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## **Political economy influences on enterprise engagement in Indonesia, Vietnam and Timor-Leste**

*J. Willetts, J. Murta, A. Gero, N. Carrard & D. Harris (Australia)*

**REFEREED PAPER**

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*Many factors influence the potential for enterprises to play effective roles in supporting water and sanitation services. This paper focuses on the importance of the national and local political economy in shaping what roles are possible and viable, and explores the range of forms of enterprise visible in the water and sanitation sector in Indonesia, Vietnam and Timor-Leste. Through interviews with government agencies at national and subnational levels, private and social enterprises, local and international civil society organisations and donors, this research provides a rich description of the ways in which history and the macro economy have shaped the role and perceptions of the private sector in each country, and the particular niche that small-scale enterprises in this sector currently occupy. It provides insights into the incentives that drive the behaviour of different actors, and points to the need for highly contextualised support for such enterprises in each country.*

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### **Introduction**

An increasing number of international agencies are supporting enterprises to provide water and sanitation products and services in rural contexts. A recent systematic review reveals that evidence of the effectiveness of this engagement, particularly in terms of outcomes for the poor, is mixed (Gero et al, 2013).

Unquestioned assumptions about enterprise engagement and roles have contributed to the mixed results to date. For example, the starting point most often assumes that enterprises will be ‘for-profit’, and has limited attention to the range of organisational types that are possible, including both private and social enterprise, which may respond to different incentives based on their motivations. Equally, assumptions have been made about the existing private sector and its status, as well as expected government leadership and support.

This paper explores the results of a political economy analysis of the dynamics and incentives shaping enterprise roles in Indonesia, Vietnam and Timor-Leste. The political economy analysis approach focuses attention on the formal and informal links and interactions between organisations and individuals that explain the current situation concerning enterprise roles and their chance of success in different country contexts. Both the macro-political economy and dynamics in the water and sanitation sector are considered.

### **Methods**

This paper summarises and compares findings across three country-level studies. The research methodology was underpinned by a political economy analysis framework (Harris et al. 2011, Ostrom 2011). This included consideration of the macro-level political economy and its recent history, the water and sanitation sector within this, and the incentives provided by formal and informal rules operating within and between organisations, issues of power, control over choice, and access to information.

Empirical research for three studies was conducted between September 2013 and May 2014. More than 120 organisations were interviewed altogether, using a semi-structured format, including government agencies at national and subnational levels, private and social enterprises, local and international civil society organisations (CSOs) and donors. Further details of the methods and country-level findings are contained in relevant country working papers (Murta et al. 2014a, Gero et al. 2014, Murta et al. 2014b).

The research took a targeted approach to choices in location and enterprise type to cover the leading edge developments in each country rather than a comprehensive study of all possible enterprise roles. This means that in Indonesia, the research was undertaken predominantly in Java, where international agencies have centred their efforts to support enterprises. In Vietnam, the research drew on a wider range of locations-provinces in the Mekong, North and North West as well as national stakeholders in Hanoi. In Timor-Leste, where private sector involvement is in its early stages, interviews were conducted in Dili and Liquica.

The research involved partnership with non-governmental organisations (NGOs) in each country (Plan Indonesia, SNV Development Organisation and East Meets West Foundation in Vietnam, and WaterAid in Timor-Leste), as well as cooperation with the World Bank Water and Sanitation Program in Indonesia.

In this paper we limit our presentation of the findings to reflections across the three countries concerning the political economy and incentives. Broader findings concerning key factors supporting and constraining enterprise development, including challenges of economies of scale in rural areas, access to finance and access to capacity building are detailed in the respective country working papers mentioned above.

## Findings

The findings are grouped into three main areas. We firstly consider the differences in the type of enterprises that have emerged in each country context, including both private and social enterprise, followed by examination of the dynamics in the macro and local political economies that have served to influence the enterprise roles and engagement in each of the three countries.

### Types of enterprise engagement

Each country exhibited slightly different levels and types of enterprise engagement in water and sanitation products and services. In general, construction companies and hardware retailers are common in all three countries, and other types of enterprises besides these have been largely initiated by development agencies.

In Indonesia, specialised enterprises providing water and sanitation services, with the exception of sludge removal businesses, were mostly initiated through external agencies, and included sanitation entrepreneurs and formalised community-based organisations managing water supply. Of the three countries, Vietnam displayed the highest level of innate business activity, however this occurred dominantly in the more densely populated plains and less so in the more remote mountainous areas. Further, in general there were few enterprises specifically focused on rural sanitation, however in the Mekong, a growing number of private enterprises were serving rural households with water supply. In Timor-Leste only a few small-scale enterprises initiated by development partners were found, within a private sector that is largely nascent beyond the confines of the capital. An overview of the types of enterprise is shown in Table 1.

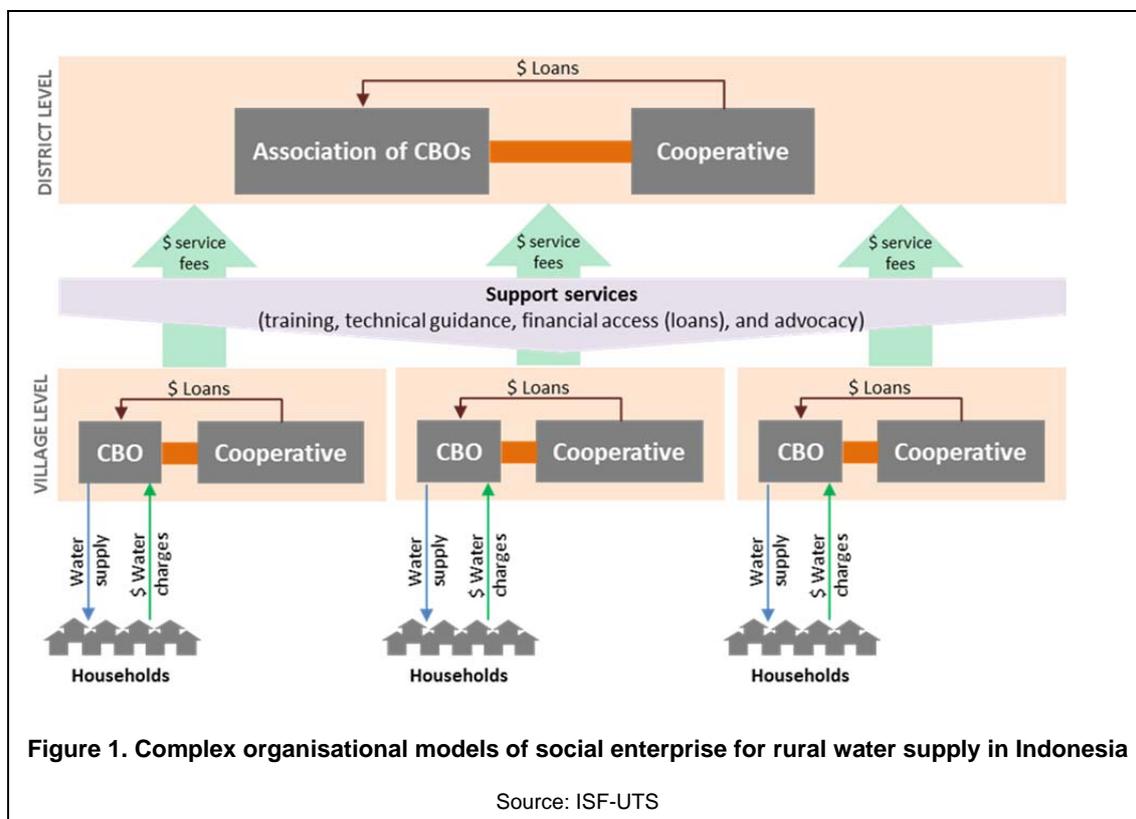
Subsector	Indonesia	Vietnam	Timor-Leste
Water	Formalised community based organisations (CBOs), village-owned enterprises or cooperatives managing rural water supply District associations of water CBOs offering loans and technical support Distributors of household water treatment products	Small-scale private water service providers Co-operatives managing rural water supply and other services Social enterprise for localised bottled water production Distributors of household water treatment products	Private companies and not-for-profit enterprises providing support to service provision Kiosks retailing water spare parts in addition to other small household products. Association of community based water committees offering support to water CBOs
Sanitation	Sanitation entrepreneurs and masons products and services Retail shops with sanitation products Associations of sanitation entrepreneurs offering training, loans and technical support Small private desludging service providers	Masons building toilets, usually as a side business to building houses Retail shops selling sanitation products Small private desludging service providers	Sanitation entrepreneurs products and services Retail shops selling construction materials in district capitals

**Organisational models of private and social enterprise**

As indicated above, both private, and what could be termed as ‘social enterprise’ were found to be active in this sector. Recently there has been a blurring of the lines between private sector and community-related not-for-profit organisations – the territory between these two enterprise types is termed ‘social enterprise’. A variety of definitions of social enterprise exist. In this research, ‘social enterprise’ was interpreted to refer to enterprises that bring together entrepreneurial behaviour with the desire to draw upon the market as a tool for meeting social goals, serving the common good for the benefit of the community (Noya et al. 2013).

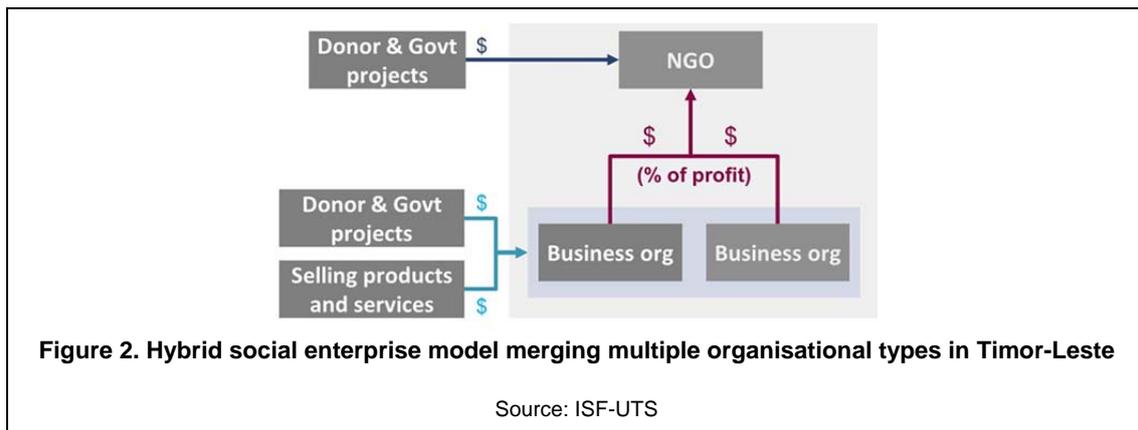
Different organisational models for private and social enterprises have arisen in conjunction with and in relation to water and sanitation services in each country. In Indonesia, ‘associations’ as a model of social enterprise were prevalent and appeared to arise from the need to solve collective action problems, since the current policy environment allocates communities and citizens (particularly in rural areas) significant responsibility within water and sanitation service provision. Such structures also appeared to help enterprises navigate the institutional complexities of access to finance and other business requirements in the Indonesian context, where ambiguities in the functioning of both the informal and the formal economy support such models. For example, an association of CBOs was registered as a cooperative to allow it to formally provide loans to CBOs providing water services to rural communities, who in turn were registered as cooperatives to be able to receive such loans (see Figure 1). In Vietnam, the majority of enterprises were simply structured for-profit businesses, run by individuals with or without extended family members. In Timor-Leste, some hybrids between for-profit and not-for-profit organisations had emerged in response to the changing landscape of possible revenue sources through donor support and government contracts (see Figure 2).

In all three countries informal businesses were common, that is, those lacking formal legal status. This is a reflection of the small business sector in each country, where informal relationships, be they with government, other business partners or with customers, are dominant factors affecting business success. In the case that enterprises did want to formalise their structure, often the most appropriate choice of legal structure was not clear, and existing legal organisational structures did not always provide a good ‘fit’ for the type of ‘social service’ offered by enterprises in this sector.



**Figure 1. Complex organisational models of social enterprise for rural water supply in Indonesia**

Source: ISF-UTS



### **Influence of history and the macro-economy**

The macro-level political economy comprises the historical, political and economic circumstance of each country. A focus on this broad context helps explain mismatches between espoused and actual priorities of political and administrative actors. It also explains prevalent attitudes towards the ‘private sector’ amongst government and community, whether ‘social enterprises’ exist, and how they too, are perceived.

#### ***Relevant history, country and sector dynamics***

In Indonesia, decentralisation of public services, including water and sanitation, has meant that district governments have greater control over local budgets and are responsible for responding to local water and sanitation needs, including the role that enterprises might play in developing these services. However, very little attention has been paid to water and sanitation by local governments, who tend to focus instead on investments with high-visibility economic outcomes or areas traditionally perceived as of higher priority (e.g. roads, education, curative health services). Further, despite the existence of certain formal processes, informal patron-client relationships and political considerations have a strong influence on the determination of investment priorities and budget allocations (Garbarino & Holland 2011). Thus, although there has been increased commitment for water and sanitation by national level stakeholders, this has not translated to budget disbursement at the local level, nor to enterprise development support within this sector.

Vietnam has changed markedly in the last 25-30 years, reaching middle-income status and facing a decline in overseas development assistance, despite outstanding inequalities in access to basic services, particularly in more remote rural areas. Despite a strong focus on market economy development, there remains a historical legacy of the state as the provider of important services such as water and sanitation. This perception (along with new forms of state intervention through ‘equitisation’) acts as an important constraint and backdrop to enterprise engagement in the sector. Authorities at the provincial level have a major influence on enterprise engagement in water and sanitation services, and hence although national policy directs a focus on development of private sector roles in the water and sanitation sector, there are wide gaps in its implementation at provincial level (Gero et al., 2014).

In Timor-Leste, quite a different picture is evident, as a post-conflict state emerging from a recent history of violence and disruption. There remains a fusion of both humanitarian and development outlooks, on the part of both government and development agencies. Hence whilst on the one hand government is poised to develop the local economy through increasing business activity, at the same time ‘free’ goods are commonly provided, which concurrently undermine viability of fragile businesses in their early stages. An example is the use of subsidies for rural sanitation, which has been a dominant approach in the past. While recent policy provides clear guidance on the use of subsidies, there continues to be an uncoordinated approach within the sector that affects efforts to engage and develop enterprises.

#### ***Limited coordination in government***

In all three countries a lack of coordination and cooperation between agencies responsible for water and sanitation, and those responsible for private sector, was evident. In Indonesia, whilst in many locations there is at least some sector coordination between planning, public works and health agencies, the departments responsible for enterprise development and trade rarely interact with this sector. Historically, water and sanitation have not been the focus of the latter departments, and they tend to focus on priorities

with more visible socio-economic outcomes. In Vietnam, NGOs described attempts to engage departments responsible for business development, or relevant chambers of business, but reported limited interest or traction. In Timor-Leste, poor coordination across several agencies responsible for private sector development was widely reported, without even considering their interaction with those responsible for water and sanitation. The outcome of this lack of coordination is a limitation in provision of financial and technical expertise to emerging enterprises in the water and sanitation sector in all three countries.

#### ***Status of the private sector and enterprise development***

The status of private sector development in each country had a profound influence on if and how enterprises were playing roles, or could be stimulated to play roles, in water and sanitation service provision. Indonesia exhibits a large number of small-medium enterprises, particularly within the food and textile industries, however in rural areas business skills and capacity were limited. Of the three countries, Vietnam has the most developed private sector and the strongest evidence of entrepreneurial spirit and drive. However this is was not uniform. While in the ‘plains’ areas and amongst the dominant Kinh ethnic group, strong economic development and business drive was evident, elsewhere in mountainous regions it was not. In Timor-Leste, although private sector development features strongly in the country’s Strategic Development Plan, the current private sector exists mostly in nascent form, with little economic activity outside of the capital, Dili. Further, the government’s private sector development efforts focused on capacity development of the construction sector rather than more broadly. In addition, the enabling environment for enterprise development, in terms of a functioning transport infrastructure or availability of loans, is not yet present.

#### ***Perceptions about private sector and its role***

Negative perceptions concerning existing private sector actors were evident in all three countries. This affects how both government and community view possible enterprise roles in water and sanitation services. Perceptions were particularly negative in relation to construction companies. In Indonesia, the term ‘contractors’ is associated with ‘marking up’ of prices and corruption: ‘*they mark up profits and only focus on profits*’ and ‘*usually 50% goes in corruption*’. In Vietnam, government stakeholders reported a similar concern, and suggested that community members would be suspicious of enterprises and unlikely to trust them in honest delivery of a social service such as water and sanitation. In Timor-Leste, some government stakeholders were unconvinced of capacity for private delivery of water and sanitation services: “...*if you ask if companies exist, companies exist, but [are they] appropriate to provide service ...[the] quality is not reliable. [It is] risky to contract these*”. Interviewees regularly mentioned ‘pop-up’ businesses, which existed only to match an opportunity to earn money quickly through government contracts, but that quickly disappeared when the work was complete with no potential for accountability around the quality of the work performed.

#### ***Influence of the local level policy environment***

The local policy environment is a highly influential factor in enterprise development and success. Across the three countries, three potential incentives for local government to support enterprise were evident. These included pressure to meet targets, financial incentives, and opportunity for prestige and recognition.

Meeting targets was a particular concern to local governments in both Indonesia and Vietnam. For instance in Vietnam, Commune People’s Committees were in some locations supportive of private enterprise development that would increase water and/or sanitation coverage in their locality. Equally, in Indonesia, local government officials displayed support for sanitation entrepreneurs through recognition of their role in improving monitoring data. A particularly complex case where this incentive came to play was where local government staff were also playing roles as entrepreneurs themselves, and hence had a dual motivation for developing their enterprise- for financial gain as well as improved coverage targets.

Prestige and recognition was also a motivator for local support for enterprises, visible particularly in Vietnam, where ‘competition’ between communes through government programs that assign communes a certain status based on access to services and other criteria.

Significant barriers to enterprise development emerged in terms of if and how local governments were able to support enterprise development. Key constraints included limits on how financial resources could be invested in relation to the private sector. In both Indonesia and Vietnam, local officials reported challenges in using their resources for this purpose. For example in Vietnam, government stakeholders reported that

funds could be used to mobilise communities concerning sanitation behaviour change, but could not be used to train masons in how to build quality toilets.

A second barrier, particularly clear in the case of Indonesia, was lack of knowledge within the public sector of how to provide effective support, as noted by one CSO stakeholder: “*if you ask them [government] to help, then they say they don’t know how*”. There was often, too, an over-riding perception that enterprises should simply survive based on their own initiative: “*if [you] say this is private sector, then they [government] respond that this is not their domain, [and that enterprises] have to survive*”. In the Vietnam water sector, there was also evidence that enterprises faced difficulties when negotiating tariffs, land and asset ownership with government. Furthermore, whilst in theory, national regulations enable provinces to make up for differences in enterprise costs and revenue in rural areas, in practice this was not observed.

## Conclusion

This paper has examined the types of enterprises emerging to play roles in the water and sanitation sector in Indonesia, Vietnam and Timor-Leste, and reviewed the ways in which the national and local political economy have affected the development of such enterprises.

A wide range of organisational types were evident amongst enterprises in the three countries, including a spectrum from fully for-profit, to hybrid entities exhibiting a commitment to a social service whilst operating on a business model, to collective social enterprises. These organisational forms each emerged from the particular political, institutional, regulatory and social structures in the relevant countries, and affect which strategies will be effective in supporting enterprise development. As regards the national and local political economy, the paper points to a complex range of contextual factors that imply external development agencies must take care when initiating support to enterprise development, and cannot afford to apply a standardised approach in the hope that newly born enterprises will survive and able to contribute to improved water and sanitation services. Negative perceptions of private sector actors, expectations for the state to deliver services, and limited translation of national policy at local level all result in challenging conditions for enterprises to exist. On the positive side, incentives to support enterprises do also exist at local level, for example coverage targets and prestige offer reasons to support enterprises. These and other incentives could be capitalised upon more explicitly by development actors and could be expected result in better targeted support to enterprise development.

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## Contact details

Juliet Willetts, Institute for Sustainable Futures University of Technology Sydney NSW 2007, Australia  
T: +61 2 9514 4950 E: Juliet.Willetts@uts.edu.au W: www.isf.uts.edu.au