Clean Team, a container-based sanitation enterprise operating in Ghana

Scaling for impact:

Lessons learnt from funding water and sanitation enterprises

THE STONE FAMILY FOUNDATION

Introduction

The Stone Family Foundation was founded in 2005 by entrepreneur John Stone and his wife, Vanessa. They started out with a blank piece of paper and over time came to focus on three portfolios: water and sanitation (WASH) in Africa and Asia, mental health and disadvantaged youth—both in the UK. How the Foundation got to this point and the early lessons learnt have been documented in previous publications: A funder journey and How to spend a penny.

The Foundation is now in its 15th year of operation and, to mark that milestone, we are sharing our latest thinking and the lessons learnt from the last five years of funding in WASH, our largest portfolio. The lessons cover everything from how we have evolved our funding approach, to our hypotheses on how WASH enterprises will scale, to how SDG6 will be financed.

Our strategy and funding philosophy

In 2015, the Foundation decided to scale up its giving in WASH significantly—from £3m per year to a notional target of £10m per year. Since then we have continued to develop our approach and, in this section, we share what that has meant for the way we fund.

1. Scaling has not stopped us from continuing to focus
Growing for us has meant going deeper rather than broader. We have continued to focus on the areas where we have the resources and expertise to generate the biggest impact possible: market-based solutions and social enterprises delivering better services to people living in Africa and Asia.

We have focused on three thematic areas: safe water enterprises, urban sanitation services, and waste to resources. We know that market-based approaches won't work everywhere so we focus on areas where we think enterprises have a role to play in delivering better services.

We have also chosen to keep our portfolio small, preferring engaged relationships with a smaller number of organisations rather than spreading resources out too thinly. Inspired partly by the Shell Foundation's approach to developing enterprises in the energy sector, we look for partnerships where providing long-term flexible finance will help deliver the breakthroughs in the sector we are all hoping to see.

Members of the Sanergy team in Kenya, a sanitation enterprise we've supported for a number of years.

2. Our analysis places more weight on management than ever before
Our strategy is underpinned by a set of guiding principles and three golden rules we use in all decision making:

i. Belief in the management of an enterprise;
ii. Evidence of the impact and acceptability to customers of the service or product being delivered;
iii. Conviction in the pathway to scale and financial sustainability.

The quality of management has always been important to us but, in the past five years, it's become even more so. Our focus on long-term support to enterprises means that we need to establish strong working relationships with the leadership to ensure a strong partnership in the face of the challenges that will inevitably lie ahead as the enterprise develops and scales.

Our assessment of management involves reviewing the whole set up from the leader through to senior management, to the staff working on the front line. We are not just interested in CVs and qualifications, we are looking for commitment and tenacity, as well as leaders' ability to rally the whole organisation behind their vision whilst also using data and evidence to drive decision making.

3. Aggregating metrics is not the answer to understanding our impact
As our portfolio has grown, it has become harder to get an overall view of whether the grants and impact investments are delivering our vision. The temptation is to ask the enterprises we work with to measure a common set of impact metrics that will allow us to aggregate our impact into a single, satisfying number.

That impulse should be resisted where possible. The Foundation only achieves its mission if the enterprises we support are successful. Our priority should be to encourage enterprises to collect data that is most meaningful to them—and will give them the data and insights they need to be successful and deliver greater impact.

Our approach to understanding our own impact is built around the four components of our vision: **scale, quality of services, affordability, and financial sustainability.** But how enterprises define what those terms mean is entirely up to them and the context they are working in—we can use this to make sense of the Foundation's overall impact.

The path to scale for WASH enterprises

Enterprise development in WASH has progressed significantly in the last five years: we understand far more about the operating and financial models that work. There is a long way to go but we remain optimistic. In this section we reflect on progress and the differing pathways to scale in water and sanitation.

4. Business models are more mature in certain parts of the sector
Our experience in the last five years suggests we need to recognise the WASH sector is not homogenous and different elements of the sector are closer to viability and breakthrough at scale than others.

For example, we are still very much in the pioneer phase in sanitation and waste to resources. Sanitation enterprises work in more complex and challenging environments, meaning they are often both building the market and trying to serve it at the same time. We still need considerable innovation in business models, operations and financing, which requires patience, an ability to pivot and flexible funding over a long time period.

Radical business model innovation is less needed in water; successful water enterprises have been able to borrow more from scaled down versions of utility business models. Delivering high quality, clean drinking water to customers is, relatively speaking, less challenging than sanitation. That said, innovation is still playing a key role in improving operational efficiencies, reducing costs, and helping provide a better level of service to customers (including piped household connections). We currently see more potential for investable propositions in the water sector—and we expect that to be the case for some time.

We are supporting Safe Water Network to expand its household connection programme — giving customers and their families the convenience of water at home and contributing to the financial viability of its Ghana programme.

5. Government is critical to WASH enterprises' success
Water and sanitation services are ultimately public goods and the government has the authority and duty to provide affordable services to all of its citizens.

WASH enterprises need positive, engaged relationship with government to grow and become sustainable. Enterprises too have a role in helping governments deliver their mandates. The exact relationships depends on the business model and operating environment—and we see several approaches in our portfolio.

In some cases, the government provides enterprises with the license to operate and establishes a regulatory framework to ensure the quality of the services. One observation from the last five years is we must find ways for regulators to enable operators to respond to opportunities and not merely control operations and stilt the market. We have high hopes for initiatives such as city-wide inclusive sanitation (see below) as a means to open up opportunities for the private sector to respond; we are actively looking for opportunities to achieve this.

Another clear pathway to scale has always been utilities and city authorities paying enterprises to deliver services, particularly for the lowest income communities. We are starting to see more and more evidence of this happening across the portfolio. For example, Loowatt, a container-based sanitation business operating in the Philippines, has successfully secured a contract to provide its toilet product and services to a water and sanitation utility—a first in the container-based sanitation sector.

6. The domestic private sector has huge potential, but structuring support is challenging
As well as supporting new entrants into WASH, we have also been considering how best to support existing operators in the domestic private sector—and whether this also needs a push at the systems levels to have impact.

There are clear, long-term advantages to supporting the domestic private sector: it makes sense to support local capacity particularly where there are already many strong operators with sound businesses embedded in the communities being served. Some of these may already be working in WASH; some may be working in adjacent sectors and looking to expand into new markets.

That said, these businesses can be small and highly informal, and need engaged and tailored support to professionalise their services. Some of these local businesses may grow, but more likely we will achieve scale by supporting the emergence of a thriving private sector made up of many local players providing high quality services to customers.

As a funder (particularly one not based in the countries it supports work in), working out how to support the domestic private sector takes time and resources. Our greatest insights about how to do this have so far come from the Cambodia Revenue Finance Facility, which supports private piped water operators in Cambodia with flexible finance to expand networks and coverage to more remote and often poorer areas.

Finding a strong partner working in-country to help source businesses and to provide ongoing engaged support to operators has been the biggest factor behind our success so far with the Facility, and we have been lucky to have Gret/iSEA as our partners to help deliver this.

One of the piped water operators we are supporting through the Cambodia Revenue Finance Facility at the construction of his water station.

7. Technology and innovation still has a role to play in supporting the path to scale

For a sector that has historically seen many shiny new gadgets and gizmos that have often delivered little, there is understandably some cynicism that innovation and new technology can have any role in advancing the cause of universal WASH services.

We've supported Jibu, a bottled water franchise operating in multiple countries in Africa, to strengthen its sales and marketing activities and create efficiencies within the business.

We take a more nuanced view. All sectors need to be open to new ideas and approaches—innovation comes in many forms (process, contractual, digital) and isn't necessarily a shiny new piece of equipment. What is critical is whether this innovation is responding to a real and well understood obstacle the sector is facing.

For example, the Safe Water Enterprises report we published with several other WASH funders in 2017 found that many water enterprises have relatively inefficient internal systems and processes that contribute to the cost of delivering services and this is preventing scale and financial sustainability.

Addressing common issues like customer tracking, mobile payments and supply chain management through adapting known technology will improve how services are delivered—and innovation has a positive contribution to make.

Supporting the wider system and enabling environment

We know that funding enterprises in and of themselves does not mean they will magically scale and become financially viable; there are a set of external conditions that enable or inhibit their ability to deliver services effectively. Here we reflect on efforts to support wider systems change and where we have a role to play—while retaining our focus on supporting enterprises.

8. Provide funding to enterprises that is "system friendly"
Over the five years we have shifted our approach to provide funding that acknowledges the external barriers to scale that enterprises may face—the externalities that exist in the operating environment; the city, the ecosystem, the market or whatever term you want to use to describe the world outside of the enterprise.

To achieve this, our preference is to provide funding that is multi-year, flexible, unrestricted or only loosely restricted to a broad business plan or strategy. We are flexible with how budgets are allocated and understand that grant milestones and targets set at the start of the grant will change over time. This allows enterprises to pivot plans and models to adapt to evolving situations in their operating environments.

A toilet construction business owner supported by WaterSHED in Cambodia. We have provided flexible funding towards WaterSHED's business plan to support rural businesses and government leadership, which has accelerated sanitation coverage from 25% to over 60%.

9. We have a role to play in creating a more enterprise-friendly operating environment where we can add value. Over the last five years we have developed initiatives that have sought to strengthen the systems within which enterprises operate—a good example being our partnership with the Global Water Practice of the World Bank in Cambodia that came to an end in late 2019.

The partnership focused on supporting the government of Cambodia to unlock key constraints and regulatory bottlenecks in the water and sanitation sector to enable better service delivery in the long term:

- For water supply, this work included supporting the Ministry of Industry, Science, Technology and Innovation to issue licenses to water operators, strengthen the tariff regime, and develop models for private sector participation in water service delivery.

- For rural sanitation, the partnership supported the implementation of the National Action Plan for Rural Water Supply, Sanitation and Hygiene, particularly the decentralisation of rural sanitation responsibilities to the provincial, district, and commune government.

One of the reasons why we believe the partnership was successful was that it built on our long-term engagement in the Cambodian WASH sector over the previous eight years. This meant we understood the sector and challenges and were well placed to co-create a programme designed to strengthen the sector. We will continue to explore similar partnerships where we believe we can add value in the same way. We are particularly interested in how city-wide inclusive sanitation could be a useful framework through which to contribute to supporting systems development at the city level.

Financing WASH enterprises

The last five years have seen an increasing focus on how to finance the significant steps forwards required to deliver the targets under SDG6. We are seeing more discussion of innovative finance, blended finance, and payment-by-results, all of which have a role to play in increasing the overall volume and effectiveness of funding. In this section we share our reflections on financing WASH enterprises.

10. Grants are still very much needed
While we are excited and encouraged by the discussion about innovative finance, we continue to believe fundamentally that most enterprises need long-term, unrestricted grant funding to scale to the point where they become investable.

Few WASH enterprises are yet investible propositions and many—particularly in sanitation and waste to resources—need to refine their business models and de-risk their path to scale and breakeven. Grants are often the best way to get do this, as it provides flexible capital that enables enterprises to grow without creating a drag on their bottom line.

This is not always the case; there are times when an early concessional investment will make sense. But we always need to be able to answer the question: *"Why is an innovative finance mechanism better than providing a grant at this point in the enterprise's journey?"*

11. Impact investment will likely be impact-first and concessional for some time—and that's OK

We have been impressed by the interest of impact investors in WASH and encouraged to see the growing levels of investment in the sector. All this is a sign of the growing maturity of WASH enterprises and the sector's ability to amplify its message more coherently and consistently to a broader audience.

The interest is great—but we are also cautious. We wonder if some impact investors' timeframes, return expectations and risk tolerance are well matched with where the sector is right now.

Many of the enterprises we support are pioneering businesses that are looking to serve the low-income populations. They are still de-risking their businesses, establishing reliable income streams, and navigating a complex relationship with government. Their business models are not ready for impact investors with three- to five-year horizons and market rates of return.

Where we see more opportunity is for impact-first investors who are willing to provide long-term flexible capital on concessional terms that reflect the social impact being created. That's our focus when making impact investments and we welcome opportunities to work with other investors looking to do the same.

12. We need new forms of patient capital beyond equity

We are interested in the different forms of patient investment capital suitable for our enterprises. Equity is the most common structure but, as a UK registered charity, regulation can make it quite challenging for us to do. The challenge of exiting well and the fact that it can be diluting for owners and founders too are other disadvantages.

We have been pushing forward our own thinking on how to deploy finance differently and how that enables impact while ensuring we are providing the right type of finance at the right time. Two areas where we have had some success are:

- **Revenue royalty finance,** where an enterprise repays an agreed multiple of the original investment from a percentage of revenues. This is what we've used to finance piped network extensions in the Cambodia Revenue Finance Facility and helps ensure that the finance is affordable and aligned with cash flows.

- **Results-based finance,** such as the Rural Sanitation in Cambodia Development Impact Bond. Here, we have invested in the third phase of iDE's Scale Up Sanitation Marketing programme and will be repaid with a modest return by an outcomes funder, in this case USAID.

  But more can always be done, and over the next few years, we will be exploring different structures and continuing to learn from other impact-first investors working in other sectors to develop these ideas.

The Cambodia Rural Sanitation Development Impact Bond is using innovative, results-based finance to achieve universal sanitation in 1,600 villages in Cambodia.

Safisana, a waste to resources enterprise we work with in Ghana, producing biogas and fertiliser at its treatment plant.

Conclusion

We have learnt a lot over the last five years—and in that time have honed our focus, developed our understanding of the different operating and financial models in the sector, as well as how to be more nuanced with the finance we are deploying.

We feel we have made progress with growing the size and impact of the portfolio over the last five years and are moving towards deploying £10m per year; but there is still a long way to go. As always, we are optimistic about the possibilities and opportunities that lie ahead and we look forward to the collaboration that will be required to achieve universal access under SDG6.


HappyTap provides a purpose-built handwashing station designed for low income settings

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