

Private Sector Development Synthesis Note

PSD in fragile and conflict-affected environments

Key takeaways

- Even in adverse situations, the private sector still provides the most important route out of poverty for the majority of poor people.
- Well-designed private sector development (PSD) programmes can be a viable way of reducing poverty in fragile and conflict-affected environments (FCAEs), but the extent to which PSD helps peace-building is less clear.
- Making PSD programmes in FCAEs a success requires that donors mobilise sufficient resources and the right staff capacities to fully understand the situation on the ground. PSD programming should be an integral part of the conflict management process.

The private sector is crucial for poverty alleviation, even in the adverse context of Fragile and Conflict-Affected Environments (FCAEs). Supporting livelihoods may also be an effective way of supporting peace-building efforts. However, carrying out Private Sector Development (PSD) work in FCAEs also presents unique challenges. The private sector of conflict-affected countries is likely to be small, informal and constrained by scarcity of resources and labour ([World Bank IEG, 2016](#)). Damaged infrastructure and low government capacity are also common.

The majority of the worst performers in the World Bank's Doing Business ranking are fragile states ([World Bank, 2017](#)). Global poverty as a whole is decreasing, but the concentration of global poverty is increasing in FCAEs ([Kaplan, 2015](#)). Poverty is often becoming more entrenched in countries that are conflict-affected, aggravating the risk of further conflict ([Collier, 2003](#); [Carment and Samy, 2017](#)).

It is now recognised that PSD can be a vital tool in conflict-affected environments. Fragile states and partners have signed a '[New Deal for Engagement in Fragile States](#)', which highlights the creation of economic foundations through employment and livelihoods as one of five peace- and state-building goals. A healthy private sector is crucial for this, if jobs and incomes are to out-last donor-funded, short-term programmes. This Synthesis Note looks at how PSD programmes can alleviate poverty in FCAEs, by examining four key questions that PSD programmes face.

>> 1. What is the relationship between conflict and the private sector?

Conflict adds new dimensions of complexity to the already difficult task of analysing the way that the private sector works. There are multiple and complex channels of interaction between peace, fragility and the private sector. In the past, governments in the developed world have argued that “poverty, weak institutions and corruption can make weak states vulnerable to terrorist networks and drug cartels” ([Brookings, 2003](#)). Some evidence has shown that , under certain conditions, there can indeed be a causal link between economic growth and violence reduction (e.g. [Blattman and Annan, 2015](#); [Humphreys et al., 2014](#)). However, significant gaps remain in knowledge about stimulating PSD in fragile states. Several important links in the theory of change do not have a strong foundation in the literature. For instance, there is a lack of empirical evidence on the causal link between job creation and reduced violence ([World Bank, 2011](#)).

Much of the literature finds nuanced relationships between private sector interventions and peace-building. For instance, Blattman and Rolston ([2015](#)) offer detailed findings on how skills training and microfinance have shown little impact on poverty or stability, but that by contrast, injections of capital—cash, capital goods or livestock—seem to stimulate self-employment and raise long term earning potential, which, if targeted at high-risk men, could have some impact. In many cases, there has not been enough learning from prior interventions in fragile environments. [3ie’s evidence gap map](#) summarises where the most pertinent gaps in evidence on this topic remain. The [DCED’s Evidence Framework](#) also gives a more general overview of the causal mechanisms that underpin PSD’s affect on poverty alleviation.

>> 2. Are PSD programmes in FCAEs viable?

In the past, some PSD programmes assumed that they could operate in fragile contexts on the basis of “business as usual” ([DCED, 2012](#)). Such an approach may have negative unforeseen consequences. Mary Anderson in her seminal book "Do No Harm" identified the ways in which international assistance can reinforce societal divisions ([1999](#)). Understanding the societal context in which interventions take place has now been identified as vital for successful programming in FCAEs. One of the key insights of an evaluation of the World Bank Group’s FCAE portfolio is that PSD has to "be done differently" in these contexts ([World Bank IEG, 2016](#)).

Given the complex and difficult contexts in which PSD programmes in FCAEs are implemented, a key consideration is cost. Because of the factors noted above, designing and implementing PSD programmes in FCAEs is likely to take significantly more resources than in a “normal” situation; as noted, results may also be more modest. A systematic review

identified that a majority of IFC projects (84 percent) in FCAEs were effective in achieving their expected outputs. But less than half were successful in reaching their target outcomes and impact ([IFC, 2016](#)). Making PSD programmes in FCAEs a success requires that donors mobilise sufficient resources to match their aspirations. Limited data availability, rapidly changing contexts, and difficulty accessing insecure areas all mean that FCAE programmes are likely to cost donors more to implement ([DCED, 2008](#)). There are also greater requirements on staff capacities and training (See Section 8.2, [DCED, 2015](#)).

In summary, PSD interventions in FCAEs must take into account the contexts in which they operate ([IIED, 2017](#)). Programmes often require more flexibility regarding timeframes, targets, and rigour of measurement. Flexible implementation practice and quick reactions to changing contexts are necessary to ensure that potential conflicts are managed ([GIZ, 2017](#)). Flexibility towards anticipated results is necessary, and adaptive management techniques may prove to be important ([Bond, 2015](#)).

>> 3. How can donors work with the private sector to build peace?

On average, after access to electricity, lack of access to finance is cited as the most significant business constraint in FCAEs ([Leo, et al., 2012](#)). External capital quickly leaves unstable countries, and is often slow to return; “once foreign investment exits, perceptions of high risk and instability may linger” ([World Bank IEG, 2016](#)). Attracting back foreign investment may take a long time. Impact investing is one solution to this problem; the term refers to the practice of making investments that seek to generate social or environmental impact as well as a financial return. The hope is that these forms of financial innovation will benefit consumers by providing the capital to improve goods and services in otherwise neglected markets ([World Economic Forum, 2015](#)).

However, traditional definitions of impact may be too restrictive for fragile markets. In fragile states, where foreign lending may have been frozen, otherwise profitable businesses may still be unable to access credit. Impact investors generally focus on bottom-of-the-pyramid consumers and innovative solutions ([Stanford Social Innovation Review, 2015](#)). In FCAEs, however, impact-focussed capital may be required even to reach relatively affluent consumers.

Another route to helping the poor in FCAEs is centred on developing market systems to function more beneficially. Market systems development “is a change in the way core functions, supporting functions and rules perform that ultimately improves the poor’s terms of participation within the market system” ([Springfield, 2015](#)). This approach has important applications for FCAEs. For example, Mercy Corps and FSD Africa outline the important benefits that financial sector market development programmes can have on markets in

FCAEs ([2017](#)). Supporting local businesses through market systems development may have advantages over cooperating with larger multinational firms. For instance, local private sector actors may be “more interested than large enterprises in supporting peace building and stabilisation, as they suffer more from conflict” ([GSDRC, 2016](#)).

>> 4. How does political economy affect PSD in FCAEs?

The term "political economy" refers to the process by which political institutions, the political environment and the economic system influence each other ([DCED, 2011](#)). The political economy of FCAEs can hold back private sector growth dramatically. This is clearly seen in the World Bank's surveys of enterprises in the developing world. More than 60 percent of respondents in fragile states answered that political instability was a leading constraint, compared to less than 40 percent of respondents in non-fragile states ([World Bank IEG, 2016](#)). Similarly, 'inadequate understanding or mitigation of the relationships between corrupt strongmen and other power-holders limited the effectiveness of US support to PSD in generating broad-based economic growth' ([SIGAR, US, 2018](#)).

On the other hand, PSD can encourage political dialogue between conflicting groups ([GIZ, 2017](#)) and make future conflicts less likely. Women's participation in conflict resolution has also been identified as important, going hand-in-hand with women's economic empowerment ([International Alert, 2012](#)).

Donors may also encounter challenges in supporting activities on the ground in FCAEs; due diligence checks may be difficult to complete thoroughly, and some groups whose permission is needed to operate safely may have unacceptable track records (e.g. [Azizi, 2017](#)).

In conclusion, many donors are increasingly focusing on Fragile and Conflict-Affected Environments, not least because much poverty is to be found there. But operations will be complex, costly and risky, requiring much local knowledge and careful preparation. Organisational mechanisms probably need to be further adapted to allow for this.

>> *Click on the following link for the DCED's PSD in fragile and conflict-affected environments Knowledge Page, with a range of useful resources on the theme:* <https://www.enterprise-development.org/implementing-psd/psd-in-fragile-and-conflict-affected/>