GENERATING PRIVATE INVESTMENT IN Fragile and Conflict-Affected Areas
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GENERATING PRIVATE INVESTMENT IN
Fragile and Conflict-Affected Areas

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Creating Markets, Creating Opportunities
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EXECUTIVE SUMMARY

The private sector can help break the cycle of conflict, fragility, and poverty that persists in many fragile and conflict-affected situations (FCS). This study draws on academic research and IFC’s experience with the private sector in FCS to derive lessons on how to engage with the private sector to foster growth, job creation, and stability.

Fragile and conflict-affected economies often exhibit several common characteristics, such as social conflict and excluded groups, poor institutions and services, inadequate infrastructure and government and firm capabilities, environmental and social issues, limited and undiversified private sectors, and low levels of trade and per capita income. While building trust, security, and strong institutions is critical to helping these countries advance and gain stability, the role of the private sector throughout the development process is increasingly seen as essential, as recognized in the g7+ New Deal for Engagement in Fragile States.1

Private firms can provide the jobs and services needed to increase income levels and meet societal needs. They can also contribute to trust and stability by building functioning markets and trading relationships that are inclusive of different groups in society, sustainable, and operate with integrity. In addition, firms often contribute directly to local social programs, and work with governments to enhance the investment climate.

However, in some cases, individual elements of the private sector have been known to act in ways that sustain, exacerbate, or even cause conflict. Accordingly, investors in conflict-affected markets must make deliberate efforts to identify how their investees can operate with positive intent, and to understand the business benefits of operating in ways that benefit all groups in society.

Private investors face many constraints in FCS. Such economies tend to rank low on investment climate indicators—especially quality of infrastructure, market size, and institutional trust. As a result, the level of private investment in FCS remains low, even if the size of an economy and its geographic characteristics are taken into consideration. Nevertheless, there are business opportunities, especially when countries are in transition after a war or decades of isolation.

Despite the investment opportunities, the challenges private firms face in FCS are often too many to overcome on their own. In this regard, development finance institutions (DFIs)2 can play a key role by providing a broad range of investment and advisory services that can help address the market and institutional failures that limit private sector growth and impact.

IFC has an extensive track record of investing in a wide range of sectors in FCS since its inception. These efforts intensified over the past decade and IFC has invested in sectors ranging from power and transport, to finance and agribusiness, in approximately three-quarters of countries it classifies as FCS. The largest investments by dollar volume have been in financial services, energy, telecommunications, and manufacturing, while the greatest number of investments have been in the financial services industry. Since 2014 IFC’s investments in FCS have increased in number by the greatest amount in the transportation, agriculture, and finance sectors, with the latter two assisted in many cases by blended finance (a combination of concessional funding provided by development partners and commercial funding provided by IFC and co-investors). IFC has also provided a higher amount of advisory services in FCS relative to its investment levels, than in non-FCS.

Some of the tools IFC is using to engage in FCS include formulating comprehensive development strategies that use a combination of public engagement, capacity building, and investment to create markets; using dedicated advisory programs; leveraging financial intermediaries to reach smaller companies; using risk-mitigation techniques such as guarantees and blended
finance; and engaging extensively on environmental and social issues and due diligence with respect to the integrity of investors and firms.

IFC’s investment process in FCS includes several important approaches that are particularly pertinent to the context, including: 1) early engagement on critical fragility issues such as integrity due diligence; environmental and social issues; conflict analysis; and government, macroeconomic, and security assessments; 2) carrying out extensive project preparation work, including addressing policy issues, and improving private sector and government capacity; 3) identifying viable sponsors and potentially bringing in new ones; and 4) recognizing the greater need for blended finance. IFC senior field country managers have identified additional key issues to consider when investing in fragile and conflict-affected countries, which include being flexible and patient; developing deep, local knowledge; identifying good local investors and firms; developing knowledge about the political economy; and being ready to seize opportunities when they emerge.

Based on experience, IFC has identified seven key principles for engaging with the private sector to achieve growth, create jobs, and improve stability in FCS. These ideas are relevant for all stakeholders—DFIs, governments, impact investors, private companies, and others—that have a desire to develop the private sector in FCS in ways that have positive impacts on their societies:

1. **Be conflict sensitive every step of the way.**
   To ensure that engagements create inclusive growth and stability, use a “fragility lens” to identify the conflict context, potential impacts of the conflict on investments, and the impact that investments could have on conflict.

2. **Avoid the dilemma of choosing between short-term and long-term impact.** Long-term and immediate development work are not mutually exclusive but must go hand-in-hand. In the short term, development actors can help mitigate immediate risks to help bring jobs and stability to communities at risk, while also working on the long-term fixes to regulatory frameworks and infrastructure that are necessary to realize the potential of private firms.

3. **Act fast during transitions but remain engaged during setbacks.** Development institutions and other investors can take more risk early on, identify and engage in those areas where private operations are possible, signal the feasibility of investments, and empower firms that can drive change. In most contexts, development institutions can engage, for example through a variety of instruments, including advisory work, trade guarantees, finance for micro, small, and medium enterprises, and public-private dialogues, or they can engage on the periphery of areas with active conflict.

4. **Commit more than money. Investing in and developing markets in FCS takes more than money.** Financial support must be accompanied by advice, regulatory reforms, staff presence on the ground, capable intermediary organizations, capacity building, management of complex environmental and social issues, and recruitment of strong lead investors.

5. **Stick to standards but be flexible on the timing.** Cutting corners on environmental and social risk management is likely to be shortsighted as higher standards help reduce project risks in the medium term, minimize social harm, and help lower the risk of future instability. However, adopting good environmental and social standards in FCS is likely to take longer than in other settings, and requires flexible timing and additional resources.

6. **Bring in new players and innovate.** An essential part of achieving stability involves engaging new and innovative investors and firms that can create a dynamic and growing private sector, while also rebalancing the local power dynamics. Innovations such as new technologies that reduce the need for fixed investments can help as well in overcoming obstacles.

7. **Keep markets open for international trade and investment.** In fragile markets, seeking opportunities abroad can often fill the vacuum in domestic economic activity. Strengthening trade facilitation and related infrastructure, as well as supporting investment climate reform can help international trade and investment to achieve its
stabilizing potential by helping markets to grow and strengthening the environment for peace.

Looking ahead, while much has been learned about generating private investment in FCS, there are several areas where further work by development institutions and other stakeholders could help improve outcomes. These include: 1) Enhancing understanding of how the private sector can contribute to conflict prevention. 2) Exploring ways to assist the private sector to address the needs of displaced populations, e.g. via hiring refugees; investing in companies owned by, or employing, refugees; and supporting firms adapting their core business to better serve refugees. 3) Developing a common set of principles on conflict-sensitive approaches to investment that could provide DFIs and other investors with a framework for operating in challenging environments. 4) Working across DFIs to share knowledge and develop joint solutions on how to collectively address some of the biggest challenges to operating in FCS.
INTRODUCTION

Conflict impoverishes communities, and poor communities are more vulnerable to conflict. This vicious cycle condemns over a billion people to ongoing fragility, conflict, and poverty.

Private enterprises can help break the cycle of fragility, conflict, and poverty. By creating jobs and income, businesses support livelihoods, and can contribute to social cohesion and become a source of stability. The private sector, and the promise it holds for stability and development, is an integral part of the mission of the International Finance Corporation (IFC) and the World Bank Group’s Maximizing Finance for Development approach. As a development finance institution (DFI), IFC’s role is to direct its efforts toward countries where financing and advisory needs have not yet been met by existing market providers. Increasingly this involves focusing on the most challenging investment contexts —those where the private sector is underdeveloped. As the largest DFI with a global presence, IFC has gained significant experience in supporting the private sector in these challenging markets, and has been able to demonstrate the investment potential and viability of the private sector in difficult contexts.

This study takes stock of the latest discussions regarding the private sector’s role in conflict-affected countries, and highlights its impact, challenges, and opportunities. Drawing on available data and IFC’s own experience and observations, this paper also recommends approaches to addressing the impediments to investing in and promoting broader private-sector growth in FCS.

BOX 1 What Types of Fragile and Conflict-affected Situations are Discussed in this Report?

Fragility is associated with governments’ failure to fulfill the basic needs of their citizens—whether through lack of capacity or lack of desire. The concept of fragility refers to the potential for adverse outcomes due to the absence of fundamental structures that ensure stability. Conflict is, by contrast, an actual event: a collision between specific parties. However, fragility and conflict are often intertwined—fragile situations often evolve into conflicts, and these conflicts bring about protracted periods of instability and fragility. Therefore, the dynamics of conflict and fragility tend to affect states simultaneously.

This report discusses private enterprises in fragile and conflict-affected situations (FCS), with a focus on those with dimensions of conflict—e.g., countries at a high risk of conflict, an active subnational or interstate conflict, or that are in post-conflict transition. Where possible, the report attempts to focus on the immediate post-conflict recovery phase, where the need for development is greatest and the challenges for investors remain daunting.

To highlight empirical patterns in their data, the authors of this report used the World Bank Group’s Harmonized List of Fragile and Conflict Situations. Data on IFC operations include as FCS all those countries that have been on the World Bank Group Harmonized list within any of the past three years.
THE PRIVATE SECTOR’S STABILIZING EFFECTS IN FRAGILE AND CONFLICT-AFFECTED SITUATIONS

Overview – Growth, Jobs, and Stability in FCS

Although fragile and conflict-affected economies exhibit a wide variety of characteristics, there are some widely found elements, mostly related to weak and non-inclusive institutions. There are often tensions and grievances between ethnic or regional groups that drive conflict. Government institutions may not be able to provide adequate services, and informal institutions—often non-inclusive, i.e. available to only certain segments of society—may take a large role in managing daily life and commerce. There is often a fundamental lack of trust in institutions within the country. Significant environmental and resource issues may have played a part in driving conflict. Poverty is often substantial, and people lack formal employment. The private sector may be fragmented, operate in only a few sectors, and have limited capacity and supply chains.

Efforts to improve the outlook for people in FCS often focus on stabilizing immediate conflicts, addressing grievances, and building trust and stronger institutions. But the private sector, jobs, and growth are also important. The World Bank’s World Development Report 2011, Conflict, Security and Development, emphasizes the need for security, justice, and jobs in FCS. The g7+ and other partners’ New Deal for Engagement in Fragile States includes the creation of economic foundations through employment and livelihoods as one of five peace and state-building goals.

Research on the impact of jobs and growth in FCS provides support for the role of economic activity in promoting stability and poverty reduction in conflict-affected situations. However, the way the private sector engages (e.g. the choice of sectors and how engagement occurs with partners and the community), and the overall context in which the private sector operates (e.g. strength of government institutions), appear to be important in realizing these potential benefits. Beyond the impacts on stability, the important role of jobs and the private sector in helping people to escape poverty is well established. Thus, promoting an inclusive and sustainable private sector in conflict-affected countries is essential for long-term prosperity and stability.

The rest of this section reviews the role of the private sector in promoting critical needs in fragile and conflict-affected countries—employment, services, and building trust and stability (Figure 1). Then the last section looks at the spectrum of potential impacts, and how private sector firms can ensure their engagements live up to the potential for positive impact.

The Private Sector as an Engine of Growth and Job Creation

The private sector can generate jobs in FCS, which is important for reaching the Sustainable Development Goals, and especially Goal 8: Decent Work and Economic Growth. Generating jobs is also closely intertwined with the first SDG on ending poverty. Jobs generate income for people living in FCS, can help lift them out of poverty, and significantly reduce their incentive to engage in conflict.

Even a single company can generate a high number of jobs. For example, in Haiti in 2010, Grupo M invested in textiles and apparel manufacturing, and nine years later, the company employs over 10,000 people. In 2015, Cargill and its partners invested in Côte d’Ivoire’s cocoa industry to strengthen its value chain. This involved upgrading logistics for 43 cocoa cooperatives, and providing support for 70,000 farmers.
Private enterprises can also create inclusive jobs, another stabilizing effect. By creating livelihoods for all sectors of the population, including marginalized and disenfranchised groups, the private sector can contribute to economic development that reaches all parts of the population—moving the country toward shared prosperity. In Colombia, for example, the local subsidiary of General Motors, GM Colmotores, partnered with a non-governmental organization to train and employ former paramilitary fighters.7 In the Mindanao region of the Philippines, which has suffered from violent conflicts for generations, Paglas Corporation and La Frutera, Inc. established a banana plantation in the 1990s that has created jobs for both Christians and Muslims, including ex-combatants.8 The economic opportunities created by this joint venture have helped promote reconciliation between the two religious communities.9

Ensuring women are included in employment generation is essential. Conflict often brings an increase in the number of female-headed households, and a decrease in public services, security and, in many cases, a decline in resources tied to men such as land and informal networks. As a result, female-headed households are more likely to suffer from extreme poverty.10 Gender inequality is correlated with greater levels of violent conflict, and women’s participation in economic life is important for conflict prevention.11 Post-conflict situations can present opportunities to improve the legal and social environment for women, which in turn improves women’s job prospects. In addition, the greater empowerment of women improves development and stability.

**Meeting the Population’s Needs for Essential Goods and Services**

For countries to transition toward stability and prosperity, governments need to provide a wide range of stabilizing functions for which they often
lack sufficient capacity. The private sector can help close some of these critical gaps—by building basic infrastructure, restoring connectivity, and paying taxes for the government to use in providing healthcare, education, and other services.

Critical infrastructure—such as roads, electricity, telecommunications, and sanitation—can be funded by the private sector through public-private partnerships. An example of this is the Liberia Electricity Corporation. In coordination with other development partners, IFC structured a partnership between the government of Liberia and a private partner, which expanded the reach of affordable electricity from 500 connections to ultimately serve 165,000 Liberians. In fragile and conflicted-affected countries, telecommunications network improvements are also often driven by private investment. In Afghanistan, for example, mobile cellular telephone subscriptions increased from fewer than 1 per 100 citizens in 2003 to over 60 per 100 by 2015. In Sierra Leone, the subscription rate improved from 2.4 per 100 citizens in 2003 to 89.5 per 100 by 2015.

As already noted, in addition to delivering needed services, formal businesses also provide the government with the tax revenue necessary to fund social services and reconstruction needs. In 2015, in Afghanistan, the revenue from the taxes on goods and services paid by private firms corresponded to four times the total net assistance provided by development agencies. Thus, as a stronger formal private sector will result in a broader tax base in FCS, the potential for tax revenue from the private sector is much greater than the amount currently realized.

**Increasing Trust and Social Cohesion through Business Action and Interlinked Markets**

Through carrying out their everyday operations, private enterprises can increase trust among different entities/players in the market and contribute to social stability. One example of how this can be achieved is through governance and standards such as those followed by foreign investors and foreign companies entering FCS markets. Foreign investment agreements increasingly include provisions on benefit sharing among investors, different levels of government, and host communities, as well as provisions for risk management in areas such as human rights and social and environmental standards.

Similarly, a growing number of lending agreements from commercial banks and development finance institutions require project operators to undertake environmental and social impact assessments, and regularly report on compliance. This is especially the case with large-scale oil, gas, mining, and infrastructure projects, and the time horizons for such agreements can span 20 years or more. Use of these agreements is also becoming more common with foreign investments in agribusiness, manufacturing, information technology, tourism, healthcare, financial services, and professional services.

In addition, private businesses can provide financial support for local security programs, social programs (education, health, and housing), and socio-cultural programs (e.g. fostering non-violent methods of conflict resolution). In some cases, businesses engage in these activities to comply with standards set by their stakeholders, or because the business owners want to gain a “license to operate” in a new community. Businesses have also collaborated proactively on efforts to enhance social cohesion in their markets of operation. In Sri Lanka, for example, business associations created initiatives to bring the businesses of different ethnic groups together.

Businesses can also be directly involved in state-building through public-private dialogues (PPDs). PPDs are structured engagements that generate trust by bringing different stakeholders together to discuss issues related
to economic and political reforms. PPDs aim to improve transparency and confidence among diverse groups through collaboration on policy and regulatory reforms to improve the business climate and prospects for growth. There are many examples of PPDs in FCS. For example, the Liberia Better Business Forum encourages better quality employment, poverty alleviation, and economic development by improving the business environment. So far reforms have helped to create over 20,000 jobs, and increased business registrations and private investment. The Myanmar Centre for Responsible Business is another successful PPD.

In some cases, private enterprises have played a direct role in peace processes. While this is not common practice, under the right conditions, the direct participation of private sector entities can have a stabilizing effect. In a variety of locations (South Africa, Nepal, Kenya, the Philippines, Rwanda, the South Caucasus region, Sri Lanka, and Uganda) the business community’s participation in peace mediation and conflict prevention has reaped rewards. In South Africa, for example, business leaders helped facilitate the country’s transition from apartheid to a multiracial state. The Consultative Business Movement held broad-based consultations with political parties, civil society, and the media, and convened a process that led up to the 1991 National Peace Accord, which put into motion South Africa’s transition to democracy.

In this transition, the private sector was able to act as a “stabilizing agent” because it occupied the space between the apartheid regime and the African National Congress, and thus could credibly promote dialogue, trust-building, and consensus-building.

**Intentional Harm, Intentional Good, and the Spaces in Between**

Although, for the most part, the private sector behaves rationally in ways that reflect its interest in peace and stability, in some cases, individual entities have acted in ways that sustain, exacerbate, or even cause conflict. In situations where law and order has collapsed, the potential for harm is magnified. Since money is so often a source of power, those who seek to advance their own interests at the expense of others (intentionally or not) can exploit their position within, or closely connected to, the business community. Still other actors in the private sector may cause harm due to negligence, as they consider stability and good environmental and social practices secondary to, or separate from, their responsibility to maximize company profit.

Multinational firms managed from outside FCS are particularly vulnerable to the latter risk. There are many examples of business practices that unintentionally contribute to exclusion. In post-conflict Serbia and Bosnia-Herzegovina, for example, workers who come...
from rural and/or minority communities, as well as others, have had disproportionately fewer opportunities for employment in multinational ventures.\textsuperscript{19} Local firms can also be constrained by the legal or institutional context in which they operate. For example, they can be compelled to contribute financially to military operations. Or discriminatory laws, which they had no role in shaping, can obligate them to avoid certain regions and/or exclude certain segments of the population from their operations.

As shown in Figure 2, there are a variety of ways that firms can intentionally generate positive and negative impact. A single firm can engage simultaneously at multiple points on this spectrum—and particularly in the middle ground where separate business activities may have impacts in different areas. For example, a social enterprise may seek to employ excluded individuals and alleviate ethnic grievances, but at the same it has a production line that causes pollution that harms local livelihoods and people’s health. Similarly, a large-scale multinational may donate resources to improve a local village’s health clinic but may be engaged with (and support) individuals or organizations that use their public connections to derive inappropriate fees for their work.

In recent decades in fragile and conflict-affected markets, there have been numerous examples of international firms, as well as local firms that source capital from international investors, shifting toward the right end of the spectrum in Figure 2. This has come about, for example, through greater awareness of environmental, social, and governance (ESG) risks, and through the rise of international organizations and campaigns that promote more responsible business practices in developing markets. Additionally, many companies now recognize that socially-responsible business practices can benefit both the company and the community.

There are encouraging examples too of companies making substantial long-term commitments to work with host-country governments through social investments or corporate foundations. These partnerships are important, since research shows that multinational firms make the biggest contribution to peace-building when they work with partners, and especially with local communities and the host-country government.\textsuperscript{20} One example is the Niger Delta Partnership Initiative (NDPI) Foundation. This was established in 2010 by Chevron, a firm that has since then committed millions of dollars to the foundation and leveraged additional funds from donor agencies. After six years, an evaluation showed that NDPI programs were helping to achieve widespread change by bringing international attention and private investment to the region.\textsuperscript{21} The partnership’s greatest impact has been through economic development and peace-building, creating a positive environment for economic growth and peace to take hold.

To ensure that business operations realize the potential for positive impact in FCS, investors must make deliberate efforts to identify how their investees can operate with positive intent and understand the business benefits of operating inclusively. Tools such as ESG plans, inclusive business strategies, and conflict-sensitive investing frameworks, which are discussed in sections five and six of this report, can not only alleviate risks to businesses and their operating environment, but can also open new avenues for business growth that provide a virtuous cycle for the company, its investors, and the local environment.

“We may be tempted sometimes, just because we want to reach our targets, to get a project approved without paying too much attention to the strength of sponsors. But when we’re going through crisis, the strong sponsors tend to be most able to manage and address the crisis.”

—BABACAR FAYE, IFC’S RESIDENT REPRESENTATIVE IN DEMOCRATIC REPUBLIC OF CONGO
WHAT PREVENTS BUSINESSES FROM FULFILLING THEIR POTENTIAL AND WHAT ARE THE OPPORTUNITIES?

Private Sector Characteristics in FCS

Countries affected by fragility and conflict are not simply at different levels of development; their business sectors tend to have significantly different characteristics. Compared to other countries at the same income level, on average, firms in FCS differ in their size and growth as they operate in small fragmented markets, where little investment takes place. Informal businesses are pervasive, particularly in sectors such as agriculture and services.

Economic activity also differs in terms of sectoral and market focus. Conflict-affected countries tend to have a greater concentration of businesses in the agricultural and services sectors, as industries such as manufacturing and construction tend to contract faster during periods of tension, and agriculture and services support the immediate needs of the local population. Also, on average, levels of trade as a share of GDP tend to be lower. Foreign sources of income such as remittances and foreign aid frequently sustain a large part of economic activity. Foreign investors may find opportunities in industries such as telecoms, mining, and banking which are characterized by low domestic competition, large investment requirements, and/or sustained by foreign demand. These broad trends mask the significant variations across regions and conflict situations. For example, for the first year after a conflict, there is often a construction boom, driven by foreign aid, and the level of trade as a share of GDP increases sharply.\(^{22}\)

Actors and business relationships are also different. Markets may rely heavily on foreign and regional investors for income, know-how, and stability, as local capacity is diminished. Regional players may be particularly important investors because of their combination of local knowledge and greater access to resources. In some cases, informal institutions, which are often non-inclusive as they are associated with traditional, ethnic, or other groups, may be important in regulating business activity. In other cases, businesses, and particularly large companies, may have arrangements with government to carve out their own business environment. Local businesses are often controlled by political elites. Overall, the potential for non-transparent rules, exclusion, and rent-seeking is high.

“You have to get the person you’re doing business with right. If you get that right, nine times out of ten, it will work out. I identified six or seven people I thought were good people, with good businesses, in growth sectors. Once you build relationships—it’s not wining and dining, it’s saying you’ll do something and delivering on it.”

— VIKRAM KUMAR, IFC’S COUNTRY MANAGER FOR MYANMAR
Constraints to Investments

Doing business—starting, operating, and expanding a firm—is difficult amid fragility and conflict. More than 70 percent of fragile and conflict-affected countries are found in the bottom quartile of the World Bank Group’s Doing Business rankings. Market challenges are often similar to those in other emerging markets, except that they are made worse by the conflict: shortages of labor, skills, and capital are compounded by a lack of modern infrastructure, regulatory inadequacies, and low demand. In addition, FCS face business risks that are much greater than those in other emerging markets. These include the destruction of physical capital, as well as deaths and injuries, weak state control, lack of security, and supply-chain disruptions.

Figure 3 below highlights these realities in more detail. When business executives in FCS were asked to evaluate aspects of their operating environment, they rated most of them as problematic—and many as very problematic—as shown by the predominance of data points in the right half of the chart. Businesses regard conditions related to their suppliers and markets—such as reliable energy supply, the quality of transportation infrastructure, the availability of finance, and low demand for their products—as their most difficult challenges. Not surprisingly, many of these challenges were also seen as more constraining in FCS than in other countries, as indicated by the vertical axis in Figure 3, which illustrates the extent to which the FCS responses differed from their counterparts in low income and lower-middle income countries. For some market challenges, such as investor protection, electricity supply, and access to loans, the difference is particularly pronounced.

These survey data align well with the findings of the World Bank’s Enterprise Surveys, which ask local
business owners to rate their top business challenges. The surveys especially highlight the severity of the challenges that poor infrastructure poses for businesses operating in FCS: frequent and prolonged power outages and water supply shortages. For example, in the most recent Enterprise Survey for West Bank and Gaza, firms reported that their losses due to electrical outages average over one fifth of their annual sales; a result of nearly 29 outages per month on average. In South Sudan, because of similar power grid failures, two-thirds of all power consumed by firms in 2014 was produced by privately owned generators, which added to firms’ operating costs, limited their size, and reduced their returns on investment.

Executives responding to the WEF Surveys also regarded institutional failings as important obstacles, including weak intellectual property rights, lack of judicial independence, and weaknesses in the legal framework for settling disputes. The quality of public governance was also seen as a major obstacle, including demands for irregular payments/bribes, untrustworthy political leaders, and favoritism in government decision making.

In general, executives in FCS perceive regulations as relatively less burdensome than market and supply conditions and risks. Often this is due to widespread belief that regulations will not be enforced, or they will only be applied selectively. This highlights the extent to which, for many companies currently operating in fragile territories, the predictability and enforcement of regulations matter more than the actual constraints that the rules impose. However, for the success of long-term growth, regulations do matter. Infrastructure projects, for example, require a minimum government capacity to operate, but also basic regulations and enforcement to protect property rights.

Another common business challenge in FCS is the volatility and unpredictably of the operating environment. For example, in the 2010 World Bank Enterprise Survey for Mali, only 2 percent of respondents identified political instability as a top obstacle to doing business, while access to finance was the top concern (44 percent). But by 2016, 23 percent of respondents in Mali identified political instability as their biggest obstacle, while access to finance had become the second most frequently cited obstacle (20 percent). It is not likely that financing had become less scarce between 2010 and 2016, but rather that the deteriorating political situation had become a much greater concern. When political instability causes such a pronounced decline in market conditions, it is no wonder that conflict and fragility are so damaging to the health of the private sector.

All these challenges in FCS impose constraints on businesses such as raising the cost of doing business, limiting access to the things that businesses need to grow, and imposing hurdles that make growth harder to achieve. These constraints also reinforce each other in negative ways.

The Impact – Low Investment in FCS, Lack of Inclusive Growth

The net result of business activity constraints in FCS is lower prospects for the kinds of growth and dynamism that the private sector needs to rapidly lift people out of poverty, and do so in a way that creates trust, inclusion, and stability. IFC’s analysis brings this into sharp focus. Although the potential for foreign investment in FCS was generally lower due to small markets and low levels of trade, actual foreign investment was even lower, which suggests that in 2014, alone, FCS were deprived of foreign direct investment (FDI) of at least $13 billion. Under conditions of peace and stability, FDI flows into these areas would be at least twice as much as is currently the case.
How FCS Challenges Shape Firm and Investor Strategies

Despite the large number of constraints in FCS, business operations do go on. Both local and international firms use several common strategies to deal with the challenges of doing business in FCS. These include avoiding geographic areas where active conflict is possible, strengthening ties with local communities to build trust, operating flexibly in order to be prepared for sudden shocks, hiring security, and following safe business practices, such as operating in daylight, or using secure enclaves.

Other strategies used by firms (especially foreign firms) to address challenges in FCS include:

• Using key staff with experience and understanding of FCS and hiring local staff as quickly as possible to provide access to local intelligence that can help mitigate security risks.

• Employing conflict-sensitive analyses and conflict-sensitive business practices (see Chapter 3) and adopting international environmental standards to mitigate reputational risk in international markets.

• Investing in stages—starting small, and only expanding when greater knowledge has been gained.

• Engaging with governments and development institutions to shape the business environment, including complementing government functions that may be missing, e.g. developing government officials’ knowledge and capacity related to the investor’s industry.

• Leveraging the systems and resources of other countries, e.g. securing loans in fragile states based on assets in countries with more stable legal systems; flying specialized equipment to other countries for repair and maintenance.

While many of these approaches can drive positive change, the way firms adapt to market conditions and the complex political economy can become part of the problem, rather than the solution. Firms may not invest adequately in their plant and people, they may pursue short-term strategies that do not build for the future, and they may adopt operating strategies and footprints for security that reinforce exclusion. Local firms may develop operations in the informal economy or rely on non-inclusive informal institutions and networks. They may also diversify their operations with illicit conflict-related activities. Multinational firms may find themselves supporting functions such as building government capacity, which are beyond their legitimate role, drain resources that are required for productive investment, and result in complex conflicts of interest.

Patterns of Post-Conflict Investment and Potential for Returns

Although there may be special difficulties to overcome, it is possible to find good investment opportunities in FCS. Trade, aid flows, and remittances can create demand that helps sustain economic activity. While areas for potential investment are very country specific, there are some historic patterns that suggest where post-conflict investment opportunities may lie. As noted previously, the potential for economic transformation is greatest.

“We are working in a very difficult environment in the Democratic Republic of Congo, but when it comes to investment transactions, we’ve used pretty much the same standards that we use in a country like Kenya. We can’t copy—we need to be more thoughtful and innovative. How can we keep doing business without taking into account the economic situation?”

—BABACAR FAYE, IFC’S RESIDENT REPRESENTATIVE IN DEMOCRATIC REPUBLIC OF CONGO
“The first wins, the first investments are going to be the local investments. You really need to know the region and the sponsors. You need to put a lot of effort up front. You also have to be very realistic about firms’ capabilities and make sure your requirements are aligned.”

—DALIA ABDEL AZIM MOHAMED WAHBA, IFC COUNTRY MANAGER FOR LEBANON

“You have to wait it out. By definition, frontier markets are not going to improve immediately. These are eight or 10-year plays. It’s not as though there is a race to the top. I’m very comfortable with that.”

—VIKRAM KUMAR, IFC COUNTRY MANAGER FOR MYANMAR

during transition periods. Recent evidence shows that only a year after the end of conflict, foreign investment inflows increase dramatically, and within three years, inflows have about doubled, relative to levels during the final years of conflict. After peace has been established, both the construction and services sectors pull labor out of agriculture to a significant extent. In the medium term, the telecommunications and transport sectors tend to show higher rates of growth. Mining and other sectors that rely on natural resources remain stable throughout the post conflict years.27

The period of post-conflict transition also represents an opportunity to implement broad-based economic reforms, as governments are often eager to change the status quo, as they want to signal to investors that their country is open for business. Over time, manufacturing and financial intermediation, which tend to be low just after conflict ends, begin to revive. In the immediate aftermath of conflicts, economies often turn to international trade to fill the vacuum in domestic economic activity. Also, in comparison to other types of investment, regional investment often takes place on a relatively larger scale.

FCS investments can not only be commercially viable, but can also produce steady returns. Multilateral Investment Guarantee Agency research shows that over the period 2006 to 2011, the average rate of return on FDI in FCS (14.5 percent) exceeded that of all low-income countries (9.7 percent), and the global average (6.2 percent).28 However, the amount of viable investments like these can be limited by the constraints discussed above. The next section discusses how development institutions can help further expand the private sector potential in FCS.

FAST FACT ON CONFLICT-AFFECTED STATES
On average, the construction sector doubles its share in total value-added five years after conflict ends.

The Role of DFIs

Ultimately, despite the many coping strategies and investment opportunities, the challenges facing the private sector in FCS are often beyond the capacity of private firms alone. These challenges include addressing grievances, building government capacity and human resources, developing appropriate regulations and capable institutions, managing natural resources effectively, coordinating the supply of inputs, building adequate infrastructure, and much more. Effectively managing these challenges requires collaboration with other actors, including other private companies, government, the international community, and development finance institutions.

“...in an institution like IFC, if you’re not pushing the boundaries, you’re underperforming. There is limited downside. By staying in a comfortable space in a comfortable market, you’re not adding value Who else will take this kind of risk?”

—VIKRAM KUMAR, IFC COUNTRY MANAGER FOR MYANMAR

Development institutions have a key role to play in this environment, as they can provide a broad range of investment and advisory services that can help address the many market and institutional failures that limit private sector growth and impact in fragile and conflict-affected countries. Many development institutions have a part of their organization that focuses on public sector development, and works directly with government on critical governance and institutional issues. Most also have private sector arms (development finance institutions), with mandates to invest directly in private enterprises, and provide funds, risk mitigation, and advice. DFIs’ mandates require that they serve in difficult markets, where private capital cannot be obtained on reasonable terms.29 While DFIs seek to invest on commercial terms, their unique government relationships and operating models enable them to take higher risks than institutions that are strictly commercial, while also pursuing development objectives.

DFIs invest a significant amount in the private sector in fragile and conflict-affected states. The most recent available data indicate that in 2016, alone, 15 of the largest DFIs invested a total of $1.3 billion. Of this amount, IFC accounted for approximately one-third.30 As a result of a strategic priority to increase investments in FCS, IFC has more than doubled investments in these countries over the last 10 years, and has ambitious plans to further increase investments over the coming 10 years. IFC has also mobilized significant investments from partner banks, at a rate in many cases higher than IFC’s mobilization of investments in lower and lower middle-income countries that are not FCS (Figure 4).31

Despite the growing role and importance of DFI commitments in FCS, other financial flows such as...
Official development assistance, foreign direct investment, and remittances are often much larger. However, DFIs play a crucial role in pioneering investment that creates markets and catalyzes other investments, and this role may grow as more DFIs focus on the private sector in challenging environments. DFI engagement also tends to be greater in post-conflict situations rather than during active violent conflicts, when private investment is most often from local investors.

The remaining sections in this chapter will review IFC’s experience in FCS to draw out key lessons for further developing the private sector.

**IFC’s FCS Focus and Results**

IFC, in partnership with the World Bank and MIGA, development partners, and clients, has a long history of supporting private investment and growth in FCS – both through investment and advisory services. One of the early IFC engagements in a post-conflict setting was in Indonesia in the late 1960s, when the country was emerging from a traumatic period of prolonged conflict. In an effort to help bring much-needed foreign investment to the country, IFC supported work on crafting new laws and regulations governing joint ventures with foreign companies and then invested in early precedent-setting examples.

The focus on FCS countries deepened in the late 1990s and early 2000s, following the conflict in the Balkans. One of IFC’s first investments in the region came in 1996, when IFC helped the German development company IPC launch Bosnia and Herzegovina’s micro and SME finance pioneer, now ProCredit Bank, less than a year after the signing of the Dayton Accords.

IFC’s focus on FCS further intensified over the past decade. In 2008, IFC created the Conflict-Affected States in Africa (CASA) Program, a donor-supported initiative focused on creating enabling conditions for private sector in the Africa region. In 2010, IFC added FCS to its strategic priority areas, and in 2012 established the FCS Coordination Unit following the publication of the World Development Report 2011 on Security, Justice and Development. IFC’s commitment to this group of countries was reemphasized in 2018 through the ambitious goals to increase the share of IFC’s investments in FCS and IDA to 40 percent by 2030.
**IFC Investment Trends: Sectors and Geographies**

The sectoral breakdown of IFC’s long-term investments in FCS over the past 5 years is illustrated in Figure 5.[^31] With regard to IFC’s *dollar volume* in FCS, the four largest sectors have been financial services, energy (electricity/gas/steam), information and communications technology (but largely telecommunications), and manufacturing. (Figure 5A).

IFC’s greatest *number* of investments have been in the financial services industry (Figure 5B), reflecting IFC’s corporate-wide focus on strengthening the banking sectors in developing markets, including facilitating the financing of MSMEs. This is particularly significant in FCS markets where there is a higher proportion of smaller firms. IFC has made fewer investments by number in the telecommunications and energy sectors in FCS as the greater size of such projects mean that they are less likely to be implemented frequently in individual countries. Also, due to their complexity and the involvement of multiple partners, energy projects have a particularly long gestation period.

Figure 5B also illustrates that IFC’s financing has been significant in several other sectors—particularly agriculture, forestry, and fishing. In the last five years, IFC has increased the number of its FCS investments the most in transportation, agriculture, and finance[^34]—all growing faster for IFC in FCS than in other low and lower middle-income countries. IFC’s growth in FCS in agriculture and finance has been assisted by the use of blended finance (a combination of concessional funding provided by development partners and commercial funding provided by IFC and co-investors).

“The focus on SMEs has proven very efficient. When we provide financing, we’re helping with capacity building, facilitating access to markets, and improving the investment climate.”

—BABACAR FAYE, IFC’S RESIDENT REPRESENTATIVE IN DEMOCRATIC REPUBLIC OF CONGO

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**FIGURE 5** IFC’s Investments in FCS, 2014–2018, by Sector

*Source: IFC calculations based on project data aggregated by ISIC Rev.4 Industrial Classification.*
Overall, the investment data show IFC’s engagement in a wide range of sectors, including infrastructure, finance, and services, and strong growth in both the capital intensive and labor-intensive sectors. In some sectors such as construction, where there has been significant investment from external sources, IFC has not been very active. This is generally due to the fragmented nature of the construction industry, which involves many local players, making it challenging for IFC to invest with the necessary scale. However, IFC does facilitate growth of the construction industry by investing in companies that supply building materials, lease equipment, invest in real estate, and build infrastructure.35

Over the last 10 years, IFC made investments in approximately three-quarters of all countries classified as FCS during that time. In the remaining FCS, IFC did not invest where there was a lack of viable investment opportunities because of: 1) widespread conflict and/or the absence of rule of law; 2) an inhospitable investment climate; or 3) very small economies where the investment sizes were too small for a large investor such as IFC.

Where IFC has been able to invest, the larger investment amounts have tended to be in countries with larger populations, although many other factors affect the level of IFC financing, including the scale of recent conflict, the state of the investment climate, and the state of infrastructure development. In 20 percent of countries that are FCS, the average IFC investment has been over $40 million per year, in another 30 percent, the average IFC investment has been between $10 million and $40 million per year, while in half the countries, IFC’s average investment has been below $10 million per year.

**IFC’s FCS Portfolio Performance**

A recent review of IFC’s FCS portfolio shows generally sound project and loan performance, with the level of non-performing loans and write-offs comparable to the rest of IFC’s portfolio. In many cases, IFC’s FCS projects have also achieved satisfactory project financial success, overall. However, on average, IFC’s own profitability in FCS projects has been below IFC’s overall average. This has been the result of two main factors: 1) higher levels of undisbursed balances, and 2) high IFC expenses per dollar invested. The latter reflects many of the constraints of working in FCS. As discussed above, higher costs result from the extra time required to develop and structure projects, develop the capacity of government staff, evaluate and advise sponsors, address environmental and social issues, ensure the security of staff, and assess the potential impact of projects on the country’s development and stability. Lower profitability also reflects the small size of many FCS investments, which means that the costs cannot be amortized over a large volume of revenue.

**IFC Trade Finance**

In addition to making long-term investments, IFC has supported trade finance in conflict-affected countries through its Global Trade Finance Program (GTFP). The GTFP enables businesses to trade in international markets while also increasing the availability of supplies locally. In many cases, the provision of trade finance is IFC’s first point of entry in FCS markets, and among IFC’s earliest engagements with the financial sector. As shown in Figure 6, IFC’s support for trade in FCS as a share of a country’s total merchandise trade is approaching levels of IFC trade support in low and lower middle-income countries that are not FCS.

**IFC Advisory Services to Firms and Governments**

In addition to finance, IFC has provided a significant amount of advisory services in countries that are FCS, both to firms and to governments. In the last few years, 20 percent of IFC’s advisory program expenditure has been in FCS, a significantly higher amount than the corresponding percentage of IFC investments in FCS, and a higher level per dollar of investment than in low and lower middle-income countries that are not FCS. This is because FCS markets require relatively more advisory services in order to build capacity and for other activities that strengthen the private sector. The largest advisory programs include investment climate work with governments, advice on infrastructure privatization, and advice to financial institutions. Other programs include advice for the manufacturing, agribusiness, and services sectors, and activities related to improving environmental, social, and governance standards. IFC sees significant opportunities in FCS to deepen its support for private enterprises by providing
additional advisory support. For example, supporting financial institutions with non-financial risk mitigation could increase banks’ performance and improve their contributions to surrounding communities through environmental, social, and governance programs, as well as supply chain development.

Key Methods and Tools Used by IFC to Engage in FCS

IFC has developed several methods and tools to use in its engagements in fragile and conflict-affected countries. These can help target investments to achieve impact and address many of the constraints identified earlier in this report.

Special Advisory Facilities

As extensive advisory services are needed in FCS, IFC has developed two special advisory facilities that focus on conflict-affected and lower-income countries. The Creating Markets Advisory Window funds advisory services in FCS and IDA countries to improve the viability of IFC’s investments. This includes providing advice to firms and building their operational capacity.

IFC’s Fragile and Conflict Situations (FCS) Africa program, which was established in 2014, provides advisory resources for the investment teams who work on early-stage opportunities in FCS in Africa. The program has built on the CASA initiative, which, since 2008, has advised on legal and regulatory reforms, built the capacity of SMEs, and improved SMEs’ access to finance. CASA has put people on the ground in most of the countries in which it operates and pioneered the use of a “fragility lens” for its projects (see Box 2). IFC also has several project development facilities such as InfraVentures, which supports the development of infrastructure projects, including those in fragile and conflict-affected countries.

Mobilizing Other Actors and Sharing Risk through Blended Finance

Blended finance is designed to address the issues of high risk and potential low profitability found in many private sector projects in FCS by offering below-market terms for finance and risk-mitigation products. This is accomplished through a mix of concessional funds from development partners such as the World Bank and bilateral development agencies, as well as

FIGURE 6 IFC Trade Mobilization Complement Investments

Source: IFC Calculations; World Development Indicators.
Blended finance is an important part of IFC’s strategy in FCS. Blended finance targets projects that are smaller and riskier—two features that are typical of firms in FCS. In 2018, blended finance supported over 40 percent of IFC’s FCS/Low Income IDA commitments, and over the last five years, nearly half of investments in the financial and agribusiness sectors of FCS. A risk-sharing agreement between IFC, the European Investment Bank, and Ecobank (a pan-African commercial and investment group) illustrates the potential for blended finance. The project was supported by the Global SME Finance Facility, a blended finance facility, and was designed to overcome the challenges of lending to smaller businesses with high risk profiles in very poor countries in West and Central Africa. The project also included advisory services to help affiliated banks scale up their lending to SMEs.

Another example of using blended finance is the Global Agriculture and Food Security Program (GAFSP). This provides investment and advisory services to private agribusiness companies, with the aim of improving opportunities for the smallholders and subsistence farmers that are part of the agribusiness value chain. For example, in Afghanistan, GAFSP helped create a state-of-the-art raisin processing plant that will improve the livelihoods of about 3,000 farmers.37

IFC is expanding the resources available for blended finance in fragile and conflict-affected countries, including through the IDA Private Sector Window (PSW), a $2.5 billion blended finance facility that was designed to mitigate the risks of private sector investment in IDA-eligible FCS and low-income countries. In West Africa, the IDA PSW local-currency facility, which protects against currency fluctuations, enabled IFC to source local currency and purchase bonds to support the development of the housing market in countries including Burkina Faso, Côte d’Ivoire, Guinea-Bissau, Mali, Niger, and Togo. As a result, 50,000 families and businesses are expected to

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BOX 2 How does IFC implement the Fragility Lens in its Projects? The CASA Initiative.

Improving the impact of a project on fragility is at the core of CASA, IFC’s special advisory program to develop investment opportunities in FCS in Africa (see text above on “Special Advisory Facilities”). The program has adopted a “Fragility Lens” to analyze both the political risks associated with implementing an advisory project in a fragile state, and any harmful effects a project might have upon the overall fragile situation on the ground. For each project where the fragility lens is applied, the following questions must be answered during the project’s implementation, supervision, and completion stages:

1. **What is the conflict context in which the project operates?**

2. **What is the two-way interaction between the project and its context?**
   - What possible negative effects could the conflict have on the project (political risk)?
   - What are the project’s expected positive effects on the conflict (outcomes, impact)?
   - What possible negative effects could the project have on the conflict (do-no-harm)?

3. **What are the best ways for the project to minimize its negative effects and maximize its positive impacts on conflict?**

The fragility lens, for example, has helped IFC to consider engaging in the cotton and cashew nut sectors in the north of Côte d’Ivoire, where the ethnic divisions and regional disparities that drive conflict need to be understood.
obtain new mortgage loans; 200,000 people will have a new roof over their heads; and about 250,000 new housing-sector jobs will be created.

Using Capable Financial Intermediary Organizations

This, as mentioned earlier, is also part of IFC’s strategy to multiply its impact in FCS. By supporting local financial intermediaries (FIs) such as microcredit banks, and venture capital and private equity funds, IFC can assist a greater number of smaller enterprises than it could on its own.38 Local FIs have comprehensive local knowledge, and can provide IFC with well-informed advice.39 In return, IFC can provide some level of financial security for FIs operating in underserved regions that are affected by conflict, or that provide finance to underserved segments such as businesses owned by women.40

Afghanistan offers a good example of the use of financial intermediaries in FCS. An estimated three million households in the country lack access to finance, with political, economic, and, security disturbances exacerbating the vulnerability of households and businesses. Since its inception, First Microfinance Bank Afghanistan, has disbursed more than $760 million in loans to more than 540,000 Afghan businesses. The bank, which is an IFC client, is the country’s leading microfinance institution, lending to about half of the country’s active borrowers, of whom 20 percent are women. Another example of using financial intermediaries is Rawbank, the second-largest bank in the Democratic Republic of Congo, and an IFC client, which launched its “Lady’s First” WIN program in March 2010, becoming the only bank in the country with a program specifically dedicated to women in business.

Performance Standards

IFC has a comprehensive set of environmental and social (E&S) performance standards that are applied in all of its projects, and these have also influenced the Equator Principles, which are the standards followed by most global banks. In the FCS context, IFC’s E&S standards are particularly important because substantial social and natural resource issues are often associated with conflicts, and governments in FCS often lack the capacity to address these issues. In many cases, IFC expends extensive resources to help its clients address E&S issues.

Operational Systems

Operating effectively and efficiently in FCS requires several changes to IFC’s normal procedures. These include: 1) a special, limited, FCS Risk Envelope that allows certain high-impact projects to proceed, despite being outside IFC’s normal risk profile; 2) adjustment of policies and procedures so they more readily facilitate engagement in the FCS context; 3) a dedicated unit to provide an FCS strategy, operations support, and promote learning; and 4) the special early application of IFC’s integrity due diligence process, which screens companies for integrity risks. This speeds up project processing and avoids dropping projects later due to sponsor integrity issues.

IFC Strategies

IFC’s current overall approach to development is called Creating Markets. Under this recent initiative, IFC and other members of the World Bank Group work closely together on comprehensive approaches to development, that link policy reform, advice, investment, and the mobilizing of additional finance. This is also closely associated with the World Bank Group’s Maximizing Finance for Development (MFD) program, which prioritizes private sector solutions, where possible, in order to conserve scarce public resources.

The Creating Markets approach is especially important in FCS, where extensive efforts are required to improve policy, build capacity, address environmental issues, and mitigate risks to enable the private sector to thrive. The strategy development process can identify the most appropriate focus areas for engaging the private sector, as well as the instruments needed to foster private sector growth and economic development.

IFC has developed several strategy development tools as part of its Creating Markets approach. The first is the country private sector diagnostic, which IFC and the World Bank undertake to rapidly assess a country’s key constraints and opportunities for market creation. The diagnostic can provide a shared basis for governments, DFIs, and donors to pursue complementary actions to create markets, focusing on the markets with the best prospects. A second important tool is the Anticipated
Impact Measurement and Monitoring Framework (AIMM), which provides metrics at both the project and market levels for assessing the likely development and financial impact of projects.

IFC’s Investment Decision Process in FCS

The tools and approaches discussed above can together make important contributions to effective investing in FCS. Figure 7 below illustrates the overall process that IFC follows in its approach to investing in FCS. In practice, the steps are far from linear, with several iterations involved at different investment stages, which include preliminary engagement with investors and firms, an early look at projects, detailed field appraisal, and a formal review before decisions are made. Nevertheless, Figure 7 captures some important aspects of IFC’s investment process in FCS which are:

- early engagement on critical fragility issues such as integrity due diligence, E&S issues, conflict analysis; and carrying out governance, macro, and security assessments;
- extensive project preparation work, including addressing policy issues, and building government and private sector capacity;
- special efforts to identify viable sponsors (investors and firms) and bring in new ones; and
- recognizing the greater need to use blended finance.

“It’s really a lot of upstream work—what we call creating markets. But you have to be patient. Can I say that we’re going to sign the agreements in the next 12 months? No. You have to be realistic. If you approach it with the same mindset, you might have in other places— ‘I want to finish this in six or 12 months’—you’re going to drop it.”

—DALIA ABDEL AZIM MOHAMED WAHBA, IFC COUNTRY MANAGER IN LEBANON
Can IFC Engage in this Country?
- Macroeconomic analysis
- Security situation
- Governance

Are there Viable Market Opportunities for Private Enterprise?
- Input from IFC networks, local offices, and client relationships
- Country Private Sector Diagnostics (CPSDs)

ESG Performance
- Are ESG and conflict issues manageable?

Integrity Due Diligence
- Are there investors/firms we can work with?

Commercial Viability
- Viable investment plan
- Qualified investor/firm
- Financial, operational risks

Impact (for DFI/Impact Investors)
- AIMM framework results – is the impact assessment satisfactory

Can the Project be Financed on Commercial Terms, with IFC Participation?
- Given the risk/return profile

Creating Markets Approach: Upstream project development, policy reform and capacity building to create viable markets

Invest and implement with project development and risk mitigation instruments, as needed.

NOT OK: EXIT

Work with investor/firm to identify ways to manage or mitigate the risks.

Encourage FDI, venture capital for start-ups, and capacity building for clean but weak sponsors.

Market creation: Advice for upstream project development, capacity building.

Improve impact: linkages, gender interventions, CSR for non DFIs

Structuring, guarantees, blended finance to improve the risk/reward balance if there are important external benefits (e.g. climate resilience, poverty reduction)

NOT OK:

OK

NOT OK:

NOT OK:

OK

NOT OK:

OK

NOT OK:

NOT OK:

OK

FIGURE 7  IFC’s Investment Decision-making Process in FCS
PRINCIPLES FOR ENGAGING IN FRAGILE AND CONFLICT-AFFECTED SITUATIONS

Until recently, international efforts to stabilize conditions in developing countries seldom included promoting private enterprise, but that is changing. Today, there is growing recognition that sustainable development in FCS cannot occur without private sector activity. In this chapter, the authors have taken stock of all the preceding discussions on the role of the private sector in FCS, the constraints and opportunities, and IFC’s experience, and synthesized seven key principles for engaging with the private sector. The following recommendations are targeted at all stakeholders—DFIs, governments, impact investors, private companies, and others—that have a desire to expand the private sector in FCS in ways that have a positive impact on their societies.

Enabling private enterprise to bring growth and stability requires different ways of working than in other low-income settings. The following seven principles apply, each of which reflects very specific dilemmas in FCS:

1. Be conflict sensitive every step of the way.
2. Avoid the dilemma of choosing between short- and long-term impacts.
3. Act fast during transitions, but remain engaged during setbacks.
4. Commit more than money.
5. Stick to standards, but be flexible with timing.
7. Keep markets open for international trade and investment.

Be Conflict Sensitive Every Step of the Way

Until recently, few development finance institutions or other investors would systematically take into account conflict dynamics when designing private sector interventions. Unanticipated reactions from local communities and adverse impacts would either drive initiatives to failure, or mute their impact on stability. Only in the last decade have multinational companies, and especially those in the extractive and agribusiness sectors, begun to manage perceived and actual conflict impacts proactively by using the “fragility lens”. The European Investment Bank was one of the first DFIs to incorporate a similar conflict-sensitive approach in its investment analysis, and IFC’s CASA initiative uses a “fragility lens” in its advisory assignments (see Box 2).

Going forward, analyzing conflict dynamics will be important to ensure that private sector investments yield their potential benefits to society. While much has been learned about how to analyze a conflict-affected environment, much more needs to be understood, and it will be important for investors, DFIs, and others to continue to build on their experience and share best practices.

Avoid the Dilemma of Choosing Between Short and Long-term Impact

In territories at immediate risk of relapsing into conflict, with significant humanitarian needs, and where the economy is not functioning, development agencies tend to focus on quick wins. This includes boosting incomes through job programs, fixing regulations, and setting up ad-hoc institutional structures that could make an immediate difference. State building, developing legal frameworks, improving government capacity, and undertaking major infrastructure projects all take time to materialize—which is time that fragile markets often cannot afford. IFC’s experience has shown that long-term and immediate development work is not mutually exclusive. Development interventions that reduce immediate risks so that jobs can be created for communities should be accompanied by parallel efforts focused on improving...
regulatory systems and the infrastructure necessary to release the longer-term potential of private firms. Every situation is a learning experience and will need to be tailored to the unique circumstances of the environment.

**Act Fast During Transitions but Remain Engaged During Setbacks**

For a long time, the development community has rejected calls to engage in FCS: instead, stabilization was a prerequisite for development work. Yet, unstable situations such as those in the immediate aftermath of conflicts are where development efforts are needed most. IFC has been leading the way for finance institutions to take more risks early on, go to the limits of what is possible in every situation, signal the feasibility of investments, and empower firms that can drive change (see Box 4 on the Seven Principles in Action). In most contexts, development institutions can engage. Working with a variety of instruments such as advisory services, trade guarantees, MSME finance, public-private dialogue, or engagement at the periphery of areas of active conflict can go a long way toward supporting solutions (Box 3).

**BOX 3 Customizing Solutions: States Emerging from Conflict**

Along the conflict continuum, countries exhibit different levels of uncertainty, government capacity, and availability of public goods such as infrastructure, education, and healthcare. An effective mix of solutions needs to take these factors into account. While each case is unique, there are some basic things to consider in choosing solutions for countries at different stages of conflict. For example, states emerging from conflict suffer from weakened institutions and turbulent power dynamics. Nevertheless, transition periods can offer significant opportunities for business development, reforms, and economic transformation. It is essential to act fast and work in parallel tracks. First, target achieving immediate results for conflict-affected communities—for example, by creating jobs (e.g. via financing labor-intensive industries or including private firms in government and donor procurement); improving basic power and transportation infrastructure; restoring access to finance; and strengthening targeted regulatory and enforcement mechanisms (e.g. via public-private dialogues). Second, build long-term foundations for growth—including laws to protect property and government capacity for enforcement. All these actions can help prevent relapse into conflict.

“There has been so much focus now on the urgent situation that there hasn’t been enough effort in building for the long term. You cannot wait for the situation to be perfect, certainly from the private sector development perspective. But we have to keep our minds open. When favorable situations occur, you have to jump and try to do something because we have a very short window for these opportunities.”

—BABACAR FAYE, IFC’S RESIDENT REPRESENTATIVE IN DEMOCRATIC REPUBLIC OF CONGO
Commit More Than Money

Assuming that funding alone will drive change is another long-standing misconception in the development community. Creating markets in FCS involves a lot more than finance—advisory services, staff presence on the ground, capable intermediary organizations, and tailored solutions are all necessary. Additional work will likely be needed to develop regulations; build government and private sector capacity; address complex environmental and social issues; identify and recruit strong sponsors; and develop holistic sectoral solutions, in partnership with government and other stakeholders. While all agree on the value of such complementary actions, few scale them up to the extent necessary to create markets.

Stick to Standards but be Flexible on Timing

To scale up quickly, practitioners often question the need to strictly apply ESG standards. Implementing these standards can be difficult because of the complexity of many issues, the lack of necessary technology, and institutional shortcomings—all of which potentially slow job and income generation opportunities for populations at risk of conflict. But cutting corners on standards is likely to be shortsighted as these help to reduce project risks in the medium term, and minimize social harm, all of which lower the risk of future instability. However, meeting environmental, social, and governance standards in FCS is likely to take longer than in other settings, and requires flexibility with timing and additional support.

Bring in New Players and Innovate

An essential part of achieving stability involves people: entrepreneurs and investors who can create a dynamic and growing private sector and improve the local power dynamics. Working with those already active in fragile markets requires caution and extensive due diligence to avoid reputational risks. IFC’s experience has shown this to be one of the hardest parts of creating markets in fragile contexts. Newcomers, regional, and diaspora investors who are not associated with toxic political dynamics can drive change, and development partners should support them.

“You need a different way of operating in FCS to be able to deliver more; to be able to deliver at all. It’s a mental shift you must develop. When you assume no one expects you to deliver anyway, you accept defeat.”

—IFC COUNTRY MANAGER FOR LEBANON, DALIA ABDEL AZIM MOHAMED WAHBA

Investing in conflict-affected countries can also be enhanced through innovations. Examples cited earlier include equity funds and blended finance. Other approaches include investments with lower fixed asset requirements, utilizing special economic zones, and harnessing new technologies. An example of the latter is the use of debit cards such as OneCard in Lebanon, which is supported by IFC. This is an instrument for cash transfers to refugees which was first developed by the United Nations in Lebanon in 2013, and extended to Jordan a year later. It is a re-loadable prepaid card with a magnetic strip that has several “wallets” for the assistance that different humanitarian groups provide.

Keep Markets Open for International Trade and Investment

Thinking global and keeping markets open is not obvious in conflict situations as borders are often closed because of international sanctions, financial transactions are hard to carry out, and essential transport connections may no longer exist. Yet fragile countries often turn abroad to fill the vacuum in domestic economic activity. Thus, improving trade facilitation and related infrastructure, and supporting investment climate reform can encourage international trade and investment, which are all necessary for markets to grow and help maintain stability. Box 4 discusses some examples of how IFC has applied the seven key principles just discussed.
**BOX 4 The Seven Principles in Action: IFC’s Solutions in FCS**

1. **Be conflict sensitive every step of the way.**

The fragility lens developed by the Conflict-Affected States in Africa (CASA) program has helped IFC consider how best to engage in the cotton and cashew nut sub-sectors in the north of Côte d’Ivoire, a relatively fragile area that would greatly benefit from economic support. The fragility lens allowed the project team to articulate more clearly how the project could address two pertinent conflict drivers: ethnic divisions and regional disparities. These disparities are particularly linked to the country’s established agriculture sector, notably cash crops such as cocoa and coffee, which historically have been concentrated in the southern part of the country. This unbalanced regional agricultural development has created grievances and intense competition for resources. By applying the fragility lens and analyzing two-way interactions between the project and conflict, the project team emphasized bringing different ethnic groups together for training, and focusing on the project’s contribution to job creation in the north.

2. **Avoid the dilemma of choosing between short and long-term impacts.**

Immediately post conflict, IFC has engaged quickly to build companies and restore jobs (see an example in principle 3 below). But concurrently investing for the long term is also possible. In 2012, Côte d’Ivoire was emerging from a decade of civil war and instability, and business activity was resuming, but a long-term obstacle loomed: power shortages. Working with the World Bank and other development partners, IFC moved to address the challenge. Years of underinvestment had degraded the country’s electricity infrastructure. To reverse this, IFC invested more than $250 million, and mobilized an additional $535 million to expand and upgrade two key gas-fired power plants—Azito and CIPREL—but without using more natural gas or generating additional greenhouse gas. Today, the two plants account for two-thirds of Côte d’Ivoire’s power-generation capacity. Now blackouts and brownouts are much less frequent, and about 2 million more people are expected to gain access to power.

3. **Act fast during conflict-to-peace transitions and remain engaged during setbacks.**

Bosnia’s civil war—the most devastating conflict in Europe since World War II—ended in December 1995. It left 100,000 people dead, 2.2 million displaced, and the economy in ruins. Within months IFC placed staff on the ground to revive the local private sector. This early action helped IFC prepare local companies for subsequent investment—particularly in the manufacturing sector. One was Akova Impex, a meat-processing company whose main factory had been reduced to rubble during the war. Rebuilding the plant required the equivalent of $4.6 million. IFC helped the company to develop a detailed feasibility study. When the results proved favorable, IFC provided a $2.2 million loan, supplementing what the company was able to obtain from other lenders. By early 1999, Akova Impex was thriving—selling its meat products to more than 2,700 grocery stores across Bosnia and employing an integrated work force of Muslims, Serbs, and Croats.

4. **Commit more than financial resources.**

Sub-Saharan Africa is home to roughly half of all the countries classified by the World Bank as fragile or conflict-affected. In 2008,
IFC recognized that these countries needed knowledge, skills, and good ideas almost as urgently as they needed finance. To attract investment, they needed to strengthen domestic institutions, improve the investment climate, and build local business capacity. IFC launched the CASA program to provide training for smaller businesses, while advising larger ones on how to develop more inclusive supply chains. It also advised governments on legal and regulatory reforms and attracting private finance for infrastructure projects. By the end of June 2018, the CASA program had advised almost 3,000 private and public entities; helped to enact 78 laws, regulations, or amendments to improve the business climate; facilitated more than $176 million in loans to SMEs from financial institutions; and trained more than 60,000 individuals, including at least 10,400 women.

5. Stick to standards, but be flexible on the timing.

In Nepal, in the hydropower sector, IFC has combined its investments with E & S advisory services to help clients find solutions to complex risks, and improve the sector overall. The expectation is that having a better regulatory framework for environmental impact assessments (launched in July 2018), coupled with a basin-wide cumulative impact assessment will result in physically, economically, socially, and environmentally sustainable and resilient hydropower projects. The approach includes initiatives to gain better understanding of the environmental and social values of the people living around the Upper Trishuli 1 hydropower project in a way that rebuilds the social fabric of the neighboring communities. IFC is also supporting hydropower developers by leading ongoing bilateral and multilateral engagements with Nepali stakeholders, providing clients with greater understanding, and taking a structured approach to a hydro power benefit-sharing scheme.44


Obtaining finance is a major challenge for newcomers. IFC’s innovative SME Ventures Program helps address the gap in equity finance by providing technical assistance to, and investing in, funds run by locally or regionally-based managers. It also works with other parts of the World Bank Group to assess the regulatory environment for private equity investment and provides recommendations for improving that environment. IFC used the SME Ventures Program to expand its work in some of the world’s most fragile markets, including the Democratic Republic of Congo, the Central African Republic, Liberia, Sierra Leone, and Nepal.

7. Keep markets open to international trade and investment.

Conflict hinders the ability of businesses to trade or attract investment—especially trade and investment from abroad. IFC’s Trade and Commodity Finance programs help address the problem by offering guarantees, risk-sharing facilities, loans, and other structured products to support trade in these markets. Through these products, IFC has enabled over $4.6 billion in trade, despite the challenging conditions in FCS. Working with other World Bank Group institutions, IFC also designs and supports regulatory reforms to expand trade and investment. In Sierra Leone, for example, the Removing Administrative Barriers to Investment program helped reduce the time and cost of registering a business. Between 2004 and 2010, the program helped create nearly 6,000 new businesses, and generate 15,000 jobs.46
FUTURE DIRECTIONS

While much has been learned about conflict-affected countries and the private sector in recent years, there are many areas where further work could help improve outcomes. These include:

**Conflict Prevention**

The 2018 United Nations-World Bank report, Pathways for Peace, highlighted the shift of the development community away from responding to crises and the aftermath of conflict, toward preventing conflict. At the center of these efforts is addressing the grievances of exclusion from access to power, opportunities, and security. The report stresses that states hold the primary responsibility for prevention, but that other actors, including the private sector and international organizations, must also play a critical role. While there is knowledge about the impacts of specific private sector projects at the micro level, less is known about how the private sector can contribute to conflict prevention at the macro level. More analytical work needs to be done to articulate how the private sector can best contribute to conflict prevention, and how policy makers and the development community can support private sector interventions that provide economic opportunities, mitigate grievances, and address the drivers of conflict. To that end, IFC is working with the World Bank on new approaches to conflict prevention, including joint work in selected pilot countries, aiming to leverage private sector projects and initiatives to support this agenda.

**Addressing the Forced Displacement Crisis**

The world is experiencing the largest forced displacement crisis since World War II, with 68.5 million refugees and internally displaced people. Forced displacement is often a symptom of conflict, but may also be driven by various other factors, such as climate change. While the private sector frequently generates livelihoods and meets the basic needs of forcibly displaced populations, the focus on how to systematically leverage the private sector to address the crisis is relatively new. For the formal private sector, viable investment opportunities to support refugees have been scarce due to policy barriers that frequently prevent refugees from working or owning a business, and their extreme poverty and insecurity. As a result, most private sector initiatives that develop livelihoods have been limited to corporate social responsibility, philanthropy, and other grant-funded initiatives.

Going forward, more policy and advocacy work needs to be undertaken to enable displaced populations to fulfill their potential as economic actors. It is also critical to connect enterprises affected by the refugee crisis with global supply chain actors and investors. Assistance may take the form of hiring or training refugees, investing in companies owned by, or employing refugees, or supporting firms that adapt their core business to better serve refugees. Another promising area for support is the use of blended concessional finance to encourage private investment that delivers impact both to forcibly displaced populations, and to the communities that host them. Progress in this area requires new and innovative partnerships between the private sector, DFIs, philanthropic actors, and the humanitarian community.

**Conflict-Sensitive Investing Practices**

A growing number of investors agree that conflict and fragility need to be considered in the projects that they undertake. This attention to conflict and fragility from the investor’s perspective is twofold. First, investors need to adapt the way they assess project risks in FCS and consider contextual risks beyond the standard ESG, due diligence, and reputational assessments. Second, investors need to bring greater attention to 1) identifying and mitigating the potential impact of projects on fragility and conflict, and 2) monitoring and management of potentially negative processes. Many private investors and some DFIs, with the help of non-governmental organizations and research
organizations, are exploring the development of conflict-sensitive approaches to investments, although to date these efforts have been fragmented and limited in scope. Going forward, the DFIs are well placed to advance this agenda, and develop a set of principles for use by both DFIs and private investors on conflict sensitive approaches to investment that could provide a framework for operating in challenging environments.

**Increasing Collaboration among DFIs**

The 2018 report, “Escaping the Fragility Trap”, published by the Commission on State Fragility, Growth, and Development highlighted the role that private sector focused-DFIs need to play in fragile states. DFIs are best placed to help catalyze private investment in FCS, and leverage aid to support pioneering firms entering these challenging markets. Yet to date, beyond joint cofinancing of projects in FCS, DFIs have rarely focused on how to collectively address some of the biggest challenges to operating in FCS, and jointly develop solutions. Promising opportunities in this regard include developing integrated sector strategies, leveraging each other’s due diligence and market knowledge, joint upstream project development, agreement to consistently apply blended finance principles, and collaborating to develop principles for conflict-sensitive approaches to investment.
ANNEX: ADDITIONAL IFC DATA

IFC COMMITMENTS IN FCS (2014–18, MILLION USD)

- Financial and insurance activities: 32%
- Electric, gas, steam: 22%
- Information and communication: 13%
- Manufacturing: 11%
- Transportation and storage: 5%
- Accommodation and food service: 4%
- Agriculture, forestry and fishing: 3%
- Other: 9%

IFC COMMITMENTS IN NON-FCS LOW AND LOWER MIDDLE-INCOME COUNTRIES (2014–18, MILLION USD)

- Financial and insurance activities: 14%
- Electric, gas, steam: 11%
- Manufacturing: 10%
- Transportation and storage: 5%
- Accommodation and food service: 4%
- Agriculture, forestry and fishing: 3%
- Other: 6%

IFC PROJECT COUNTS IN FCS (2014–18)

- Financial and insurance activities: 48%
- Electric, gas, steam: 12%
- Information and communication: 10%
- Manufacturing: 9%
- Transportation and storage: 5%
- Accommodation and food service: 4%
- Agriculture, forestry and fishing: 3%
- Other: 1%

IFC PROJECT COUNTS IN NON-FCS LOW AND LOWER MIDDLE INCOME COUNTRIES (2014–18)

- Financial and insurance activities: 48%
- Electric, gas, steam: 13%
- Manufacturing: 11%
- Transportation and storage: 6%
- Accommodation and food service: 3%
- Agriculture, forestry and fishing: 3%
- Other: 5%
COMMITMENT GROWTH IN FCS BY INDUSTRY (MILLION USD, %, 2014-2018 COMPARED TO 2009-2013)

- Agriculture, forestry and fishing: +547%
- Administrative and support service: +108%
- Financial and insurance activities: +33%
- Transportation and storage: +131%
- Manufacturing: +135%
- Electricity, gas, steam: +1900%
- Wholesale and retail trade: +122%
- Mining and quarrying: +724%
- Human health and social work activities: -33%
- Accommodation and food service: +1900%
- Real estate activities: +65%
- Construction: +124%
- Water: +135%
- Professional, scientific and technical: -69%
- Education: -69%

COMMITMENT GROWTH IN NON-FCS LOW AND LOWER MIDDLE-INCOME COUNTRIES BY INDUSTRY (MILLION USD, %, 2014-2018 COMPARED TO 2009-2013)

- Human health and social work activities: +10%
- Wholesale and retail trade: +117%
- Real estate activities: +24%
- Education: +124%
- Electricity, gas, steam: +83%
- Accommodation and food service: +65%
- Financial and insurance activities: +137%
- Agriculture, forestry and fishing: +79%
- Transportation and storage: +17%
- Manufacturing: -10%
- Administrative and support service: +10%
- Mining and quarrying: +3%
- Information and communication: -56%
- Professional, scientific and technical: -40%
- Construction: -25%
- Water: -30%
- Public administration and defence: +25%
REFERENCES

1. The New Deal is a key agreement between fragile and conflict-affected states, development partners, and civil society to improve the current development policy and practice in fragile and conflict-affected states. It was developed through the forum of the International Dialogue and signed by more than 40 countries and organizations at the 4th High Level Forum on Aid Effectiveness on November 30th, 2011 at Busan, Korea. For more information, see International Dialogue on Peacebuilding & Statebuilding website at http://www.pbsbdialogue.org/media/filer_public/07/69/07692de0-3557-494e-918e-18df00e9ef73/the_new_deal.pdf.

2. Development finance institutions (DFIs) are development institutions that finance the private sector.

3. The World Bank Group’s Maximizing Finance for Development (MFD) approach helps countries maximize their development resources by drawing on private financing and sustainable private sector solutions in order to enable governments to reserve their scarce public finance for areas where private sector engagement is not optimal or available.

4. Countries and regions can be affected by dimensions of fragility and conflict that are beyond the scope of this report, including fragility that has been heightened by natural disasters and epidemics. The authors acknowledge that it is important to consider the private sector’s role in such types of fragility, but a separate analysis is required for this.

5. The g7+ is a voluntary association of countries that are or have been affected by conflict and are now in transition to the next stage of development. For more information, see g7+ website at https://g7plus.org/who-we-are/

6. For more information on Peacebuilding and Statebuilding Goals (PSGs), see International Dialogue on Peacebuilding & Statebuilding website at http://www.pbsbdialogue.org/media/filer_public/07/69/07692de0-3557-494e-918e-18df00e9ef73/the_new_deal.pdf.


9. It is important not to overstate the magnitude of inclusive job creation that occurs in FCS, however. Firms may have little incentive to make proactive efforts to seek out employees from marginalized groups, and low employment levels overall mean that many groups remain largely excluded from jobs.


13. Guáqueta 2006; Datzberger and Denison 2013, pp. 21-22; Goldberg, Kim, and Ariano 2014; Blattman and Ralston 2015, pp. iii, 11, and 12.


17. Utterwulge and Gjerloeff 2014.

18. For more information, see United Nations and World Bank 2018.


25. Low local demand, for example, can be attributed to widespread poverty, which limits the volume of business activity that the local population can sustain. Foreign markets often remain out of reach because of the poor quality of transport infrastructure.

26. This analysis is based on a model of the potential for foreign investment in a country based on economic fundamentals such as population, GDP, accessibility, natural resources, and trade. See World Bank Group (2017) GIC.

27. The analysis of investment opportunities post conflict are based on the first twelve years after conflict, WBG (2017) GIC.


29. For more information about the IFC Articles of Agreement, see IFC website at https://www.ifc.org/wps/wcm/connect/CORP_EXT_Content/IFC_External_Corporat_Site/About+IFC_New/IFC+-+Governance/Articles/

30. IFC analysis (conducted July 2018) of 2016 commitments, the most recent year for which data is available. DFIs included in the research represent those with the largest overall investment volumes.

31. Note the high mobilization in 2018 was due to a large transport investment.

This section refers to IFC’s track record in long-term financing; short-term financing investments are discussed later in this section. “Volume” includes investments made from IFC’s own account. Years indicated refer to IFC’s fiscal year. For reporting of long-term finance commitments in FCS from 2015 onwards, IFC considers as FCS all those countries that have been on the World Bank Group Harmonized List of Fragile and Conflict Situations within any of the past 3 years.

Excluding administrative and support services, which had few projects in either period.

Additional information on IFC’s sector focus and growth is contained in the annex.

For more information on IFC’s FCS Africa Program, see IFC website at https://www.ifc.org/wps/wcm/connect/REGION__EXT_Content/IFC_External_Corporate.Site/Sub-Saharan+Africa/Priorities/Fragile+and+Conflict+Affected+Situations/

Mustafa and Kanchi 2018.

IFC 2015.

Mac Sweeney 2008.

IFC 2017.

For more information, see Collier, Besley and Khan 2018, p. 35ff.


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http://www.ifc.org/wps/wcm/connect/Industry_EXT_Content/IFC_External_Corporate.Site/Financial+Institutions/Priorities/Global+Trade


About IFC
IFC—a sister organization of the World Bank and member of the World Bank Group—is the largest global development institution focused on the private sector in emerging markets. We work with more than 2,000 businesses worldwide, using our capital, expertise, and influence to create markets and opportunities in the toughest areas of the world. In fiscal year 2018, we delivered more than $23 billion in long-term financing for developing countries, leveraging the power of the private sector to end extreme poverty and boost shared prosperity. For more information, visit www.ifc.org.