

**STRENGTHENING THE  
ECONOMIC DIMENSIONS  
OF PEACEBUILDING**  
**PRACTICE NOTE SERIES**

‘Peacebuilding essentials for economic development practitioners’

## Practice note 3: Foreign Direct Investment in conflict-affected contexts

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### 1: Introduction to series

#### 1.1. About this note

If all goes well, Foreign Direct Investment (FDI) contributes to peacebuilding. In the worst case, it may itself be a source of conflict. This practice note explains why and how the operations of foreign investors are relevant for economic development planners and practitioners in conflict-affected contexts. It presents some of the main issues, risks and opportunities that economic development professionals need to bear in mind when designing programmes and initiatives that seek to attract foreign investors to unstable contexts. It also introduces the key stakeholders and processes, questions to be considered in programming, and main lessons learned. The final section points the reader to additional resources on the topic.

#### 1.2. Who should read this series?

Policy-makers and practitioners, specifically those that are working in conflict-prone and conflict-affected states.

#### 1.3. The series will help you to:

- Better understand key economic recovery challenges and opportunities in conflict and post-conflict contexts;
- Draw on existing good practice for your own economic development planning and programming in this area;
- Maximise the positive contribution your strategy and programme can make to economic recovery and peacebuilding; and
- Ensure that your intervention is conflict-sensitive.

## 2

## Section 2: Key issues, risks and opportunities

### 2: Key issues, risks and opportunities

Countries need equitable, broad-based economic development if they are to recover from violent conflict. If the state of the economy improves and the benefits of economic growth are widely distributed, the former conflict parties are more likely to develop a stake in peace and learn to resolve differences through mainstream political negotiations rather than through violence. If the economy falters, the struggle to control scarce – sometimes highly profitable – resources is likely to remain one of the key strategic goals of continuing warfare.

Enhanced global linkages mean that economic interconnections between war economies and the industrialised world can be extremely diverse and complex. The challenge for policy-makers and practitioners working on and in conflicted-affected countries is to ensure that these interconnections have a positive lasting impact and contribute to addressing some of the most urgent socio-economic priorities.

During violent conflict, a variety of market systems continue to operate (see also guidance note on Market Development in Conflict-Affected Contexts). However, few investors – whether domestic or foreign – are prepared to commit significant sums to new wealth-creating commercial initiatives whilst fighting continues. Equally, they may be slow to make substantial new commitments for several years after wars come to an end because of enduring instability and insecurity.

This practice note focuses specifically on the role of foreign direct investment (FDI) in the wider process of economic recovery. It argues that FDI from a variety of different commercial sectors can be an important ingredient in recovery. However, it is clear that FDI can never be the panacea. Foreign companies are themselves influenced by wider political and economic developments, and will scarcely invest at all if the host government fails to provide a conducive environment, or if the country is still considered to be unsafe. Furthermore, the impact of individual investments will depend on the extent to which they are managed in a conflict-sensitive manner.

The objective of economic development planners and practitioners must be to use their influence to ensure that FDI contributes to a “virtuous cycle”, whereby peacebuilding initiatives in the political arena create an environment conducive to well-designed investments, which themselves serve to reinforce the wider social foundations of peace.

#### Foreign Direct Investment

Foreign direct investment (FDI) has traditionally referred to ownership by a foreign entity of physical assets such as offices, factories and mines. It is now taken to include foreign shareholdings that are large enough to provide the basis of a long-term relationship and – in the words of the OECD definition – ‘a significant degree of influence on the management of the enterprise’. The term “inward investment” refers to investment from another region, whether from within the same country or abroad.

Some foreign investments take the form of entirely new ventures. Others are purchases of existing businesses, or joint ventures with local or international partner companies. Joint ventures provide a means of sharing both the financial costs and the risks of the business, as well as sharing expertise. Foreign companies often particularly value the local knowledge and business contacts provided by their in-country partners.

Foreign portfolio investment takes the form of smaller shareholdings that are not accompanied by management control. Portfolio investment has tended to imply less commitment to the host country in times of crisis, in part because it is much easier to sell shares than physical assets.

## 2.1 Key peace opportunities

The key benefits most typically associated with FDI include first that international companies will typically have greater financial resources than their local counterparts; and second that they bring specialist expertise not only in the form of technological know-how, but also in areas such as international marketing. Third, they may be able to contribute to local transport and communications infrastructure either by the nature of their own business (as with telecommunications companies); or because they need to build roads to service their own operations (as is commonly the case with natural resources companies); or as part of a wider agreement with the government. It is notable that many recent agreements between Chinese companies and African governments have included undertakings to develop local infrastructure such as roads and transport communications. These deals reflect the importance attached to infrastructure, although many commentators have questioned whether they are structured in a way that is truly beneficial to the host country.

There is perhaps a further, less tangible benefit in that the presence of reputable international companies signals both to the country's own citizens, and to the world at large, that the country is "open for business". Coca Cola's investment in Bosnia in 1999/2000 was widely welcomed as tangible evidence that the country was well on the path to recovery. More recently, HSBC's decision to open a bank branch in Jaffna, northern Sri Lanka, in November 2009 was seen as a sign of confidence that the country was at last beginning to emerge from the devastation caused by decades of civil war.

## 2.2 Key conflict risks

The key conflict risks apply equally to domestic and foreign investments. The most significant differences are first that foreign investments are often – but by no means always – larger in size and therefore in impact, which can have both positive and negative implications. Second, foreign companies' engagement with conflict-affected regions raises sensitive questions about national and international accountability: how should international companies behave in countries with poor standards of governance? And how far do their responsibilities extend?

The common points applying to all major investments are that their social, economic and environmental impacts almost always involve winners and losers, and that conflicts between different interest groups are therefore inevitable. Similarly, there are often disputes about precisely who is entitled to compensation for negative impacts of foreign investments, or to royalties and rents. In states with strong institutional foundations, these conflicts are managed through the normal political and planning processes, or the courts, usually without violence. In war-torn states, such mechanisms are – almost by definition – less likely to work impartially. If there is a dispute about the impact of an investment project, resorting to violence may become a viable alternative for those that have lost out.

### Case example: Niger Delta

Nigeria's Delta region is a particularly acute example of local populations arguing that they have suffered the worst of the environmental and social impacts of natural resource development with few of the economic benefits.

Petroleum development in the region began in the late 1950s but, even today, many villages lack adequate sources of power. The underlying questions include the division of responsibilities between international companies, their local commercial partners and the national and regional governments. The companies have tended to argue they may be able to make a useful contribution, for example, by sponsoring village development projects, but that it is the responsibility of the government to decide how it allocates oil and gas revenues. Further complications arise from the ethnic diversity of the region, including a recent history of conflict between neighbouring communities, as well as Nigeria's wider history of flawed democratic governance and frequent military coup d'états.

In 1995, the government's execution of local activist Ken Saro-Wiwa and eight others prompted accusations that Royal Dutch Shell (operating in a joint venture with the Nigerian National Petroleum Corporation) was complicit in government repression. Since then, local militancy has increased, with frequent kidnaps, blockades, and theft of oil ("bunkering") on an industrial scale. International companies in the region depend on the protection of Nigerian government forces for their security.

In June 2009, Shell reached a US\$15.5 million out-of-court settlement with the families of Ken Saro-Wiwa and the other executed activists. A few weeks later, the Nigerian government announced plans to increase the allocation of revenue to the Delta region, entered into a series of talks with local militants, which are intended to result in the disarmament of local militias. Nonetheless, it will take years of sustained and coordinated economic and political initiatives to resolve the region's long history of internal conflict and ensure that the initial peace gains are preserved and built on.

The security arrangements of large projects in high-risk areas are particularly sensitive. The government security forces that are deployed to protect strategic assets are part of official command structures that operate independently of the companies concerned. Nevertheless, the companies can scarcely avoid being associated with the way that these security forces behave. In countries as such Nigeria, Burma, Sudan and Colombia, there have been cases where foreign companies have been accused of complicity in human rights abuses committed by government or private security forces.

It is essential to address these concerns, while at the same time facilitating responsible, and necessary, investment. However, one can argue that, from a wider economic development perspective, the greatest risk to a poor country may be that it does not get much-needed investment at all. Commercial and development planners should therefore work together to balance three priorities:

- They need to ensure that the benefits of both domestic and foreign investment are shared equitably;
- They need to ensure that foreign investment does not fuel conflict, for example through insensitive company conduct; corrupt relations with governments; increasing dependence on a few sectors; or generating tensions between rival social groups; and
- They need to promote sensitive entrepreneurship and help tackle unnecessary bureaucratic obstacles to new entrepreneurs, whether from within the country or abroad (see also practice note on Business Environment Reforms in Conflict-Affected Contexts).

### 2.3. Risks and impacts

Companies naturally consider the risks posed to their own interests by external parties. However, when making pre-investment assessments, they have historically been less sensitive to the impact that their own activities will have on local communities and other players. This is now beginning to change. The principles of social and environmental impact assessment are now better established, and there is a growing emphasis on extending the range of assessments to include a review of the potential impacts on human rights and conflict. From a conflict perspective, it is vital to ensure that there is a holistic assessment of both risks, impacts and power relations, not least because poorly managed impacts, which lead to local resentment, will in themselves be a source of future political and security risk.

## 3. Major actors, institutions and processes

The task of managing both risks and impacts – and thus achieving an investment agreement that is seen as both fair and sustainable – should involve a range of different actors. If they are to work together effectively, it is essential that they appreciate each other's points of view, and their separate and mutual interests.

### International interests

#### *International companies*

Companies vary in their attitude to risk according to their size, sector, country of origin, sensitivity to reputational issues, and their individual investment strategies. Development specialists need to appreciate these differences in order to gain a more nuanced understanding of the kinds of companies that may or may not consider investments in conflict-affected and post-conflict countries. Examples of these different approaches to risk and reward include:

- Small “junior” mineral exploration companies offer would-be shareholders a combination of high risks with the possibility of high returns from relatively small investments in the event of a major discovery. Such discoveries are most likely to be made in countries which have hitherto been “off the map” of the mainstream international mining and petroleum industries. The juniors are therefore typically among the first companies to move into conflict-affected environments if there is even a slight improvement in the security situation, and if the potential economic opportunities outweigh the risks.

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## Section 3: Major actors, institutions and processes

- By contrast, the task of developing a new mine or gas field – as distinct from discovering it – requires substantial investments, often running to billions of dollars, over one or more decades. The “major” petroleum and mining companies – household names such as BP, Shell and Exxon – have the financial capacity to make these investments. Like most companies, they will consider taking higher risks in pursuit of major opportunities. However, the size of their financial commitments – and the long timeframe needed to recover them – means that they are markedly more conservative in their approach to political and security risk than the juniors.
- Mobile phone companies require smaller investments, in the low tens of millions of dollars, and they start making returns as soon as the first subscriber makes a call. The combination of relatively low investments and early returns helps explain why mobile phone companies have been quicker to move into conflict-affected contexts in Africa – for example Sierra Leone or the Democratic Republic of Congo (DRC) – than companies from other sectors. These investments have often been highly profitable. According to the 2009 UNCTAD Information Technology Report, mobile subscriptions in Africa rose from 54 million to almost 350 million between 2003 and 2008. In a post-conflict setting, the information and communications technology (ICT) sector is especially important because it helps provide infrastructure that other businesses need in order to grow. However, it may be difficult for companies from other sectors – which operate according to different business models – to repeat the same speed of expansion.
- International engineering construction companies are often among the first to begin work in conflict-affected areas and, to the extent that they are paid out of development assistance budgets, face limited financial risks. By the nature of their work, they tend to be primarily concerned with immediate security risks during the period of construction, regarding the longer-term social impacts as the responsibility of their clients.
- Retail banks tend to be slow to invest in conflict-affected environments, partly because of the greater difficulty of “knowing their customers”, and the risk of being caught up in money-laundering allegations. Standard Chartered is an example of a bank that has been willing to move early into conflict-affected contexts, for example to Afghanistan in 2004. However, an important part of its motivation was the need to follow existing customers in the aid and development communities. Retail banking serving Afghan customers has been very slow to develop.
- The truly global companies are often reluctant to take significant political and security risks to invest in what they regard as niche markets in small conflict-affected countries. By contrast, smaller regional players regard these same “niche” markets as significant opportunities, while also judging that their greater regional knowledge makes them better placed to manage risks. For example, Austrian companies have been at the forefront of investment in Bosnia and other former Yugoslav states. Similarly, the last decade has seen a major expansion of South African business elsewhere in Sub-Saharan Africa.
- Non-Western, state-owned companies are less sensitive to reputational risks than listed companies that are accountable to shareholders and – more broadly – to public opinion in their home countries. This is part of the reason why state-owned companies from China, India and Malaysia have led on petroleum investments in war-affected Sudan, for example.

### **Sources of private finance**

Individual companies rarely carry the financial risk of investing in conflict-affected environments on their own. Typically, they will join forces with local or international joint venture partners, and they will seek financing from one or more investment banks. Similarly, they will need to seek insurance for political and security risks, not least because their banks require this. In both cases, they need to be able to demonstrate that they have correctly assessed political, security and environmental risks, and have the capacity to manage them.

Companies are of course also accountable to their shareholders, including both individuals and institutional shareholders. Socially Responsible Investment (SRI) funds in particular will want to know how the companies that they own – or part-own – are managing risks in conflict-affected environments.

### **Multilateral institutions**

The various multilateral institutions play a variety of roles in setting standards and – to the extent that they are involved financially – in sharing and mitigating risk. Important examples include:

- The International Finance Corporation (IFC – [www.ifc.org](http://www.ifc.org)) is the World Bank's private investment arm, with a mandate to make loans to international companies investing in developing countries. The IFC's *Performance Standards* set out the social and environmental management standards required of IFC clients, including on security management. The Multilateral Investment Guarantee Agency (MIGA – [www.miga.org](http://www.miga.org)) provides political risk insurance to private companies. The Foreign Investment Advisory Service (FIAS – [www.fias.net](http://www.fias.net)) is based at the IFC and advises governments on how to improve investment conditions.
- The Organisation for Economic Cooperation and Development (OECD – [www.oecd.org](http://www.oecd.org)) is a Paris-based association of industrialised countries, which currently has 30 member states. It plays an important role in setting recommended standards both for governments (for example through the *Policy Framework for Investment*, which includes a chapter on governments' role in fostering responsible business conduct) and for private companies (for example through the *Guidelines for Multinational Economic Enterprises*).
- The United Nations agencies whose work impinges on foreign investment include the UN Conference on Trade and Development (UNCTAD – [www.unctad.org](http://www.unctad.org)) which, among other activities, monitors annual FDI flows. The United Nations Development Programme (UNDP) Crisis Prevention and Recovery team (<http://www.undp.org/cpr/>) has recently produced a report on *Post-conflict Economic Recovery*.<sup>1</sup> The UN Global Compact ([www.unglobalcompact.org](http://www.unglobalcompact.org)) promotes Corporate Social Responsibility (CSR) standards among international companies.

### **International NGOs**

A wide range of international NGOs monitor foreign companies' activities in conflict-affected countries in accordance with their respective mandates – whether these are related to peacebuilding, human rights or the environment. In addition to International Alert ([www.international-alert.org](http://www.international-alert.org)), peacebuilding specialists include swisspeace ([www.swisspeace.org](http://www.swisspeace.org)). Human rights specialists include Amnesty

<sup>1</sup> UNDP (2008). *Post-conflict economic recovery*, available at [http://www.undp.org/cpr/we\\_do/eco\\_recovery.shtml](http://www.undp.org/cpr/we_do/eco_recovery.shtml)

([www.amnesty.org](http://www.amnesty.org)) and Human Rights Watch ([www.hrw.org](http://www.hrw.org)), as well as the Business and Human Rights Resource Centre ([www.business-humanrights.org/Home](http://www.business-humanrights.org/Home)).

All these organisations provide important sources of information and advice which can be of great value to both companies and governments.

### **National interests**

National political and economic interests are often far from being aligned either on the merits of foreign investment in general, or on the benefits of particular projects. On the companies' side, one of the main challenges is to negotiate a way through what is often a labyrinth of competing political and bureaucratic actors. To the extent that development specialists can make this task easier, they may be able to help attract foreign investment on more favourable terms to the host country. Achieving this objective in practice requires both technical skills and political savvy.

#### ***The host government***

For international companies, the most important individuals and institutions include the national leader, the key ministers and their ministries, the armed forces, and the judiciary. Overall standards of governance are as important as specific economic policies. Most governments also have specialist investment promotion agencies (IPAs) whose task is to promote their country's image internationally, seek out potential investors, provide them with the information and facilities that they need, and – to a degree – to help the government understand how to address their legitimate needs. IPAs have an important potential role as long as the basics are already in place: minor taxation incentives for investors are of limited use if the national capital is subject to repeated bombing raids, for example. On the other hand, if the country is already in recovery, minor benefits – or extra pieces of information – can make a decisive difference.

Many countries emerging from conflict have limited experience in working with foreign investors, and development practitioners can make an important contribution by helping identify sources of expertise. The World Bank's Foreign Investment Advisory Service (FIAS) specialises in this area. Certain international civil society organisations may be able to provide an additional source of expertise. For example, the International Senior Lawyers Project ([www.islp.org](http://www.islp.org)) helps coordinate experienced legal practitioners who offer *pro bono* advice on, among other issues, foreign investment regimes.

National and sub-national leaders are of course political actors. The questions that they ask are not necessarily 'is this project good for the country?', but rather 'will this project enhance my political power base?' The less satisfactory answers to this question take the form of bribes that feed into political war chests, or commercial projects that benefit particular "clients" of political leaders, and thus risk exacerbating conflict. Ideally companies should be able to demonstrate that their activities make commercial sense, are in the wider national interest, and are therefore of indirect political benefit to the local leaders who facilitate investment.

#### ***Local companies***

From the foreign investors' perspective, local companies play a variety of roles. First, if the government has failed to provide an "enabling environment" (see below) for local business, it is unlikely that it will be conducive to foreign investment: the success or failure of local companies is therefore a key indicator for external investors. Second, they will need local companies as suppliers and possibly as

partners. Third, however, local competitors may provide a source of both legitimate and less legitimate competition.

As other guidance notes in this series point out (see also guidance note on Economic Legacies of War), war economies – often based on the patronage networks of particular leaders – do not automatically change their characteristics when there is a ceasefire. The leaders, and their networks, will continue to compete for power and profit under the new dispensation.

The implications for investment and peacebuilding are twofold: first, these patronage figures may use their influence to limit the role of foreign investors (or independent local entrepreneurs). Second, to the extent that investors become aligned with companies linked to specific political interests, they may reinforce their power structures and therefore – wittingly or unwittingly – become part of the local political power structure.

### ***Local civil society***

Like their international counterparts, local civil society organisations (CSOs) can be an important source of information and advice both for potential investors and for development practitioners. In the economic arena, business associations – for example local chambers of commerce – are of particular interest, and may play a constructive advocacy role, for example by highlighting bureaucratic obstacles that impede entrepreneurial activity. However, in conflict-affected settings, CSOs often lack organisational skills and capacity. Still more importantly, they cannot operate at all without minimum acquiescence from the conflicting parties, and they may be co-opted or otherwise aligned with specific interests.

It is therefore essential to evaluate local CSOs with particular care with a view to helping them build up their expertise and organisational skills, and become more broadly representative within their own communities. The US-based Center for International Enterprise (CIPE – [www.cipe.org](http://www.cipe.org)) is an example of an international NGO that has worked with business associations to help them become “market-enhancing” organisations serving the wider public interest, as distinct from “rent-seeking” groups, serving sectional interests.

### ***Communities***

Local communities typically are the most affected by major investment projects and – all too often – the least consulted. National and regional administrations commonly claim the right to speak and make decisions on their behalf, but frequently fail to engage in any meaningful process of consultation. All too often, the result is a violent backlash in response to what is seen as a failure to keep promises. This may take the form of – for example – a road blockade to prevent company employees from gaining access to their worksite, damaging company property or infrastructure, or even kidnappings.

In practice, companies need to develop their own strategies for community engagement, whether the host government judges this to be necessary or not. Often, one of the hardest tasks that companies face is identifying which local leaders and interlocutors are truly representative. The resource section at the end of this paper points out emerging good practice in this area that should be promoted by economic development practitioners.

## 4

## Section 4: Key questions to consider

## 4. Key questions to consider

The companies that take the risk of investing in conflict-affected environments look for commensurate economic rewards, and – not unnaturally – they will expect these to be higher than in a peaceful environment. As noted above, different kinds of companies have different approaches to risk. The common factor is that they need to negotiate an agreement with host countries that both sides think is fair.

Development specialists can play an important role in bridging the gap between investors and governments, with particular reference to the need to take account of social and economic impacts on local populations, as well as risks and rewards for the companies. Ultimately, a broad-based approach is in the interests of all parties. Investments that contribute to conflict – however unwittingly – are unlikely to be sustainable in the long-term. A conflict-sensitive approach can therefore be seen as a form of investor protection.

If they are to fulfil this role effectively, development practitioners will often find themselves playing the role of “interpreters”. Their task is to ensure that all parties – governments, companies and communities – understand each other’s interests and intentions. They also need to ensure that they ask the right questions.

***Is there a worthwhile commercial opportunity?***

The first question is the most basic. If the answer is negative or ambiguous, then there is nothing further to discuss. The key questions include not only the availability of a natural resource, product or market, but also the skills of the local workforce, the local transport and communications infrastructure, and the existence of a worthwhile market, either locally or internationally. An additional factor is competition: conflict-affected countries may have to accept – at least in the short term – that they are at a disadvantage compared with other regions competing for the same investments.

Government planners on occasion take an unrealistic view of what makes commercial sense to foreign companies, and then are disappointed if the companies fail to respond to perceived opportunities. Development specialists may be able to help manage the expectations both of governments and citizens, for example by: conducting and publicising research on the factors that influence the investment decisions of particular sectors; assessing the extent to which these do or do not apply to the host country concerned; and, where necessary, suggesting remedial action.

***A commercial opportunity for whom?***

Of course different companies will have their own definitions of “worthwhile”. In general, larger international companies tend to look for larger opportunities and markets. In many conflict-affected contexts, the size of the local market – or of available regional markets – will fall short. However, the same markets may be attractive to smaller regional players from neighbouring countries, or to niche international operators.

The major international companies are more sensitive to their reputations: they also have the advantage of greater resources, and may well employ their own corporate responsibility specialists. To that extent, it may be easier to open a dialogue with them on the need for conflict-sensitivity, for example when allocating jobs. Smaller regional companies typically are less well-attuned to wider international debates

on the social role of business. It should nevertheless be possible to engage with them by emphasising the practical consequences of conflict-insensitivity. If fighting breaks out, they will lose profits, and possibly their entire business.

***Is it safe?***

Very few companies of any description will commit substantial sums of investment to an area that is directly affected by conflict. However, in many countries, conflict is confined to specific regions: the would-be investor then has to make a judgement as to whether this will always be the case. Investment promotion specialists may be able to play a role in presenting a more nuanced view of the host country's current security situation. This can be a frustrating exercise: countries in recovery often suffer from a "reputation lag" long after fighting has died down.

A related question concerns the nature of local security arrangements. How professional are the government security forces? Do they understand the needs of foreign companies? Are they attuned to the needs and anxieties of local communities?

As noted above, there have been a number of cases where foreign companies have been accused of complicity with human rights abuses committed by government and private security forces. Such abuses are less likely if these forces operate professionally with clear rules of engagement. Security sector reform is therefore a critically important investment issue, as well as a social and political priority, in countries emerging from civil war. At first sight, the need for such reforms does not belong to the agenda of an economic development specialist. In practice, it is often crucial.

***Does the host country provide an "enabling environment" for business?***

The "enabling environment" includes questions such as the speed and number of individual license applications required when setting up new businesses, and the speed and efficiency of customs and revenue collection agencies (see also guidance note on Business Environment Reforms in Conflict-Affected Contexts). The task of addressing such concerns is typically low on the agenda of countries that are in the midst of war: it needs to be prioritised once conflicts slow down or cease.

It is important that any such reforms should be accompanied by a process of dialogue with the people most affected, including – for example – small farmers who themselves run "businesses", and who are often poorly represented in national decision-making. Development specialists may be able to play an important role in ensuring that such voices are heard.

***What kind of legal system is there? Does it work? What happens if there is a dispute?***

The answers to these questions influence investors' perceptions of the long-term security of their investments. Is the investment vulnerable to capricious turns of government policy? What kind of legal system is there, and does it take account of the needs of the private sector?

In many conflict-affected contexts, government legal mechanisms are poorly developed, often for reasons that are only partly related to the conflict. For example, Bosnia had to negotiate a post-socialist transition that would have been necessary regardless of the war. World Bank research in the *World Development Report 2005* suggests that small and informal companies suffer from poor governance even more than larger concerns, for example, if there is a lack of confidence that courts

will uphold property rights.<sup>2</sup> Countries that consolidate legal reform quickly and efficiently are better able to protect the rights of their own citizens, as well as the legitimate aspirations of both domestic and foreign investors.

***Does the host country suffer from high levels of corruption?***

All the OECD member states now have laws making it possible to prosecute companies that pay bribes to foreign officials to secure business, even if the bribe is paid abroad. The US is particularly active in enforcing its Foreign Corrupt Practices Act (FCPA), and other OECD states – especially Germany – are catching up. High levels of corruption may therefore serve as a deterrent to well-run companies planning new investments, and the risks are likely to be higher in countries emerging from conflict that are still in the process of rebuilding their government institutions and improving transparency and accountability.

Poorer and less powerful local actors typically suffer even more from corruption than the larger local and international companies. Often, they have to face what amounts to a form of extortion, for example to gain access to education or medical care. To the extent that development practitioners can promote higher standards of integrity in government and business, they will be performing a service both to investors and the wider population.

***How does the proposed investment fit in with regional development plans?***

As noted above, foreign investment is often associated with large, high-value projects, notably in the natural resources and energy sectors. Such projects often present major economic opportunities, but challenges arise because the benefits are poorly distributed – for example if the revenue goes straight into the national exchequer, with limited input into regional economies. Such imbalances can easily lead to severe political tensions, and in the worst case, to outright violence.

Development specialists should look for ways to work with both companies and governments to mitigate such imbalances. Decisions on the allocation of revenue are primarily the responsibility of governments. However, the outcome matters for companies because they will face increased political and security risks if the wider population is not seen to benefit from their activities. Potential mitigating strategies could include – for example – support from the investor company for training schemes to assist local entrepreneurs.

***Who are the potential investors? What kind of record do they have?***

A welcoming approach to foreign investors does not mean that the host government and other local partners should neglect their own due diligence enquiries into potential investors: how reliable are they? Who actually owns them? What is their approach to CSR?

Development advisers with wide international experience may be able to assist host governments to make the right judgements. It is often relatively easy to assess records of the larger international companies from a combination of their own websites, the international news media, and NGO reports. It may be harder to make similar assessments of second- and third-tier companies, but it is nevertheless essential if the host country is to avoid dealing with “cowboys”.

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<sup>2</sup> World Bank (2005). *World Development Report 2005: A better investment climate for everyone*. Available at [www.worldbank.org](http://www.worldbank.org)

***Who are the local partner companies for international firms?***

Many international investments take the form of joint venture partnerships where the local company shares part of the financial risk and – still more importantly – provides guidance and advice on local operating conditions. Well-run international companies will always conduct “due diligence” enquiries to check the backgrounds of potential partners, for example to assess whether they have been involved in past corruption scandals. They will also need to check to what extent the partners are associated with past or future conflict.

The kinds of question international partners will need to ask include ownership structures: do they know who really owns the company? Is there a “hidden” owner who is explicitly linked to one of the parties in a conflict, or with a government minister? What are their employment practices? Do they employ the best and most competent people, or only people who belong to a particular community, religious group, or set of relatives?

For their part, local companies may not be aware of the kinds of issues that are important to their would-be international partners. For example, they may not see the need for strict accounting practices, and may see a connection with a powerful politician (or a warlord) as an asset rather than a liability.

Development practitioners may be able play a helpful role in educating potential local partners on the expectations of their international counterparts, and helping them to raise standards accordingly.

***Does the company have a popular “license to operate”?***

The phrase “license to operate” entered the vocabulary of international companies in the 1990s. The point behind it is that licenses issued by governments – especially national governments – may give companies formal legal permission to operate. However, this will be insufficient if the government itself is not genuinely representative, and if the company faces active hostility, particularly at the community level. It is not sufficient for companies to deal solely with office-bound technocrats in the national capital.

A company’s ability to secure and maintain a popular license to operate will often depend on matters of detail, such as employment practices (see Section 5 below). It will also demand excellent two-way communication: companies need to find ways of communicating effectively with local communities, to explain both the positive and the negative impacts of their current programmes. Equally, they need to ensure that they are seen to listen to the responses, and to act accordingly by following the best-practice approaches outlined below.

## 5. Existing good practice and guidance

In assessing risks, impacts and opportunities, companies, governments and local communities need access to full information. Development specialists can play an important role in making sure that all sides have the best possible sources and – perhaps even more importantly – are asking the right questions. Likewise, economic development practitioners can play a key role in promoting uptake of good, conflict-sensitive business practices by foreign investors.

# 5

## Section 5: Existing good practice and guidance

### Country-level “due diligence”

From the company’s perspective, the first set of enquiries will begin at the country level, and will include: overall assessments of the country’s political outlook, including the prospects for internal or external conflict; its approach to foreign investors; and its record on human rights. On the basis of these initial enquiries, the company will need to decide whether to proceed to the next level of engagement.

### Local reviews: Assess both risks and impacts

The most significant conflict risks and impacts will arise at the local and regional levels, and it is here that development practitioners may be able to make a particularly valuable contribution based on local knowledge. In particular, it is essential to ensure that companies and agencies assess both risks to the proposed project, and its impact on the local environment, economy and human rights situation.

The task of impact assessment in turn will require a nuanced understanding of local power relationships. For example, which village leader is linked to which regional politician? If the company works with one village leader rather than another, does it strengthen his prestige, thus upsetting the local power balance? Will he direct benefits from the company’s project to his own supporters rather than the wider community? If so, what are the risks of some kind of backlash?

### Local consultation and engagement

This in turn requires local consultation, especially for large projects, even if the host government does not require this. In principle, local consultation should be as wide as possible. In practice, both companies and government agencies often need to work through intermediaries who speak the local language, and can help them make the right contacts. Selecting such intermediaries is itself a sensitive issue in that they are likely to have their own personal agendas and, in divided or fragmented societies, will always be associated with one side or another. Key concerns include:

- **Land.** Companies’ acquisition of land is a frequent source of conflict. Problems often arise because traditional systems of land tenure differ from the conventions of Western or post-colonial legal systems, and it can be hard to establish exactly who does and does not have land rights. Papua New Guinea has a long history of disputes over such issues.
- **Employment.** A second related issue concerns employment. Local communities are likely to see the prospects for employment as one of the key benefits of foreign investment. However, it may be difficult to find local recruits with the required levels of education and expertise. Frustrated expectations on this account are a frequent source of tension that in the worst case may lead to violence.

### Security arrangements

In principle, the investment project’s security should be founded on the consent of the local community, and this underlines the importance of working with communities.

As noted above, international companies have on a number of occasions been accused of complicity with human rights abuses committed by host governments’ security

forces. To prevent this from happening, companies need to include enquiries into the human rights records of the government security forces and private security companies that are responsible for protecting their assets. They also need to use their influence to ensure that these forces have clear rules of engagement: for example, security forces should not open fire on unarmed civilian demonstrators. And they need to have procedures for reporting any human rights abuses that do occur. The *Voluntary Principles on Human Rights and Security* is a multi-stakeholder initiative to promote these principles (see Section 6).

### **Promote public/private/civil society partnerships**

Companies may wish to make a wider contribution to local social development, beyond their core commercial activities, but often lack the technical expertise or local knowledge. In such cases, cooperation with local government or civil society organisations may offer an efficient and rewarding solution for all three sides of the “triangle”.

### **Act quickly on governance, but plan for the long term**

The good governance agenda is as important for responsible companies as it is for citizens. In the immediate aftermath of a ceasefire there may be a political “window” – some analysts have spoken of a “golden hour” – when it is easier to institute tough but necessary governance reforms. It is vital to take such opportunities while recognising that it takes time for the full benefits of, for example, reforming the judicial system to come into effect. On this point, see also the practice note on Business Environment Reforms in Conflict-Affected Contexts in this series.

### **Be realistic**

Conflict-affected contexts need to adopt a realistic view of the kinds of companies that they can hope to attract, and the speed with which they can attract them. The leading international companies with the best-known brand names may have the greatest resources. However, they typically are less likely to commit funds to small high-risk markets than smaller niche companies from neighbouring countries.

Similarly, while doing all they can to promote their country’s image, government planners may have to accept that it will take time for the perception of their country by outsiders to improve. As noted above, retail banks will in any case be slower to invest than – for example – mining exploration companies.

## **6. Where to find out more**

### **Conflict-sensitive business practice**

- The ‘Peace and Economy’ section of the International Alert website ([www.international-alert.org/peace\\_and\\_economy/index.php](http://www.international-alert.org/peace_and_economy/index.php)) presents research and guidance relating to both domestic and international companies.
- CDA Collaborative Learning Projects ([www.cdainc.com](http://www.cdainc.com)) is a US-based non-profit organisation with a particular focus on “Do no harm” conflict impact assessment. Its Corporate Engagement Project focuses on the lessons learnt from the experience of international companies in conflict-affected areas.

# 6

## **Section 6: Where to find out more**

- Swisspeace ([www.swisspeace.ch](http://www.swisspeace.ch)) runs a 'Business and Peace' programme, which includes research and case studies on business engagement in conflict-affected areas.
- The Red Flags ([www.redflags.info](http://www.redflags.info)) initiative by International Alert and FAFO lists activities that should raise a "red flag" of warning to companies of possible legal risks, and the need for urgent action.

### Multilateral institutions

- The International Finance Corporation (IFC – [www.ifc.org](http://www.ifc.org)), which is the private-sector arm of the World Bank, publishes a set of social and environmental Performance Standards. Performance Standard 4 on *Community, health, safety and security* covers best practice in company security arrangements (See: <http://www.ifc.org/ifcext/sustainability.nsf/Content/PerformanceStandards>).
- The online publications of the *Foreign Investment Advisory Service* (FIAS – [www.fias.net](http://www.fias.net)), which is also part of the World Bank, include the *Rough guide to investment climate reform in conflict-affected countries* (2009). FIAS's Foreign Direct Investment Promotion Center (<https://www.fdipromotion.com>) provides a series of tools and information guidelines for FDI promotion practitioners.
- Other useful websites produced by the World Bank Group include [www.doingbusiness.org](http://www.doingbusiness.org), which ranks countries according to the ease of a selection of business/government transactions, and an enterprise surveys database ([www.enterprisesurveys.org](http://www.enterprisesurveys.org)), which provide a series of benchmarks on the business climate.
- The World Bank's 2004 report, *A better investment climate for everyone. World Bank Development Report 2005* (Washington & New York: World Bank & Oxford University Press) provides an interesting analysis of the conditions that make for an "enabling environment" of both domestic and international businesses, and this is broadly applicable to conflict-affected contexts as well as other developing economies. It is available at [www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2005/08/01/000011823\\_20050801104043/Rendered/PDF/2882902005E.ver.010.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2005/08/01/000011823_20050801104043/Rendered/PDF/2882902005E.ver.010.pdf)
- The United Nations Development Programme (UNDP – [www.undp.org](http://www.undp.org)) published *Post-conflict economic recovery: Unleashing local ingenuity*. As its title suggests, the report places particular emphasis on local private sectors, but many of the initiatives that it recommends are likely to be of equal importance to international companies.
- The UN Global Compact ([www.unglobalcompact.org](http://www.unglobalcompact.org)) promotes corporate responsibility on human rights, labour, the environment and transparency. Its current programmes include a 'Business and Peace' initiative. Recent online publications include *Sustaining business and peace – A resource pack for small and medium-sized enterprises*.
- The Organisation for Economic Cooperation and Development ([www.oecd.org](http://www.oecd.org)) sets standards for both governments and international companies. These include the *Policy framework on investment*, which outlines the policies that governments can introduce to improve investment conditions for responsible business, as well as the *Guidelines for multinational enterprises*, which define basic corporate responsibility

standards. The OECD has also published a *Risk awareness tool for multinational enterprises in weak governance zones*.

### Guidance for specific commercial sectors

- The website of the *International Council on Mining and Metals* (ICMM – [www.icmm.org](http://www.icmm.org)) publishes a series of best practice handbooks for international business in conflict-affected areas. Recent publications include *Human rights in the mining and metals sector: Handling local concerns and grievances* (2009).
- The International Petroleum Industry Environmental Conservation Association (IPIECA – [www.ipieca.org](http://www.ipieca.org)) provides similar advice for petroleum companies. Notable publications include: *Operating in areas of conflict. An IPIECA guide for the oil and gas industry* (2008).
- International Alert's *Conflict-Sensitive Business Practice* (CSBP) is available at [www.international-alert.org](http://www.international-alert.org) and provides guidance to companies in the extractive sectors on conflict-sensitive business practices at various stages in the investment process
- *International companies and post-conflict reconstruction: Cross-sectoral comparisons*. CPR Working Paper No. 22, Washington: World Bank in association with International Alert, February 2005, available at [www.international-alert.org/pdf/International\\_companies\\_post-conflict\\_WBank.pdf](http://www.international-alert.org/pdf/International_companies_post-conflict_WBank.pdf). This is a comparative study of the different approaches to investment by companies from the natural resources, construction, telecommunications and finance sectors.

### Human rights and conflict

- The *Voluntary Principles on Security and Human Rights* (VPs – [www.voluntaryprinciples.org](http://www.voluntaryprinciples.org)) are the result of a multi-stakeholder initiative involving the governments of Canada, the Netherlands, Norway, the UK and the US, Colombia and Switzerland, as well as 18 companies and eight NGOs (including International Alert). The principles lay down guidelines for human rights and conflict-risk assessment as well as company relationships with government security forces and private security agencies. Participants hold an annual plenary meeting to review progress in implementing the VPs, as well as other meetings to address specific issues.
- The Business and Human Rights Resource Centre ([www.business-humanrights.org/Home](http://www.business-humanrights.org/Home)) provides an extensive online database of news and analysis. Among other services, it provides a repository for documents produced by and for Professor John Ruggie, the Special Representative of the UN Secretary General on human rights and business. Ruggie's April 2008 report to the UN Human Rights Council, entitled *Protect, respect and remedy* is a key text in the ongoing task of clarifying international companies' human rights responsibilities, with important implications for engagement in conflict-affected areas.
- The International Business Leaders' Forum (IBLF) has published a draft *Guide to Human Rights Impact Assessment and Management*, available at <http://www.iblf.org/resources/general.jsp?id=123946>.

## About the Practice Note Series

This practice note forms part of a series of Peacebuilding Essentials for Economic Development Practitioners that Alert is producing, in partnership with leading experts and practitioners from relevant fields, in the course of 2009-2010. The aims of the series are to:

- Introduce economic development practitioners to key economic recovery and peacebuilding challenges in conflict-affected and post-conflict contexts;
- Share lessons and good practice on how to strengthen the economic dimensions of peacebuilding;
- Provide practitioners and planners with the knowledge and tools to ensure that their interventions are conflict-sensitive;
- Promote experience-sharing between economic development and peacebuilding practitioners, to enhance synergies between the two.

Topics covered in the series to date include:

- Market Development in Conflict-Affected Contexts
- Socio-Economic Reintegration of Ex-Combatants
- Foreign Direct Investment in Conflict-Affected Contexts
- Business Environment Reforms in Conflict-Affected Contexts
- Supporting the Economic Dimensions of Peace Processes
- Economic Legacies of War
- Natural Resource Governance in Conflict-Affected Contexts

## About the Project

'Strengthening the Economic Dimensions of Peacebuilding' forms part of International Alert's wider work, ongoing since 1999, on improving business conduct and promoting a peacebuilding approach to economic interventions in conflict-prone and conflict-affected contexts. Our firm belief is that just and lasting peace requires broadly shared economic opportunities, including decent work, to redress economic issues and grievances that fuelled violent conflict in the first

place, and to address the economic impacts of conflict on the livelihoods and lives of conflict-affected populations.

Indeed strengthening the private sector and market-based economies has become a key concern for development assistance in recent years, including in countries affected by conflict. But while the links between peacebuilding and the economy may be obvious, it is less clear how a peacebuilding approach to such economic interventions can be achieved in practice, and how they can be made conflict-sensitive. Understanding the ways in which these interventions can interact with pre-existing conflict dynamics is crucial given that the allocation of resources and economic opportunities feature prominently as root causes in many conflicts; therefore any external intervention targeting the economic sphere is bound to interact with core conflict issues and the economic legacies left by violent conflict. This will be to the detriment of the local conflict context, and programmes, alike.

The objectives of the overall project are three-fold:

1. To identify lessons in order to generate evidence-based resources and guidance for policymakers and practitioners to improve the conflict-sensitivity and peacebuilding impacts of economic interventions
2. To promote uptake of such good practice
3. To put the links between economic recovery and peacebuilding on the agenda of relevant national and international actors through advocacy, outreach and networking

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To find out more, visit

[http://www.international-alert.org/peace\\_and\\_economy/index.php?t=3](http://www.international-alert.org/peace_and_economy/index.php?t=3)

## About International Alert

International Alert is an independent peacebuilding organisation that has worked for over 20 years to lay the foundations for lasting peace and security in communities affected by violent conflict. Our multifaceted approach focuses both in and across various regions; aiming to shape policies and practices that affect peacebuilding; and helping build skills and capacity through training.

Our field work is based in Africa, South Asia, the South Caucasus, Latin America, Lebanon and the Philippines. Our thematic projects work at local, regional and international levels, focusing on cross-cutting issues critical to building sustainable peace. These include business and economy, gender, governance, aid, security and justice. We are one of the world's leading peacebuilding NGOs with more than 120 staff based in London and our 11 field offices. For more information, please visit [www.international-alert.org](http://www.international-alert.org)

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