that municipal governments default on payments, or results-based financing such as output-based aid, which provides some type of subsidy for the provision of services to the poor.

A small number of recent World Bank projects are designed to explicitly provide support to initiatives aimed at fostering private sector participation in upgrading activities (housing, services), though there is much room for scaling this up. Examples include policy loans such as in Morocco, Brazil, and Mexico, and investment loans such as the Cambodia Provincial and Peri-Urban Water and Sanitation Project.

In the context of the policy loans—the Morocco Housing Sector Development Policy Loan (2005), Mexico's Affordable Housing and Urban Poverty Reduction Policy Loans (2004, 2005, 2007), and Brazil's Programmatic Loan for Sustainable and Equitable Growth: Housing Sector Reform (2005) support is provided to foster private sector involvement in the low-income housing market (e.g., opening up new land areas) and in expanding access to private sector housing finance for low-income residents (e.g., in Morocco a program for those working in the informal sector).

The Cambodia Provincial and Peri-Urban Water and Sanitation Project (2003) used two approaches which utilized private sector resources and expertise in expanding and improving water supply services including in poor urban areas: a Design-Build-Lease (DBL) scheme and an Output Based Aid scheme. The DBL scheme is similar to a construction contract, and the OBA scheme was explicitly designed to provide a subsidy for connections made to pre-identified poor households. The private sector operator will provide the financing for the trunk, primary, and secondary networks in four pilot towns and will receive \$500 per connection to the poor households. The same contractor is made responsible for operating and managing the water supply system over a 15-year period, but is not required to pay a lease fee to the government.

In conclusion, this paper has demonstrated the many roles that the private sector can play in slum upgrading along with the existing challenges that they face. The paper points to a few lessons learned that may be relevant in exploring new approaches to improve living conditions in urban slums. Such efforts merit strong support and innovation on the part of donors and multilaterals in finding ways to scale up these activities.

⁸⁶ C.K. Prahalad presents the image of an "ecosystem for wealth creation" that results from the "symbiotic nature of the relationships between various private sector and social institutional players that can lead to rapid development of markets at the BOP," pp. 63-6.

⁸⁷ World Development Report, 2005.

REFERENCES

- Alabaster, Graham, and Iole Issaias, "Removing human waste—the Vacutug solution," *Habitat Debate: Water and Sanitation for Cities* 9:3, September 2003.
- Angel, Shlomo and Somsook Boonyabancha, "Land Sharing as an Alternative to Eviction: The Bangkok Experience," *Third World Policy Review* 10:2, 1988, pp. 107-127.
- Baker, Judy, forthcoming, "Opportunities and Challenges for Small Scale Private Service Providers in Electricity and Water Supply: Evidence from Bangladesh, Cambodia, Kenya, and the Philippines," World Bank Report, 2009.
- Berner, Erhard, "Learning from informal markets: Innovative approaches to land and housing provision," *Development in Practice* 11:2/3, May 2001, pp. 292-307.
- Budds, Jessica, Paulo Teixeira and SEHAB, "Ensuring the right to the city: pro-poor housing, urban development and tenure legalization in Sao Paulo, Brazil," *Environment and Urbanization* 17, 2005, pp. 89-113.
- Burra, Sundar, "Towards a pro-poor framework for slum upgrading in Mumbai, India," *Environment and Urbanization* 17, 2005, pp. 67-88.
- Campa Sole, Regina and Laura Moser, "Scaling up Housing Microfinance for Slum Upgrading," *Housing Finance International*, December 2006.
- Clarke Annez, Patricia, "Urban Infrastructure Finance from Private Operators: What Have We Learned from Recent Experience?" World Bank Policy Research Working Paper 4045, Nov. 2006.
- "Combining Profit and Social Development," *Global Envision*, May 27, 2003, <http://www.globalenvision.org/library/5/484> [accessed Feb. 15, 2008].
- "Community Water and Sanitation Facility: A Cities Alliance Initiative," Factsheet from the Fourth World Water Forum, Mexico City, March 2006.
- Conan, Herve, "Scope and scale of Small Scale Independent Private Water Providers in 8 Asian Cities," <http://www.adb.org/Documents/Events/2003/3WWF/conan.pdf>.
- Drees-Gross, Franz et al., "Output-Based Aid in Water: Lessons in Implementation from a Pilot in Paraguay," *OBA Approaches* Note Number 7, May 2005, <http://www.gpoba.org/docs/OBAApproachesParaguaywater.pdf>.
- Ehrhardt, David, "Impact of Market Structure on Service Options for the Poor," for the conference Infrastructure for Development: Private Solutions and the Poor, May 31 – June 1, 2000, London, UK, http://www.castalia.fr/SITE_Default/x-files/1863.pdf.
- Farvacque-Vitkovic, Catherine, Lucien Godin, Hugues Leroux, Florence Verdet, and Roberto Chavez, *Street Addressing and the Management of Cities, Directions in Development*, Washington, DC: World Bank, 2005.
- Ferguson, Bruce, "Housing microfinance—a key to improving habitat and the sustainability of microfinance institutions," *Small Enterprise Development* 14:1, March 2003.

-
- FIABCI, Brasil, "FIABCI Premia Cohapar e Terra Nova, Do Parana," *FIABCI Brasil Informa*, Apr. 19, 2005, <http://www.fiabcibrasil.com.br/Noticias.asp?CodNoticia=582>.
- Franceys, Richard and Almud Weitz, "Public-Private Community Partnerships in Infrastructure for the Poor," *Journal of International Development* 15, 2003, p. 1083-1098.
- GPOBA, *Activities*, <http://www.gpoba.org/activities/index.asp>, 2008.
- Gwinner, Goldberg, Solo and Didoni, 2005, "From Financial Exclusion to Inclusion, Increasing the Availability of Credit to the Urban poor in Latin America.", *En Breve* Number 98, World Bank.
- Imparato, Ivo and Jeff Ruster, *Slum Upgrading and Participation: Lessons from Latin America*, Washington, DC: World Bank, 2003, p. 284.
- Kjellen, Marianne and Gordon McGranahan, "Informal Water Vendors and the Urban Poor," IIED Human Settlements Discussion Paper Series, March 2006, <http://www.iied.org/pubs/pdfs/10529IIED.pdf>.
- Kundu, Amitabh and Debolina Kundu, "Urban Local Government and Private Sector Partnership in Gujarat," in Ponna Wignaraja and Susil Sirivardana eds., *Pro-Poor Growth and Governance in South Asia: Decentralization and Participatory Development*, London: SAGE Publications, 2004.
- McIntosh, Arthur C., *Asian Water Supplies—Reaching the Poor*, Asian Development Bank, London: IWA Publishing, 2003, http://www.adb.org/Documents/Books/Asian_Water_Supplies/asian_water_supplies.pdf.
- McLeod, Ruth, "SUF Local Finance Facilities: what they are, why they are important, and how they work," UN-Habitat Slum Upgrading Facility (SUF) Working Paper 8, April 2008.
- Mehta, Meera, "Balancing Commercial Viability with the Needs of the Poor in the Development of Urban Water Supply and Sewerage Projects," *Project Notes* 14, USAID Indo-US Financial Institutions Reform and Expansion Project—Debt Market Component FIRE(D), January 1999, <http://www.niua.org/indiaurbaninfo/fire-D/ProjectNo.14.pdf>.
- Mukhija, Vinit, "Enabling Slum Redevelopment in Mumbai: Policy Paradox in Practice," *Housing Studies* 16: 6, 2001, pp.791-806.
- Olinger, David S., "The Role of the Private Sector in Delivering Low Income Housing in Developed and Developing Countries," International Housing Coalition, paper prepared for the World Urban Forum III, Vancouver, Canada, June 2006.
- Painter, David L., "Scaling up Slum Improvement: Engaging Slum Dwellers and the Private Sector to Finance a Better Future," paper presented at the World Urban Forum III, June, 2006.
- Pathak, Bindeshwar, "Toilets for all," *Habitat Debate* 9:3, United Nations Human Settlements Programme, Sept. 2003, p. 13.
- Pathak, Bindeshwar, "Sanitation is the key to healthy cities—a profile of Sulabh International," *Environment and Urbanization* 11:1, Apr. 1999, <http://eau.sagepub.com/cgi/reprint/11/1/221.pdf>.

Prahalad, C.K., *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits*, New Jersey: Wharton School Publishing, 2005.

Ramsamy, Edward, "The World Bank & Urban Programmes in Zimbabwe: A Critical Appraisal," *Review of African Political Economy* 33:109, pp. 515-523.

Revistazo.com, "100 millones de lempiras podría obtener Siri Zúñiga por negligencia de Alcaldía en pleito de tierras ejidales," Jan. 2003, <http://www.revistazo.com/ene-03/index.htm>.

Sachs, Tillmann and Robert LK Tiong, "The impact of political risks on public-private partnership (PPP) opportunities in Asia," 2005, <http://www2.ntu.edu.sg/ResearchPaper/ODR/2006/Impact%20of%20political%20risks%20on%20PPPs%20-%20CEE.pdf>.

Sandoval, R. "Block by Block," *Stanford Social Innovation Review* Summer 2005.

Smith, Alastair, "Mixed Income Housing Developments: Promise and Reality," NeighborWorks Program, Joint Center for Housing Studies of Harvard University, Neighborhood Reinvestment Corporation, October 2002, http://www.jchs.harvard.edu/publications/W02-10_Smith.pdf.

Solo, Tova, *Between Financial Exclusion and Community Development*, 2009, World Bank Institute and Cities Alliance.

Solo, Tova, "Financial Exclusion in Latin America—or the Social Costs of Not Banking the Urban Poor", 2008, *Environment and Urbanization*, Vol. 20, No. 1, 47-66.

Sulabh International Social Service Organization website, Profile, Aims and Objectives, <http://www.sulabhinternational.org/pg01.htm>.

Turner, John F. C., *Housing by People: Towards autonomy in building environments*, New York: Pantheon Books, 1977.

United Nations Human Settlements Programme (UN-Habitat), *The Challenge of Slums: Global Report on Human Settlements 2003*, Sterling, VA: Earthscan, 2003.

United Nations Population Fund (UNFPA), *State of the World Population 2007: Unleashing the Potential of Urban Growth*, 2007.

Viloria-Williams, Julia, *Urban Community Upgrading: Lessons from the Past—Prospects for the Future*, Washington, DC: World Bank Institute, 2006.

World Bank, Development Outreach, "Business and Poverty: Opening Markets to the Poor," June 2008.

World Bank, Slum Upgrading Case Studies, "Aguateros: Small Scale Water Entrepreneurs," *Upgrading Urban Communities: A Resource Framework*, "Setting up Payment Systems," *Water and Sanitation for All: A Practitioners Companion*, "Mathare 4A Slum Upgrading Project," *Upgrading Urban Communities: A Resource for Practitioners*, <http://web.mit.edu/urbanupgrading.html>.

World Bank, *World Development Report*, 2005.

World Resources Institute, *The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid*, 2007.

Weitz, Almud and Richard Franceys eds., *Beyond Boundaries: Extending Services to the Urban Poor*, Asian Development Bank, August 2002,
http://www.adb.org/documents/books/beyond_boundaries/beyond_boundaries.pdf.

ANNEX. CASE STUDY SUMMARY TABLE

REVIEW OF PRIVATE SECTOR INITIATIVES IN SLUM UPGRADING

Program	Country/ Location	Year	Sector of Slum Upgrading	Description	Sector Involvement (private, public, donor, NGO)	Beneficiary responsibility	Source(s)
Patrimonio Hoy	Mexico, Nicaragua, Colombia, Venezuela, and Costa Rica, Dominican Republic (under study)	1998/ 2002	Housing (in situ)	Innovative product marketed to poor self- builders; bundling of credit line for cement with technical assistance, storage	100% private venture by Cemex	All	Israel Moreno Barcelo, "Patrimonio Hoy," <i>Development Outreach</i> 10:2, World Bank Institute, June 2008, pp. 27-29.
Micasa	Peru	2000	Housing	Microfinance institution providing small loans for improvement, expansion, sub-division, rebuilding or replacement of existing housing	100% private venture by Mibanco (originally a non- profit NGO, turned commercial bank 1998)	All (private loan repayment)	Bruce Ferguson, "Housing microfinance - a key to improving habitat and the sustainability of microfinance institutions," <i>Small Enterprise Development</i> 2003, 14:1, p. 21-31.
ARGOZ Communities	El Salvador	1977 to present	Slum prevention	Private developer subdivides land and provides lease-to- own terms appropriate for households making 1-2 minimum wages.	100% private venture by ARGOZ eventually supported in 1992 by a national law decriminalizing ARGOZ developments that don't meet city subdivision standards	All	"Case Examples," <i>Upgrading Urban Communities: A Resource Framework</i> , web.mit.edu/urbanupgr ading/upgrading/case- examples/index.html.
Aguateros	Asuncion, Paraguay	past 20 years	Water	Small scale water entrepreneurs drill wells near new developments that are not serviced by public sector and provide potable water for 25 to 50% more than public authorities (better quality and reliability, no subsidy).	100% private venture by small entrepreneurs with minimal regulation (semi- annual water quality certification) by public authorities	All	"Case Examples," web.mit.edu/urbanupgr ading/upgrading/case- examples/index.html.

CFWshops, Mi Farmacita Nacional	Kenya, Mexico		Healthcare	Franchised pharmacy offering government approved health products and pharmaceuticals, others, quality audits carried out by franchiser	100% private venture by small businesses and franchises	All	<i>The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid</i> , World Resources Institute, 2007, p. 40.
Water desalination, disinfection and filtering innovations	Various		Water	Private companies invent and sell at market price (low cost) various technologies for purifying water	100% private venture, innovations by Sur'Eau (Madagascar), Procter & Gamble (PuR, US), Watercose, International Development Enterprises (Shapla Arsenic Filter), IIT-Kanpur (Mytry, India), Hindustan Lever Limited (Pureit, India), Eureka Forbes (Acquagard), KX Industries (KX World Filter, US), LifeStraw with some support by the US CDC and some bulk purchase by international donors and NGOs	Varies, mostly direct sale, some distribution through donors or NGOs	<i>The Next 4 Billion</i> , p. 57.
Sulabh Sanitation Movement	India	1970	Sanitation	Company builds and maintains per-per-use public toilets for pavement dwellers and slum communities, and builds low cost home toilets, using lower water use and inexpensive technology	100% private venture, innovation by the NGO Sulabh	Pay-per-use	Bindeshwar Pathak, "Toilets for all," <i>Habitat Debate</i> 2003, p. 13.
Aquacard prepaid water	Philippines		Water	Water system is provided on a fee-per-liter system that is prepaid through a debit card connected to each user's water account; company uses solar-powered pumps to pull deep well water	100% private venture, innovation by WorldWater (New Jersey based), with financing from local banks and a contract with municipal authorities	Pay-per-use	Robert E. Sullivan, "A novel private sector initiative for the poor," <i>Habitat Debate</i> 2003, p. 16.

Terra Nova	Brazil	1999 to present?	Land titling	Private real estate company negotiates prices with land owners and residents, buys the land, makes improvements and then resells it to residents.	Public-private venture of Terra Nova and the state construction company Cohapar through a partnership with municipal governments of Curitiba, Saint Jose dos Pinhais, Paranagua and Matinhos, others	All (for purchase of their own improved lot)	"FIABCI Awards Cohapar and Terra Nova, of Parana," FIABCI Brasil Informa, Mar. 19, 2005, www.fiabci brasil.com.br/Noticias.asp?CodNoticia=582 , and www.grupoterranova.com.br
Vacutug	Kenya	1997 (first tested)	Sanitation	Low-tech portable waste removal tank for emptying of pit latrines	Innovation by Manus Coffey Associates with support from UN-Habitat and operation by small service providers	Pay-per-use	Graham Alabaster and Iole Issaias, "Removing human waste - the Vacutug solution," <i>Habitat Debate</i> 2003, p. 17.
Lobito-Benguela Urban Environmental Upgrading	Angola		Sanitation	WB project introduced a new latrine fixture that caught on quickly and was purchased by individual families spontaneously	Innovation, private distributors with dissemination by the World Bank of the innovative latrine design (marketing)	All	"Case Examples," web.mit.edu/urbanupgrading/upgrading/case-examples/index.html .
Bangkok Land Sharing	Bangkok, Thailand	1980s	Securing tenure, housing improvement, services	Community organizations negotiate with landowner for rights to a percentage of land, in return for clearing out the rest of the land for development, varying levels of payment for land, assistance for rebuilding, housing improvement, and services installation is also included in the agreement	Negotiation by community-based organizations of compromises with private and public land owners/developers as alternative to litigation	Varies depending on agreement	Shlomo Angel and Somsook Boonyabancha, "Land Sharing as an Alternative to Eviction," <i>Third World Planning Review</i> 10, May 1988, p. 107-27.
Genesis Empresarial - Microcredit for housing	Guatemala		Rural housing	Non-profit microfinance institution receives commercial lines of credit from local private commercial banks without donor or government guarantees for micro-enterprise and housing lending	Local microfinancial institution Genesis Empresarial accessing private credit lines from local commercial banks	All (loan repayment)	Ivo Imparato and Jeff Ruster, <i>Slum Upgrading and Participation: Lessons from Latin America</i> , WB 2003, p. 284. also www.genesisempresarial.com

Special Social Interest Zones (ZEIS), as a component of a new policy framework in SEHAB	Sao Paulo, Brazil	2004	Housing (new and reconstructed serviced developments)	Municipal legislation to change incentives to private sector development including exemption from building rights fees to projects that include social housing, transfer of building rights (to municipal gov't), exemption from municipal taxes for certain properties that include social housing	Private finance and operation by private land developers in response to incentives by the Municipal Secretariat of Housing and Urban Development (SEHAB) with support from the World Bank, IADB, Cities Alliance, and government of Japan with funding for new legislation	Rent (capped at 10-15% of income for low-income households, or subsidized with vouchers), maintenance, utilities	Jessica Budds, Paulo Teixeira, and SEHAB, "Ensuring the right to the city: pro-poor housing, urban development and tenure legalization in Sao Paulo, Brazil," <i>Environment and Urbanization</i> 2005, 17, p. 89-113.
New Institutional Framework for Slum Upgrading in Mumbai	Mumbai, India	post-1995	Housing (reconstructed serviced developments)	Increased incentives to developers to produce free apartments in return for additional FSI (which could be sold as TDRs) north of the social development	Private finance and operation by private land developers in response to incentives by central and municipal governments developed in partnership with SPARC, the National Slum Dwellers Federation (NSDF) and Mahila Milan	Maintenance, utilities, property taxes (rent-free housing)	Sundar Burra, "Towards a pro-poor framework for slum upgrading in Mumbai, India," <i>Environment and Urbanization</i> 2005, 17, p. 67-88.
WaterHealth International pilot in Bomminampadu	India		Water	Private company with public and private funding provides home delivery of UV disinfected water to households	Joint public-private venture of WaterHealth International with public funding	All, with potential subsidies	<i>The Next 4 Billion</i> , p. 55.
Heritage Livelihood Services	India		Water	Private company investing in water tanks and working capital for bulk payments of water supplies for private water truck companies that sub-contract with the government to distribute water beyond the network, company also does social marketing of clean water	Joint public-private venture between Heritage Livelihood Services and Hyderabad Metropolitan Water Supply and Sewerage Board	All	<i>The Next 4 Billion</i> , p. 55.
Urban I and II	Zimbabwe	1985, 1989	Housing	Building Societies encouraged to loan to low-income families for purchase of serviced lot and minimal shelter	Bank lending by building societies for private sector land development, but possibly with risk guarantees intermediated by the World Bank?	All (principally, payment of mortgage loans)	Edward Ramsamy, "The World Bank & Urban Programmes in Zimbabwe: A Critical Appraisal," <i>Review of African Political Economy</i> 2006, 33:109, p. 515-523.

Community Led Infrastructure Financing Facility (CLIFF)	India	pre-2000?	Housing and infrastructure	Community as client for private and public lending is supported by non-commercial bridging loans, guarantees, knowledge grants, and TA through CLIFF	Private lending to communities with loan guarantees funded by DFID and Sida and supported by Cities Alliance, Homeless International and SPARC (in India)	Loan repayment through community (user fees, housing payments)	Ruth McLeod, "Financing housing for the urban poor: opportunities for civil-society-state-private sector collaboration," <i>ID21</i> 2003, www.id21.org .
Capital investment plan of the Ahmedabad Municipal Corporation; Slum Networking Project "Parivartan" (Transformation)	India	1998-2006; 1995-2001	Water, sanitation	Municipal bond issue with 7-year term to support a citywide water and sanitation project including many slum areas	Issuance of municipal bonds by Ahmedabad Municipal Corporation to individual investors (through 25% public offering), State Bank of India, Unit Trust of India, Housing Development Finance Corporation Ltd., other commercial banks, mutual funds, after review by Credit Rating and Information Services of India (CRISIL) and with matching funds and support from USAID FIRE-D project and a central government loan to complete budget.	All citizen's responsible to pay back loans through taxes, water and sanitation user fees	David Painter, "Scaling up Slum Improvement: Engaging Slum Dwellers and the Private Sector to Finance a Better Future," paper presented at the World Urban Forum III, 2006. **Success of this project described as "limited" by Taimar Samad, "Institutional synergies in the delivery of urban upgrading services: lessons from the Slum Networking Program in Ahmedabad, India," Thesis MIT 2006.
Greater Bangalore Water and Sanitation Project; Water and Sanitation Pooled Facility	India	2005	Water, sanitation	Pooled municipal bond issue to support water and sanitation projects across 8 small cities including many slum areas	Issuance of municipal bonds by 8 city governments around Bangalore to private investors and the Karnataka Urban Infrastructure Development and Finance Corporation (KUIDFC), for upgrading work supported by the NGO Janaagraha and slum dweller participation	All citizen's responsible to pay back loans through taxes, water and sanitation user fees	David Painter, "Scaling up Slum Improvement: Engaging Slum Dwellers and the Private Sector to Finance a Better Future."