OVERVIEW
Output-based aid (OBA) is helping low-income households in rural Bangladesh access microloans to invest in hygienic sanitation facilities. The OBA grant subsidizes the cost of the facilities, reducing the overall cost for cash-constrained households, and the microloans help them to spread repayment over time. The OBA grant also serves as an incentive for local microfinance providers to participate in the program.

DEVELOPMENT CHALLENGE
Bangladesh is the only country in South Asia to have nearly eliminated the practice of open defecation, which in 1990 was used by an estimated 34 percent of the population. However, with access to improved sanitation at only 61 percent, considerable work is still needed to reach universal access to improved and safe sanitation in accordance with the Sustainable Development Goals. Market failures and additional challenges persist for the sanitation sector, including the quality of sanitation coverage. Many existing latrines are poorly constructed and unhygienic, which can be harmful to the environment and the user. While households are interested in upgrading their sanitation facilities, the lump sum required is often unaffordable for rural households. In many cases, they are not able to borrow to finance this purchase, as sanitation is not considered a productive investment.


**BACKGROUND AND ENABLING ENVIRONMENT**

Strong government sanitation initiatives and programming support from international donor and nongovernmental organizations (NGOs), as well as increased private sector participation, have contributed to development of the sanitation sector in Bangladesh. The government has played a central role through national sanitation campaigns starting in early 2000, at which point open defecation was reported at close to 20 percent of the population.3

As progress was made on reducing open defecation, attention increasingly turned toward hygienic latrines as the next generation of toilets—given the ability to restrict waste from contamination of both the user and environment—in the climb up the sanitation ladder. In 2009, the World Bank (through the Water and Sanitation Program) extended technical assistance to the government of Bangladesh under a sanitation marketing initiative. The initiative emphasized the creation of demand for sanitation products, as well as supply-side support to facilitate private sector investment through work with local construction firms and microfinance providers.4 Bangladesh has a well-established microfinance sector with a strong cultural presence, which was tapped as a resource under the program.

For poor households, the high upfront costs to buy a hygienic latrine can be prohibitive. Meanwhile, local construction firms are limited in their service offerings by their small size, which restricts them from being able to offer the longer-term repayment periods with lower installments that appeals to cash-constrained households. The sanitation marketing initiative linked microfinance providers with construction firms to help them access flexible loans, enabling them to grow and extend their services and products, including through creation of new low-cost hygienic latrine technologies.5 The program also facilitated the development of a sanitation loan product (a microloan to purchase a hygienic latrine) for households to help overcome the affordability gap. Follow-on technical assistance has continued in a more recent World Bank program, initiated in 2015.

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**BLENDED FINANCE APPROACH**

The sanitation marketing work, combined with a well-developed microfinance sector and strong government support, were critical for the roll-out of a complementary project funded by the Global Partnership on Output-Based Aid (GPOBA). Approved in 2016, the US$3 million output-based aid (OBA) grant aims to make hygienic sanitation infrastructure affordable and feasible for rural low-income households through microfinance. The program partners include the government of Bangladesh; a government-backed wholesale microfinance institution, Palli Karma-Sahayak Foundation (PKSF); and 21 local microfinance providers, referred to as partner organizations (POs).

PKSF, the main implementing agent, provides wholesale financing to the POs, which then extend sanitation loans (minus the subsidy) directly to households to purchase the latrines. To qualify for the subsidized loan, households must agree to work with a pre-approved construction firm that has received training on how to install appropriate hygienic sanitation technologies. This reduces performance risk and helps to ensure the spread of hygienic practices.6

The OBA subsidy is released to PKSF and channeled to the POs once construction of the latrine has been verified. This process holds the installers and financiers accountable and ensures delivery of quality hygienic sanitation structures. The subsidy covers 10 percent to 12.5 percent of the total loan value and is applied to sanitation investments ranging from US$45 to $US128.7 By offering the subsidy only for the lower-cost technologies, the project uses self-selection to target low-income consumers who cannot afford the more expensive designs. Households pay back the loan over a 55-week period at a fixed interest rate of 12.5 percent.8

**RESULTS**

The OBA subsidy blended with the sanitation loan reduces the total loan amount and debt service owed by households. The lower system cost

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5 For more information, see Ikeda and Ahmed, 2015.

6 World Bank, 2016.

7 Ibid.

8 This is calculated as a flat rate based on the market MFI rate of 20-25 percent declining balance, for ease of payment and collection by consumers and field staff.
provides an incentive to consumers to buy and install latrines, and access to microfinance offers households the opportunity to spread the cost of the investment over time. By increasing the affordability for households, the grant also reduces the lending risk for the POs, which in turn spurs loan product development and market growth. The project is intended to provide an initial stimulus for the market for rural sanitation, building a core of early adopters and providing a demonstration effect for other microfinance institutions and local entrepreneurs on sanitation lending and construction.

The project expects to mobilize US$22 million in microfinance to build 170,000 hygienic latrines, reaching 850,000 individuals in rural areas. The small OBA subsidy demonstrates a high leveraging effect in terms of crowding in additional private sources of capital through participating POs. The initial uptake of the products has been strong—as of March 2018 (one year into implementation), nearly 150,000 household loans have been disbursed to buy and install hygienic latrines through approximately US$18 million in microfinance lending. The majority of borrowers from participating POs are women. Repayment rates have been recorded at over 99 percent.

**SUCCESS FACTORS**

The OBA sanitation project builds on earlier efforts and draws on a suitable enabling environment. Technical assistance and capacity building assistance, both for past efforts and under the current project, have been instrumental for success in the form of marketing support, activities to change behavior, training construction firms to install

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10 World Bank, 2018.
Technical assistance has helped prime the market for sanitation microfinance, and the blending of OBA subsidies further facilitates the opening of the market and increased access by the poor communities.

Bangladesh’s embedded microfinance sector has been critical for the success of the program. The cultural familiarity with microcredit, the breadth of the existing network, and the ease of outreach to the rural areas, where most of the population resides, guarantees a readily accessible customer base for sanitation products. The established and trusted relationships already in place reduce the risk of nonpayment. Moreover, the POs are finding that the sanitation product is helping them increase their client base as new borrowers approach them to apply for a sanitation loan.

References

