Making a case for Responsible Investment in Fragile and Conflict-Affected situations (FCS): A Multi-Stakeholder task

An IDPS Secretariat Paper
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Making a case for Responsible Investment in Fragile and Conflict-affected Situations (FCS)\(^1\): A Multi-Stakeholder task

Background to IDPS Secretariat work on the Private Sector

Building economic foundations for peace is one of the New Deal’s five Peacebuilding and Statebuilding Goals (PSG no. 4). The New Deal also recognises that responsible business and investment are vital to achieving all the other PSGs.

Since 2013, the International Dialogue has been grappling with how to create a ‘New Deal for the private sector’. In 2014, the IDPS Steering Group charged the IDPS Secretariat with responsibility for defining concretely what a New Deal for the private sector would look like. So, in early 2015 (Jan), the International Dialogue Secretariat brought together g7+ focal points with representatives from the private sector, multilateral development and private banks, bilateral donors (US and Netherlands) with experts from think tanks and NGOs working on business and conflict (think tanks, and NGOs) to brainstorm. Out of this, an IDPS New Deal for the Private Sector Strategy\(^2\) was created. Its aim was to promote more and better business in FCS. It was presented at the Steering Group Meeting 2015 (Abidjan) where it was endorsed. The strategy consisted of three priority areas of work:

I. Country based work to promote more and better business and investment.
II. Global advocacy on development finance: To ensure that the use of ODA to leverage additional sources of development finance supports conflict sensitive investment in FCS
III. Distilling and disseminating guidance on responsible business of relevance to FCS for IDPS and private sector stakeholders

A virtual network of ‘champions’ for this work, emerged within the IDPS and included the Netherlands, the World Bank FCV group, the g7+ secretariat, focal points from g7+ countries (Liberia, Sierra Leone and Afghanistan). External champions included attendees at the inaugural brainstorming meeting. In 2016, CSPPS, also began to take a greater interest in this work led by the IDPS secretariat, and with its member Oxfam-Novib has developed a work stream on the private sector. The EU’s investment plan for FCS, could also pave the way for greater EU engagement in this work.

Dedicated financial support for this work stream has been provided by the European Union, the OECD, and Germany, since 2015, with a small financial contribution from BNP Paribas Investment Partners in 2016.

Key achievements to date include:-

- **A multi-stakeholder workshop in Sierra Leone in August 2015** on “Private sector resilience, recovery, and resurgence: Information Communication Technology (ICT) spotlight”
- **Greater awareness created in private / investor circles about the New Deal** (eg special session on IDPS work at Arab-DAC Dialogue, Vienna Jan 2016, UN Global Compact meeting Dubai, Article WEF, ECPDM, UN Global Compact, OECD Private Sector Engagement horizontal peer review)

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\(^1\) FCS are a diverse group of countries and situations. Whilst conflict-affected situations are inherently fragile, not all fragile situations are the same, and not all fragile situations are conflict-affected. According to the OECD, fragility results from the accumulation and combination of risks combined with insufficient capacity by the state system, and/or communities to manage it, absorb it, or mitigate its consequences (*States of Fragility 2016: Understanding Violence*, OECD, 2016). This situation of exposure to risk can lead to negative outcomes, including violence, protracted political crisis, and chronic underdevelopment (http://www.oecd.org/dac/conflict-fragility-resilience/states-of-fragility-2016.htm).

A brochure on key international standards for responsible business conduct and how they apply to fragile states in 2015 Making a case for responsible investment in fragile and conflict-affected situations (FCS): A multi-stakeholder task 2016, in collaboration with BNP Paribas, who provided intellectual input, covered the cost of communication tools and part of the costs of the expert commissioned to conduct the research. An executive summary of the draft note is provided below.

Executive Summary

Extreme poverty is increasingly concentrated in fragile and conflict-affected countries. Investors can contribute to ending poverty and consolidating peace by providing the much needed finance for long-term job-creating businesses, in particular domestic ones. Although these geographies tend to be avoided by investors, there is too much at stake not to explore how to attract responsible investment these regions.

The International Dialogue on Peacebuilding and Statebuilding, an OECD-hosted partnership with the governments of 20 countries affected by conflict and fragility (g7+), and civil society, together with BNP Investment Partners in 2016, sponsored a review to understand the scope and landscape of private sector investment in fragile states. Interviews conducted over a year and consultation with experts in the worlds of investment and development co-operation alike, led to an analysis of preliminary findings and involved expert feedback. A report based on these findings and consultations recommends joint action by investors working in partnership with development actors to address the multiple risks faced by investors which impede the scaling up of responsible investment in fragile and conflict affected situations.

Two billion people live in countries where development outcomes have been seriously affected by fragility, conflict, and violence. The World Bank estimates that extreme poverty will increasingly be concentrated in these contexts, rising from 17% of global poverty today to 46% by 2030, due to high population growth rates and weak economic development. Yet fragility is not confined to low-income countries: it affects middle-income countries as well. The investor community increasingly acknowledges that addressing conflict and fragility must be a priority and is critical for achieving the overall ambition of the Sustainable Development Goals.

1. [https://www.pbsbdialogue.org/media/filer_public/6f/96/6f96d1ad-45bb-48ae-8614-8d84d6f7b2e9/id-rbc.pdf](https://www.pbsbdialogue.org/media/filer_public/6f/96/6f96d1ad-45bb-48ae-8614-8d84d6f7b2e9/id-rbc.pdf)
2. [https://www.pbsbdialogue.org/en/](https://www.pbsbdialogue.org/en/) This is an extract of a longer paper, to be finalized and published in May 2016
3. [https://www.pbsbdialogue.org/media/filer_public/6f/96/6f96d1ad-45bb-48ae-8614-8d84d6f7b2e9/id-rbc.pdf](https://www.pbsbdialogue.org/media/filer_public/6f/96/6f96d1ad-45bb-48ae-8614-8d84d6f7b2e9/id-rbc.pdf)
Development Goals to end extreme poverty by 2030\textsuperscript{10}. Building sustainable peace is key to this\textsuperscript{11}. It is now widely acknowledged that, if all countries are to meet the SDGs, the global community will require “trillions” in investments of all kinds: public and private, national and global, in both capital and capacity\textsuperscript{12}.

The critical question today is how development assistance can be used in more innovative ways to leverage other sources of finance for development\textsuperscript{13}. While the contribution of development aid is crucial, as the g7+ countries acknowledge, there is a role for investors and the private sector in general\textsuperscript{14} for two reasons.

First, investment and a proactive private sector are key to stimulating economic growth, and job creation that can help to create the sorts of economic foundations that will enable countries to transition out of fragility and consolidate peace over the long term.\textsuperscript{15} Yet investment in FCS is often either lacking, not matched to demand (due to the small scale, fragmented financing requirements), not tailored to the specific needs of the context (which often means being not long term enough) nor patient enough to cope with temporary periods of volatility or the slow pace of reform. Some critical business sectors, including Small and Medium Enterprises (SMEs) and start-ups that in many Fragile and Conflict-Affected Situations (FCS) particularly in conflict contexts, are a vital coping mechanism, and play a critical role in revitalising local economies, generating jobs and other economic opportunities, often struggle to attract much needed investment. As the g7+ countries point out, investors are faced with peculiar challenges in fragile and conflict-affected countries.

Second, the scale of financing required, in the context of high strains on public finances, cannot be underestimated. This is particularly true for small and mid-cap investments, which can often have a more positive impact on productivity than large scale investments. Development aid does not have the financial capacity to meet the challenge on its own; a joint effort is required.) The g7+ have called for more systematic international support for private sector development that is well adapted to conditions in fragile states, rather than driven by standard models, and which is designed to have impact on a large scale\textsuperscript{16}.

Demographic trends and a growing middle class in many FCS (eg Nigeria) are generating a rising demand for consumer goods, infrastructure, services, and agribusiness, which could provide new opportunities for investors\textsuperscript{17}. This is an opportunity, particularly as slow growth in many OECD countries has encouraged some investors to look towards emerging markets. In some FCS, growth prospects are promising and over the last few decades, Foreign Direct Investment (FDI) in many FCS economies, at least prior to 2008, grew more quickly than flows to other parts of the world, albeit from a very low starting point. However, much of this FDI was largely concentrated in the extractives sector and in a few countries and more recently, has

\textsuperscript{10} Measured as people living on less than USD 1.25 per day.

\textsuperscript{11} All 17 SDGs are critical. See \url{http://treasury.worldbank.org/cmd/htm/World-Bank-BNP-Paribas-TeamUp-2030-Agenda-Sustainable-Develop-Goals-Innovative-Finance.html}.


\textsuperscript{13} The Addis Ababa Action Agenda, the outcome of the Third International Financing for Development Conference, July 2015.

\textsuperscript{14} G7+ Briefing Note 3, The Private Sector in Conflict-affected Situations. ‘The private sector has the potential to accelerate progress towards resilience and development in fragile or conflict-affected countries (FCAS). http://g7plus.org/test-site/sites/default/files/basic-page-downloads/FFD_side_event_BRIEF_3-private_sector.pdf.

\textsuperscript{15} Paul Collier, professor of economics at Oxford University, has argued that robust economic growth has proven to be more critical than political reforms in preventing a return to conflict. Collier, Hoefler, Söderbom (2007).

\textsuperscript{16} G7+, The Private Sector in Conflict-affected States, Briefing Note.3, p.1

\textsuperscript{17} \url{http://data.worldbank.org/country/Nigeria}. 
shown signs of decline, following last year’s slump in commodity prices. The challenge is to broaden the
scope of private investment. While many FCS can potentially be attractive as emerging markets for
institutional investors, common disincentives to investment in FCS are well documented: weak business
environments; poor regulatory frameworks; and weak social and environmental standards, all of which
dissuade investors from making discerning choices, based on context-specific knowledge.

Among many would-be investors, there is a consensus that real and perceived risks are the main
impediments to progress in attracting more and better investment to FCS. All too often, ‘red flag reflexes’
on the part of investors, mean that all FCS tend to be tarred with the same brush and avoided as too high
risk, because of their fragile / conflict-affected status. Yet not all FCS are the same. Syria is not Sierra Leone.
A new more nuanced narrative is called for, that enables investors to differentiate between countries and
sectors, based on an understanding of the opportunities for doing good business, doing good, and
effectively managing the associated risks.

The real risks are often the result of legacies of violent conflict and the war economies left in their wake.
The long run challenges associated with different types of fragility related to political instability include
insecurity, socio-economic factors and weak legal and regulatory frameworks, to name but a few. These
conditions create particular types of operational challenges for would-be investors. While real, these risks
can also be mitigated, in part by sharing and managing them and reducing the associated collateral costs.
Options include ensuring that mechanisms for underwriting risks of this kind (guarantees/blending) are
made available to investors seeking to invest responsibly in FCS. Here development cooperation, and in
particular the multilateral development banks have a critical role to play. Other means of addressing
financial risk, include risk-pooling mechanisms and ensuring that appropriate innovative financial
instruments or investment vehicles are created. Two instruments in particular, are widely believed by the
investors and increasingly by the aid community, to have great potential: social bonds and social impact
bonds for FCS (call them ‘yellow bonds’ for a brighter future for FCS). These would require adaptation for
specific purposes, building on the experience of existing social and green bonds and of social impact and
development impact bonds.

The perceived risks resulting from the negative narrative that clusters FCS together under a ‘red-flag’ group
of non-investor friendly or worthy countries, can be addressed by bridging the information and connection
gap that currently exists in the investor community. This can be overcome by making granular information
available to investors, on where to invest, what to invest in, who to interface with, the actual risk–returns,
and how to invest responsibly. Civil society organisations, development agencies and private sector actors
are critical partners in this endeavor, as they can provide such granular local knowledge.

Investors are also deterred from investing in geographical areas that are perceived, rightly or wrongly, to
suffer from high levels of corruption, or human rights or environmental violations. They do not wish to be
associated with social or environmental controversies. Furthermore, complying with sufficiently robust due
diligence standards might require knowledge many investors simply do not have and that is extremely
resource-intensive to acquire. The feedback from interviews with investors, development actors and the
Ministries of Finance of g7+ countries, suggest that a robust multi-stakeholder effort could develop a
labelling scheme to screen ‘investment-worthy’ companies and investment intermediaries (financial

19 Context, sector and company-specific.
20 Information about risks-return is often misconstrued due lack of transparency or functioning financial market. The
gathering of this data, as part of an effort to bridge the information gap would allow for a better understanding of risk – return by
investors.
21 The negative narrative prevents investors from even considering accessing the available risk guarantee mechanisms
where they might exist and which could facilitate their access to these markets.
institutions) that operate in FCS. This could be another way of enabling investors to de-risk\textsuperscript{22}, both from a reputational and financial perspective.

Such a screening process based on a solid methodology combining existing standards and due diligence approaches with relevant criteria,\textsuperscript{23} could help with selecting companies or local financial institutions that could lend to them, that are commercially viable and meet relevant global, country and sector-specific standards for responsible business. The labelling mechanism could also include processes and criteria/metrics for measuring and monitoring investments in companies operating in FCS, so that accountability and social ownership of investments could be guaranteed, by tracking the impact of investments on conflict risk.

Feedback from investors interviewed, suggests that nothing short of a robust \textit{global and country level multi-stakeholder effort} is required to deal with these real and perceived risks.

**Preliminary Conclusions**

More and better investment in FCS is key to promoting inclusive growth, sustainable peace and development, and therefore, to meeting many of the Sustainable Development Goals, not least their core ambition which is to eradicate poverty by 2030. This note, based on an initial collaborative effort to unpack key issues and opportunities has focused on identifying ways of addressing the real and perceived risks concerns of potential investors in FCS in three ways: first, by making available the right sorts of financial instruments; second, by setting up a process for screening / labelling investor-worthy opportunities; and third, by facilitating the sharing of information and networking between investors and would-be investees at country level.

One way forward, as was suggested during interviews with investors and development actors in preparing this note, would be a robust multi-stakeholder initiative, focused on targeted simultaneous action in each of the three domains. Why? Because action in each of the three would be mutually reinforcing and most likely to have a positive impact in attracting more and better investment to fragile and conflict-affected situations.

These ideas are at a very preliminary stage of development and represent a first attempt to ambitiously think outside the box. They are intended as food for thought for members of the International Dialogue and its network of collaborators, including BNP Paribas Investment Partners, working to promote responsible business in FCS. They clearly require further discussion but merit serious consideration.

\textsuperscript{22} De-risking for FATT issues should be different from de-risking when it comes to conflict-affected situations. In some cases, business will have to work with the existing political economy. Francis Skrobiszewski led an initiative in post-Berlin Wall Poland that used the existing institutional structures to leverage financial intermediation and investment. http://www.iwp.edu/news_publications/detail/francis-skrobiszewski-gives-lecture-on-using-economic-mechanisms-to-achieve-foreign-policy-objectives