Understanding DFIs' Private Sector Engagement in African Fragile and Conflict-Affected Situations

Review of Development Finance Institutions' Activities in Côte d'Ivoire, the Democratic Republic of the Congo, Liberia and Sudan

December 2018

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List of Acronyms

AFD	Agence Française de Développement
AfDB	African Development Bank
AS	Advisory Services
BIO	Belgian Investment Company for Developing Countries
CAR	Central African Republic
CASA	Conflict-Affected States in Africa
CDI	Côte d'Ivoire
CMAW	Creating Markets Advisory Window
CPI	Corruption Perception Index
CPIA	Country Policy and Institutional Assessment
CTT	Telecom, Media, Technology, Venture Capital Investment, and Private Equity Funds
DAC	(OECD) Development Assistance Committee
DB	Doing Business
DEG	German Investment and Development Corporation (German Development Bank)
DFI	Development Finance Institution
DFID	Department for International Development (UK)
DTF	Distance to the Frontier (of Doing Business)
DOTS	Development Outcome Tracking System
DRC	Democratic Republic of the Congo
EBRD	European Bank for Reconstruction and Development
EAIF	Emerging Africa Infrastructure Fund
EIB	European Investment Bank
EIF	European Investment Fund
ESG	Environmental, Social and Governance
EM	Emerging Market
EITI	Extractive Industries Transparency Initiative
EU	European Union
EUR	Euro
FCS	Fragile and Conflict-affected Situation
FDI	Foreign Direct Investment
FIG	Financial Institutions Group
FINNFUND	Finnish Fund for Industrial Cooperation (Finnish DFI)
FMO	Netherlands Development Finance Company (Dutch Development Bank)
FSF	Fragile States Facility
FSI	Fragile States Index
GDP	Gross Domestic Product
GIZ	German Development Agency
HQ	Headquarters
IC	Investment Climate
ICD	Islamic Corporation for the Development of the Private Sector
IDA	International Development Association
IDB	Inter-American Development Bank
IEG	Independent Evaluation Group

IFC	International Finance Corporation
IFI	International Finance Institution
IFU	Danish Development Finance Institution (Danish Development Bank)
IIC	Inter-American Investment Corporation
INFRA	Infrastructure and Natural Resources
IS	Investment Services
IsDB	Islamic Development Bank
ITFC	International Islamic Trade Finance Corporation
KII	Key Informant Interview
LMIC	Lower Middle-Income Country
LTF	Long-Term Finance
M&E	Monitoring and Evaluation
MAS	Manufacturing, Agribusiness and Services
MDB	Multilateral Development Bank
MIGA	Multilateral Investment Guarantee Agency
MFI	Microfinance Institution
MNC	Multinational Corporation
NGO	Nongovernmental Organization
NIB	Nordic Investment Bank
NPL	Non-Performing Loan
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OFID	OPEC Fund for International Development
OPEC	Organization of the Petroleum Exporting Countries
OPIC	Overseas Private Investment Corporation
PCR	Project Completion Report
PEP	Politically Exposed Person
PPD	Public-Private Dialogue
PPP	Public-Private Partnership
PROPARCO	French Development Finance Institution
PSD	Private Sector Development
SDG	Sustainable Development Goal
SEZ	Special Economic Zone
SME	Small and Medium-sized Enterprise
SSA	Sub-Saharan Africa
STF	Short-Term Finance
SWEDFUND	Sweden Development Finance Institution
TA	Technical Assistance
TF	Trade Finance
TMT	Technology, Media and Telecommunications
UN	United Nations
UNDP	United Nations Development Programme
UNHCR	UN High Commissioner for Refugees
USAID	United States Agency for International Development
USD	United States Dollar
WAVF	West African Venture Fund
WBG	World Bank Group
WTO	World Trade Organization

Executive Summary

Development finance institutions (DFIs) are mandated to invest in a sustainable private sector to spur private sector-led growth in developing countries. DFIs' engagement in developing countries has grown significantly, from USD 10 billion in 2002 to USD 70 billion in 2014[1]. In fragile and conflict-affected situations (FCS), approximately USD 4.9 billion was committed by 15 DFIs between 2014 and 2016[2]. Despite their growing role in FCS, few studies have examined the work of DFIs in these contexts[3]. Through the exploration and analysis of four case study countries – Côte d'Ivoire (CDI), the Democratic Republic of the Congo (DRC), Liberia and Sudan – this paper seeks to better understand what efforts have been undertaken by DFIs in Sub-Saharan African FCS countries.

Overview of DFI Activities in FCS

Although the relevance of DFI commitments in FCS is growing, the amount of DFI commitments between 2008 and 2016 was less than other financial flows such as overseas development assistance (ODA), foreign direct investment (FDI) or personal remittances in case study countries.

Multilateral DFIs were leading investments in CDI, the DRC and Liberia between 2008 and 2016, both in amount and number of projects, compared to bilateral DFIs (USD 1,776 million, with 123 long-term and short-term financing projects by multilateral DFIs in three countries versus USD 810 million, with 51 projects by bilateral DFIs). In CDI and the DRC, International Finance Corporation (IFC) is the largest multilateral DFI investor. The Islamic Development Bank Group (IsDB), through the International Islamic Trade Finance Corporation (ITFC) and the Islamic Corporation for the Development of the Private Sector (ICD), is the biggest DFI investor in Sudan. The research also suggests that bilateral DFIs with significant investment portfolios have historical ties with the case study countries (e.g. Liberia for the Overseas Private Investment Corporation (OPIC), CDI for Proparco of Agence Française de Développement (AFD), and the DRC for the Belgian Investment Company (BIO)).

Across case study countries, the top two sectors which have received the largest amount of DFI long-term financing investment are infrastructure and natural resources (INFRA) (USD 1,257 million), and manufacturing, agribusiness and services (MAS) (USD 675 million). DFIs also utilized short-term financing instruments (USD 460 million) across all case study countries between 2008 and 2016. In CDI, the DRC and Liberia, the median size of DFI commitments in the Financial Institutions Group (FIG) is smaller than those of other sectors, ranging from USD 1.15 million in Liberia to USD 2.65 million in CDI, while the number of FIG investees represents approximately one third of the total number of private sector companies which received DFI investments between 2008 and 2016 (20 FIG investees out of 66 companies in case study countries excluding Sudan).

[1] Savoy, Conor M., Carter, Paddy, and Lemma Alberto (2016). Development Finance Institutions Come of Age: Policy Engagement, Impact, and New Directions. Washington, DC: Center for Strategic & International Studies; Charles Kenny, Scott Morris and Vijaya Ramachandran (2018). Comparing Five Bilateral Development Finance Institutions and the IFC. Washington, DC: Center for Global Development.

[2] IFC and other DFIs collaborate annually to share self-reported data on their investment/commitments.

[3] There are a few notable studies on DFIs. These include Savoy, Conor M., Carter, Paddy, and Lemma Alberto (2016). Development Finance Institutions Come of Age: Policy Engagement, Impact, and New Directions. Washington, DC: Center for Strategic & International Studies; and Charles Kenny, Scott Morris and Vijaya Ramachandran (2018). Comparing Five Bilateral Development Finance Institutions and the IFC. Washington DC: Center for Global Development.

Entering a new FCS Market and Re-Engaging with an FCS Country

When it comes to DFIs' engagement in FCS, fragility is not an exclusionary criterion for their business development and investment decisions. However, certain political economic and security constraints, including sanctions, influence DFIs' decision to open a country office or deploy staff. While DFIs and donors temporarily suspend their work during periods of active and intense violent conflict, it is suggested that local private investors keep their operations going.

DFIs have high-level strategies (e.g. the Country Partnership Framework for IFC as part of the World Bank Group) to guide whether and when to enter a specific FCS market. However, the choice to pursue a specific project is more opportunistic and pragmatic. A key criterion to pursue a specific investment opportunity is the quality of each investee/project. The second significant factor is the potential size of the investment, as DFIs are better equipped to process larger projects, putting some constraints on smaller FCS markets. In Liberia – the smallest economy among the four case study countries – the median size of DFIs' investment is smaller across industry sectors[4] compared to the other three case study countries (four times smaller vis-à-vis the DRC or CDI for MAS; three times smaller vis-à-vis CDI, and two-and-a-half times smaller vis-à-vis the DRC for INFRA).

DFIs utilize a range of strategies to increase their footprints in FCS. They leverage existing relations with current or past investees to expand business in a new market and work with financial intermediaries to reach small and medium-sized enterprises (SMEs). DFIs also utilize technical assistance (TA) (e.g. capacity building, investment climate, sector development, or direct client support/advisory services) at the initial stage of their engagement with a new FCS country. DFIs use TA to gather market intelligence and identify key private sector players. DFIs and private investor interviewees have indicated the important role of TA to enhance the capacity of a business entity and to meet global standards. However, not all DFIs are offering TA. DFIs with a larger footprint in FCS such as IFC, the European Investment Bank (EIB), the Dutch Development Bank (FMO), the French Development Finance Institution (Proparco), the African Development Bank (AfDB), the IsDB, and OPIC have the capability to do so.

Management of Financial and Non-Financial Operational Risks in FCS

FCS is not a place where the usual business development and investment approach would sufficiently address both financial and non-financial risks. Interviewees who participated in the study echoed this sentiment, stressing that managing both financial and non-financial risks requires persistence, practicality, and flexibility. To address financial risks, DFIs deploy a range of de-risking tools and approaches, including local currency, blended finance, co-investment among DFIs, and diversification, taking a portfolio approach through small investments across different country contexts or across sectors. DFIs are, however, less prepared for contextual risks, including political economic issues, conflict dynamics, and fragility drivers. Although poorly managed non-financial risks in FCS could pose significant reputational risks for DFIs, they are viewed largely outside of the project scope or control and are thus difficult to mitigate.

Conflict sensitivity is particularly new to DFIs, and not systematically integrated into their operations vis-à-vis private sector development (PSD) donors who are more familiar with the approach. Conceived in the 1990s, conflict sensitivity supports external actors with sizeable financial investment to assess two-way interaction between a project and the context in which it is being implemented, and proactively mitigates potential negative impacts. DFI professionals indicated that they learned about conflict sensitivity as they operate in FCS; especially, they gain operational insights most often after promising projects fell through due to unmitigated fragility/conflict risks.

None of the 15 DFIs has fully operationalized conflict sensitivity into the investment project cycle, while some efforts have been made by the EIB and IFC at the time of the research. For example, the EIB has developed a guideline on conflict sensitivity and has been offering support to investment teams on how to incorporate conflict sensitivity with their projects since 2015. IFC's Conflict-Affected States in Africa (CASA) initiative introduced the 'fragility lens' in 2015 and IFC advisory service projects funded by CASA are required to articulate how they identify and address fragility issues. Otherwise, DFIs have managed fragility-related non-financial risks through negative screening (not investing in certain sectors), multi-stakeholder/public-private dialogue on project-specific risks, and enhanced project-level environmental, social and governance (ESG) impact assessments.

[4] The industry sectors in this paper were organized as manufacturing, agribusiness and services (MAS); the Financial Institutions Group (FIG); infrastructure and natural resources (INFRA); technology, media and telecommunications (TMT); and telecom, media, technology, venture capital investment, and private equity funds (CTT).

Sequencing of DFI Interventions in FCS

DFIs and other PSD stakeholders such as donors and development banks pursued investment climate and market reform efforts immediately after the countries analyzed in this study signed peace agreements or formed a transitional government after a period of violent conflict. Yet it is difficult to conclude that business climate reform is a pre-requisite condition to attract direct investments in FCS. DFIs undertook direct investment and business climate reform efforts simultaneously in all case study countries.

When looking at the preferred types of PSD interventions in different fragility contexts, no intentional sequencing in relation to fragility is observed. Long-term financing (LTF), short-term financing (STF), and TA projects have occurred across varying levels of fragility in each country. Interviewees have suggested that, given the fluctuating and constantly changing FCS contexts, a linear sequencing approach would not be practical.

STF products such as trade finance were pursued at the early stage of IFC engagement in FCS for its relatively low risk profile. However, there is no evidence that STF always preceded LTF investment (e.g. loans, guarantees, or equity investments)[5].

The study also found no evidence of sectoral sequencing strategies by DFIs in FCS markets. However, companies in the FIG sector have received both TA support and direct investment from DFIs across the case study countries despite these countries' fluctuating fragility scores. A review of IFC datasets shows that investment in the FIG sector occurred at the early stage of IFC's engagement in FCS.

Recommendations for Consideration

Below is a summary of suggestions that DFIs could consider when they intend to expand their footprints in FCS, based on interviews with 116 individuals from DFIs, PSD donor agencies, host governments, civil society organizations, and the private sector.

- A single approach or template for sequencing is not realistic for DFIs' engagement in FCS since contexts vary dramatically, and investments are mostly opportunistic because of a limited pool of opportunities. While waiting for investment climate reform to be initiated, implemented or completed, DFIs could pursue business development and identifying investment opportunities simultaneously. In all the case study countries, practitioners from DFIs and private investors were able to identify 'viable' investment projects a few years after (or earlier) they began operating in FCS countries.
- TA has several benefits in terms of market intelligence gathering, relationship building with key stakeholders, and building critical business skills and capacity for local or regional companies. As FCS markets do not have a consistent pipeline of investable companies, DFIs could consider investing in additional efforts at the origination stage of deals, for example, by accompanying certain high-risk projects with TA. If DFIs do not have a dedicated TA program, they could consider partnering with other institutions with TA capabilities.
- A more systematic and proactive measure tailored for a high-risk FCS project is needed to help DFIs mitigate a range of fragility drivers and non-financial risks. Specifically, DFIs could consider developing an FCS-related tool such as practical guidelines or a training program, which can help investment professionals to identify, assess and respond to fragility risks. Operationally, these efforts could include project- / sector-specific political economic analyses, private sector-focused fragility assessments, project-level conflict analysis and mitigation, client/value chain capacity building on conflict sensitivity, and ongoing operational support through in-house expertise. Systematic non-financial risk mitigation through conflict sensitivity requires additional time, budget, and human resources, thus DFIs could consider allocating or seeking separate resources to address conflict risks and support investment teams.
- Governments in FCS often lack institutional capacity to effectively support companies to mitigate fragility risks inadvertently introduced by the private sector. DFIs may consider stepping up their responsibilities to offer support to investees. Simultaneously, DFIs may consider collaborating to develop a common approach to operationalizing conflict sensitivity at the country or regional level to gain synergies.

[5] AfDB (2017). Trade Finance in Africa: Overcoming Challenges. Abidjan: African Development Bank.

Introduction

Through the exploration and analysis of four case study countries[6] – CDI, DRC, Liberia and Sudan – this research paper attempts to understand the efforts undertaken by DFIs in FCS[7]. Specifically, it reviews how DFIs have entered and whether they have utilized any sequencing strategies when operating in FCS environments. It also explores whether and how DFIs' operations have been sensitive to the contextual understanding of FCS countries. Through the analysis of publicly available data on DFI investments and qualitative interviews with various private sector development practitioners, including DFI professionals, the paper focuses to address the following three main questions.

- When and how have DFIs entered FCS countries?
- What efforts have DFIs made to mitigate both financial and non-financial risks in FCS?
- Have DFIs' interventions in FCS employed any sequencing strategies in terms of industry sectors or instruments, vis-à-vis fragility?

Development Finance Institutions

National and international DFIs are specialized development banks or subsidiaries set up to support private sector development in developing countries. They are usually majority owned by national governments, and source their capital from national or international development funds, or benefit from government guarantees. This ensures their creditworthiness, which enables them to raise large amounts of money on international capital markets and provide financing on very competitive terms. (Source: Organisation for Economic Co-operation and Development (OECD))

The paper follows the efforts of DFIs given their increasing importance in shaping the private sector development agenda in emerging and developing economies. These countries have expanded rapidly in the last 20 years, while DFIs' investment in such countries grew significantly over the period, from USD 10 billion in 2002 to USD 70 billion in 2014[8].

In 2012, DFIs' support to the private sector represented a significant share of capital flows to developing countries, reaching USD 18.6 billion in commitments, 68 per cent of which were provided by international finance institutions[9]. According to the self-reported data among 15 DFIs[10] with direct investments in FCS countries, DFIs committed approximately USD 4.9 billion in FCS countries around the world between 2014 and 2016.

[6] These four countries show signs of the descriptive factors of the deep fragility category – weak institutions, corruption, and weak and uneven service delivery – to varying degrees, while there are inherent differences in terms of the levels of conflict and violence experienced over time and the reasons behind it. Categories of fragility can create their own realities, and obscure other underlying drivers of fragility. Although these countries do have certain issues in common, a nuanced perspective reveals that such issues do not play out in the same way across the focal countries.

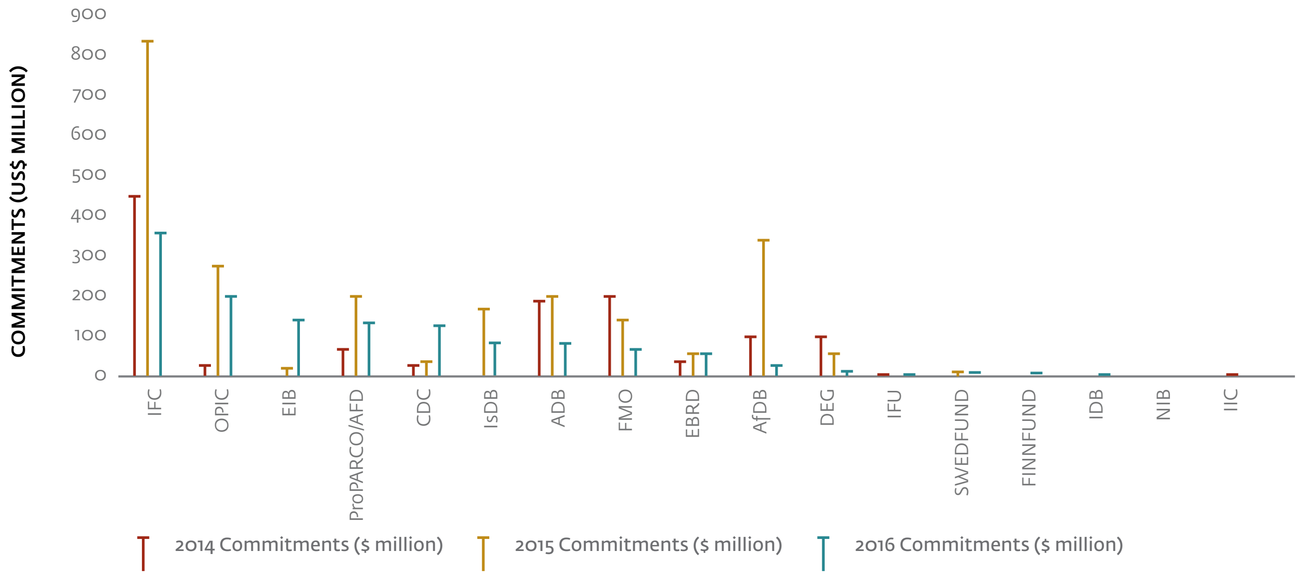
[7] The paper defines FCS based on a Harmonised List of Fragile Situations, which is updated annually by the World Bank Group (WBG). A country is classified as 'fragile' if it has a harmonised average Country Policy and Institutional Assessment (CPIA) rating of 3.2 or less, or has had a United Nations (UN) and/or regional peacekeeping or peacebuilding mission present during the past three years. While IFC follows this list, it continues to label any country which has appeared on the Harmonised List in the past three years as fragile. For more information, please see Annex I. This paper follows the latest IFC FCS when making a reference to Sub-Saharan African FCS countries. For all other FCS references in open data from the WBG, it follows the latest WBG FCS list.

[8] Savoy, Conor M., Carter, Paddy, and Lemma Alberto (2016). Development Finance Institutions Come of Age: Policy Engagement, Impact, and New Directions. Washington, DC: Center for Strategic & International Studies; Charles Kenny, Scott Morris and Vijaya Ramachandran (2018). Comparing Five Bilateral Development Finance Institutions and the IFC. Washington, DC: Center for Global Development.

[9] Klen, Alexander, Sangare, Cecile and Semeraro, Giovanni Maria (2014). Chapter 4: The Growing Development Potential of Other Official Flows. In Development Co-operation Report 2014: Mobilising Resources for Sustainable Development, by the OECD.

[10] IFC and other DFIs collaborate annually to share self-reported data on their investment/commitments.

Figure 1: DFI Commitments in FCS (2014-2016)



With a strategic priority to invest in FCS, IFC has become the largest DFI investor in FCS. Similar efforts have been made by other DFIs in the last few years, as reflected in their new strategies. While trying to achieve investment targets in these complex settings, DFIs face significant challenges, including identifying at what stage and in what context different engagement approaches are appropriate in countries with complex political, economic, and social dynamics. Despite DFIs' increasing role in FCS, there are relatively few studies looking at the role of DFIs in supporting private sector development in developing economies, and very few examine the work of DFIs in relation to fragile situations[11].

The primary purpose of this paper is to illustrate the types of efforts DFIs have undertaken in some of the most challenging business environments, and to offer snapshots of their engagements. The paper is divided into six sections, which are structured as follows: Section 1 explains the wider context for the research and the case study contexts, while Sections 2, 3 and 4 outline the findings of the research under each of the three overarching research questions. Section 5 provides brief final reflections, including a list of recommendation for DFIs to consider. Research methods as well as limitations can be found in the annexures. Field research was conducted between May and October 2017, and the study reviewed 138 LTF and 48 STF projects that DFIs committed to between 2008 and 2016.

[11] There are a few notable studies on DFIs. These include Savoy, Conor M., Carter, Paddy, and Lemma Alberto (2016). Development Finance Institutions Come of Age: Policy Engagement, Impact, and New Directions. Washington, DC: Center for Strategic & International Studies; and Charles Kenny, Scott Morris and Vijaya Ramachandran (2018). Comparing Five Bilateral Development Finance Institutions and the IFC. Washington, DC: Center for Global Development.

01. Key Concepts and a Brief Overview of the Country Context

A. Broader Context: The Private Sector, and Fragility and Conflict

In 2016, only one year after global leaders made ambitious commitments to pave the way to a sustainable future through the adoption of the UN Sustainable Development Goals (SDGs), the world saw a surge of violent conflicts. In 2016 alone, approximately 26,000 people died from terrorist attacks, and 560,000 people lost their lives because of violence[12]. The UN High Commissioner for Refugees (UNHCR) reported that 65.6 million people were forcefully displaced in 2016 – the highest number of people since the end of the Second World War. It is estimated that by 2030, between 60 per cent and 80 per cent of all of the world's poor will live in fragile countries[13]. Clearly, without addressing the needs of FCS countries, achieving the UN SDGs by 2030 – including Goal 16's objective of 'building peaceful societies' – would be nearly impossible. To respond to the urgent needs of FCS countries, supporting their development has become a strategic focus area for the WBG, one of the world's largest sources of funding and knowledge for development countries, as well as other international financial institutions and development partners.

In most FCS, economic development has frequently been stalled and interrupted, or continues only in pockets of the country. It is widely accepted that conflict depresses growth, especially in the short term. Conflict also exacerbates an already deteriorating business environment and associated employment opportunities[14]. The complex and reinforcing relationship between fragility and conflict, and economic development is widely recognized[15]. Furthermore, many FCS do not follow a linear path from fragility towards stability, but rather experience recurrent cycles of conflict and violence – armed conflict is 90 per cent more likely in countries that have previously experienced violent conflict[16] – making the effective timing of specific approaches difficult to predict.

The private sector matters in FCS for a range of reasons, including, but not limited to its ability to create jobs and generate revenue streams for governments[17]. Yet there are various challenges that impede the development of a vibrant private sector in FCS, including damaged or poorly developed infrastructure, small private sectors, and weak institutions and regulatory environments. In addition, governments are often operating with a limited tax base, while entrepreneurs and SMEs struggle to access capital and training[18].

[12] OECD (2018). States of Fragility 2018. OECD: Paris; United Nations; World Bank (2018). Pathways for Peace: Inclusive Approaches to Preventing Violent Conflict. Washington, DC: World Bank.

[13] In 2015, the OECD State of Fragility Report predicted that 60 per cent of the world's poor will be living in fragile situations. In 2018, the OECD State of Fragility Report increased this figure, indicating that without substantial efforts, 80 per cent of the world's poor will be living in fragile contexts. In 2018, about 1.8 billion people are estimated to live in fragile contexts, but this figure is projected to grow to 2.3 billion by 2030. Please see more details in the following reports: OECD (2015). States of Fragility 2015: Meeting Post-2015 Ambitions. Paris: OECD; and OECD (2018). States of Fragility 2018. Paris: OECD.

[14] Buckley, J., McIntosh, K. (2016). A Delicate Balance: Economic Development and Job Creation in Fragile States. GREAT Insights Magazine, Volume 5, Issue 61. February 2016.

[15] United Nations; World Bank (2018). Pathways for Peace: Inclusive Approaches to Preventing Violent Conflict. Washington, DC: World Bank.

[16] World Bank (2011). World Development Report: Conflict, Security and Development. Washington, DC: World Bank.

[17] The private sector creates revenue streams in the form of taxes so governments can provide essential services to their citizens and become less dependent on aid. World Bank (2016). Private Sector Development in FCS. Core Course on Fragility, Conflict and Violence. Washington, DC, May 25, 2016.

[18] Buckley, J., McIntosh, K. (2016).

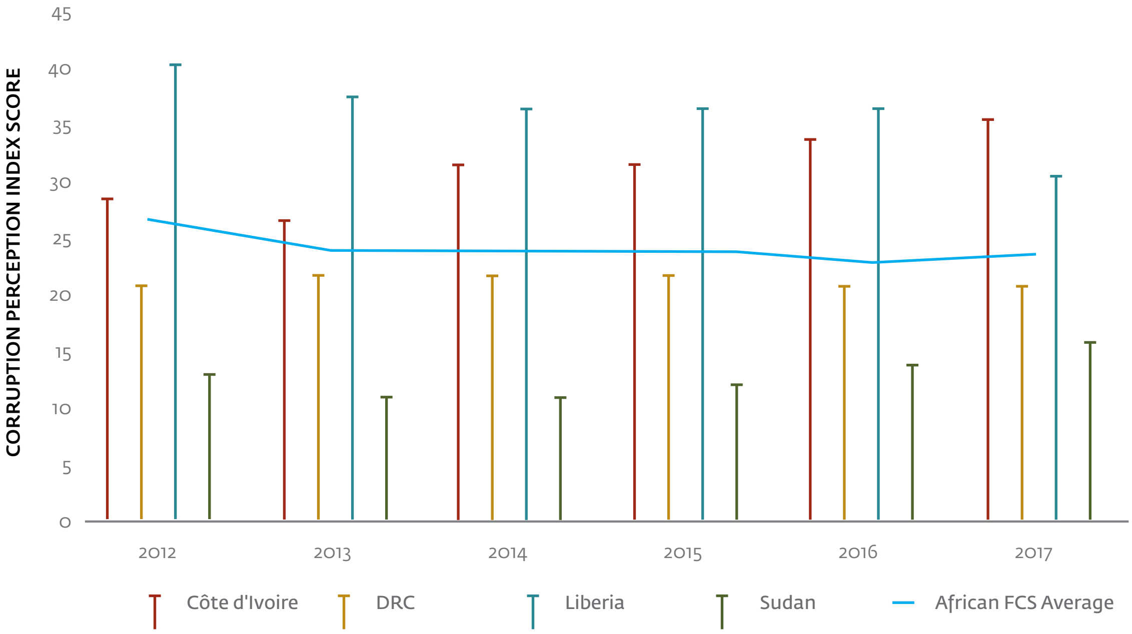
B. Comparing Country Contexts: Obstacles to Doing Business, and Fragility and Corruption

Each country in this study has been selected due to its unique characteristics. CDI is one of the fastest growing FCS countries and has pre-existing private sector infrastructure. The DRC is resource-endowed and a large economy, but is burdened with a poor investment climate and the presence of active violent conflicts. Liberia, a post-conflict country that has maintained stability for more than a decade, has demonstrated improvements around the business investment climate, but has a small economy. Sudan is a so-called pariah state under international sanctions but is well endowed with resources and has a large economy.

All four countries show signs of the descriptive factors of the *deep fragility* category – weak institutions, corruption, and weak and uneven service delivery – to varying degrees. *Deep fragility* is therefore an accurate descriptor in this sense; even where FCS countries show signs of transition, they remain fragile at deeper levels. This manifests in weak institutions that have difficulty providing public services in an inclusive manner. All four of the case study countries experience a considerable degree of unevenness in the delivery of essential services and infrastructure.

The weakness of institutions varies between sectors and between countries, although institutional capacity is particularly weak in Sudan and the DRC. Corruption poses a challenge in all four countries, although it appears to be more manageable in CDI and Liberia. It is, however, pervasive in the DRC, and political infiltration into business is acute in Sudan (see Figure 2).

Figure 2: Corruption Perception Index (CPI) Score in Case Study Countries (2012-2017)



A key driver of fragility that has consistently appeared across the case study countries is contestation over access to land and natural resources, and the gap between statutory and customary systems of land rights. This is an important cause of conflict and can directly affect businesses in the agricultural and resource extraction sectors.

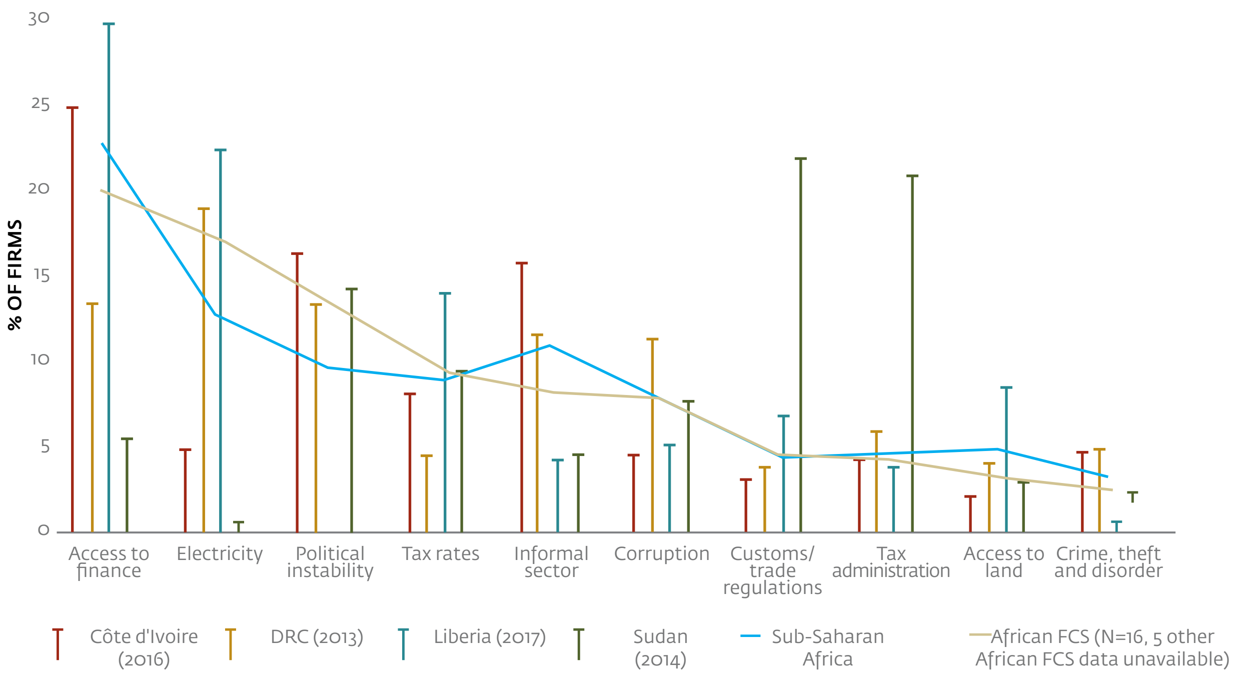
Inhibiting factors in the investment climate in the studied FCS countries often coalesce with factors of fragility and are impacted by them – for instance, the coalescing of the impact of corruption on rates and frequency of taxes, patronage systems creating unfair competition, and education during conflict impacting on human capacity and skills. In addition, investment climate conditions can have negative impacts on conflict, such as the uneven distribution of key infrastructure and services exacerbating exclusion, and overlapping customary and statutory land regulation impacting negatively on livelihoods.

Some of the above-mentioned challenges are reflected both in the World Bank's Enterprise Survey and in interviews on the four case study countries. The Enterprise Survey data reveal that poor access to finance, political instability and poor electricity supply emerge as the top three co nstraints in the case study countries as well as in other FCS countries in Sub-Saharan Africa, as shown in the Figure 3[19]. There is, however, a wide variation within each country. In line with the findings of the Enterprise Survey, interviewees from all stakeholder groups frequently mentioned limited access to financial services as a challenge of operating in case study countries. Particularly, the concentration of financial services in the capital was cited as an obstacle, as rural or regionally based SMEs and business faced more pronounced difficulties in accessing finance. In such contexts where conflicts have had regional dimensions, uneven distribution of financial services could also serve to fuel sentiments of exclusion[20].

The high cost of electricity, as well as unreliable power supply, was frequently mentioned by interviewees as an inhibiting factor in the case study countries. These are further substantiated by the low level of access to electricity in these four countries. Even in the generally good infrastructure environment of CDI, several interviewees highlighted the very high cost of energy as a barrier to development. In Liberia, the DRC and Sudan in particular, interviewees cited a notable regional disparity in both access to and the cost of electricity. Businesses outside of Kinshasa are unable to rely on the DRC's national energy grid, as most of the country receives just two or three hours of electricity per day, while Liberia has one of the lowest electricity access rates in the world[21]. In 2016, only 18.9 per cent of Liberians had access to electricity compared to the average figure for all FCS countries of 48.9 per cent.

Infrastructure more broadly was also regularly cited as an ongoing constraint, except for CDI. In Sudan, water, electricity, and roads are severely lacking outside of Khartoum, and companies explained that they must often finance these themselves for larger operations outside of the capital. The poor state of Liberia's infrastructure adds further challenges to businesses that need to transport goods and cash long distances from the capital, such as agriculture firms, extractives companies, wholesalers, and banks. Transport was continually highlighted as a major issue in the DRC, given its large land mass and severely lacking road network. Conversely, in CDI, relatively good infrastructure, which was not destroyed during the conflict, was cited by many DFIs and private investors as a key enabling factor.

Figure 3: Top 10 Obstacles of Four Case Study Countries



Source: *World Bank Enterprise Surveys*

[19] The years in which these surveys were conducted are: CDI in 2016, the DRC in 2013, Liberia in 2017, and Sudan in 2014. The countries included in Sub-Saharan African FCS are Burundi, CDI, the Republic of the Congo, Djibouti, The Gambia, Guinea-Bissau, Liberia, Madagascar, Mali, Mozambique, Sudan, Sierra Leone, South Sudan, Togo, Zimbabwe, and the DRC. Out of 21 Sub-Saharan African FCS countries, no information was available for Chad, Comoros, the Central African Republic, Guinea-Bissau, and Somalia.

[20] European Investment Bank (2017). Banking in Sub-Saharan Africa: Interim Report on Digital Financial Inclusion.

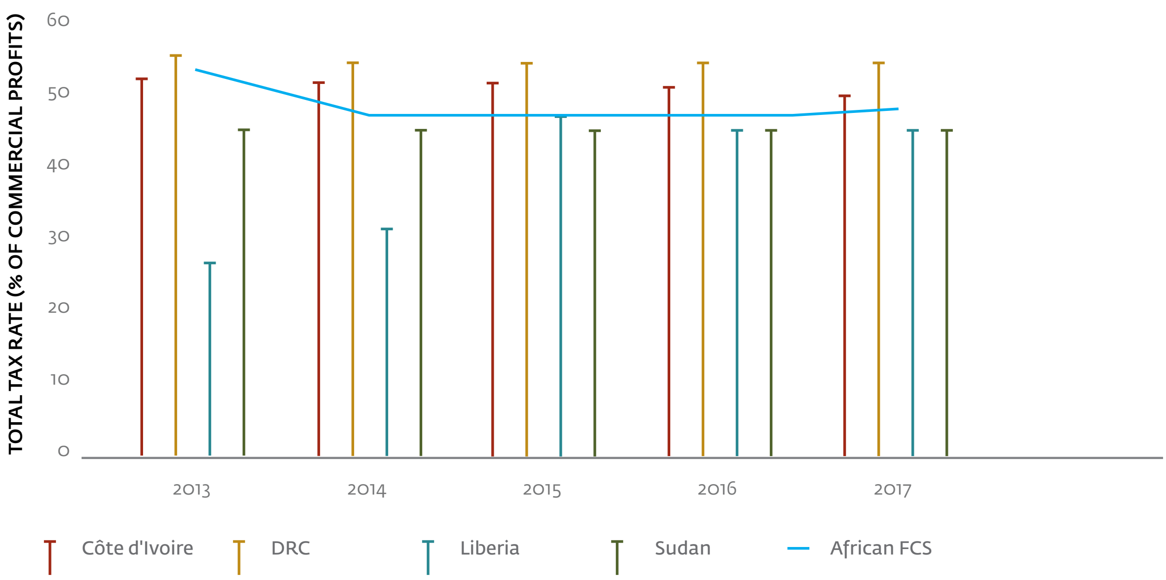
[21] USAID, DRC Power Africa Factsheet, accessed at https://www.usaid.gov/powerafrica/democratic-republic-congo; and Liberia Power Africa Factsheet, accessed at https://www.usaid.gov/powerafrica/liberia.

Many interviewees (especially in the DRC and Sudan) cited significant governance challenges associated with corruption and patronage politics. These are also reflected in the low score on the Corruption Perception Index of these four countries (see Figure 2). Particularly, the DRC and Sudan are below the average of 21 FCS countries in Sub-Saharan Africa. In the DRC, investors of all sizes find harassment and corruption on the part of government officials to be the major constraint to current and future investment and doing business. Companies in Sudan suffer from political interference at every level of business. Investors in Liberia and CDI also mentioned corruption as an issue.

In both Sudan and the DRC, high tax rates and frequency of taxes were commonly cited as an inhibiting factor to investment by interviewees. Even more debilitating to many investors is the harassment by tax officials and unreliable enforcement of taxation. In the DRC, corruption and harassment are described as a daily reality for businesses; the bigger companies that have the means to staff legal departments report that they are overwhelmed with harassment related to tax claims and fines (so-called tracasserie).

Tax issues in the DRC are also pronounced when comparing the total tax rates (% of commercial profits) of the four case study countries, as reflected in Figure 4. Tax administration was in the top three obstacles in Sudan, but not in the DRC, according to the Enterprise Survey data. This disparity may be explained by a more honest assessment of so-called tax issues being the result of corruption in the DRC. In Sudan, where political infiltration into business is so pervasive, what might be seen by outside onlookers as corruption would be considered a 'tax' – a normal part of doing business in Sudan.

Figure 4: Total Tax Rates (% of Commercial Profits) of Four Case Study Countries (2013-2017)



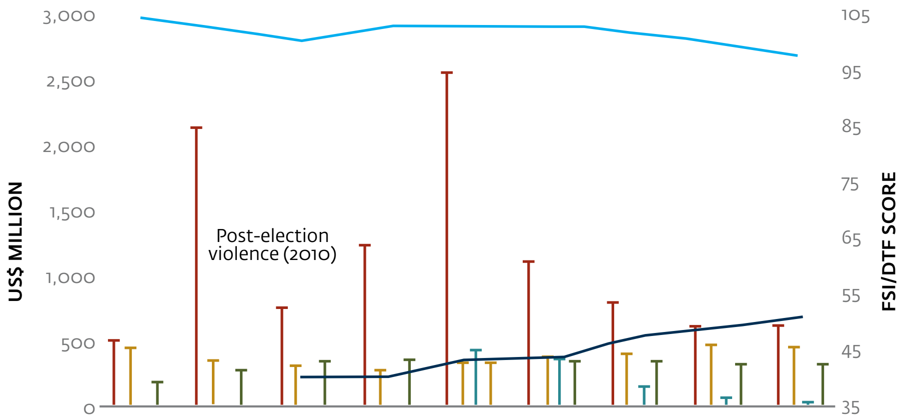
Despite not being identified as a significant obstacle in Enterprise Survey data, human capacity was repeatedly mentioned as an inhibiting factor to investment by interviewees in the DRC, Liberia, and Sudan (but much less so in CDI). In Liberia and the DRC, this has significant connections to the conflict, which has resulted in a generation of people who have missed schooling entirely, or who have very low educational levels. An important driver of fragility that has consistently appeared across the case study countries during interviews is contestation over access to land and natural resources, and the gap between statutory and customary systems of land rights. This is an important cause of conflict which appear to directly affect businesses in the agricultural and resource extraction sectors.

In FCS, where conflict and fragility can often have a regional dimension, understanding these disparities is extremely important. Regional disparities, for instance between access to electricity and access to finance, can be better illustrated in enterprise survey data.

02. Understanding DFIs in Four FCS Countries

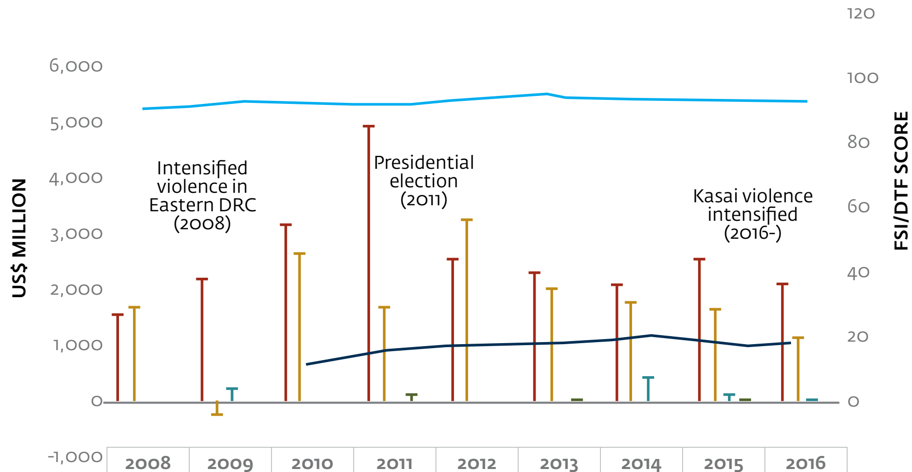
Figure 5: Cross-Border Financial Flows vis-à-vis Fragile States Index (FSI) and Distance to the Frontier (DTF) scores

CDI: Net ODA, FDI inflows, personal remittances and DFI commitments vis-a-vis FSI and DTF scores (2008-2016) (GDP in 2016: 36,372 US$ million)



		2008	2009	2010	2011	2012	2013	2014	2015	2016
T	Net ODA received (constant 2015 US$ million)	530.60	2,149.00	775.20	1,242.00	2,599.30	1,148.80	833.50	653.10	655.60
T	FDI, net inflows (BoP, current US$ million)	466.50	396.00	358.10	301.60	330.30	407.50	438.80	494.20	481.00
T	DFI commitments (US$ million)			11.90	11.80	452.00	406.70	180.50	131.40	60.40
T	Personal remittances, received (current US$ million)	198.90	315.10	373.50	396.60	367.10	384.70	386.70	336.30	342.00
—	FSI score	104.60	102.50	101.2	102.80	103.60	103.50	101.70	100.10	97.90
—	DTF score			40.54	40.69	43.38	44.07	47.95	49.83	51.04

DRC: Net ODA, FDI inflows, personal remittances and DFI commitments vis-a-vis FSI and DTF scores (2008-2016) (GDP in 2016: 35,381 US$ million)



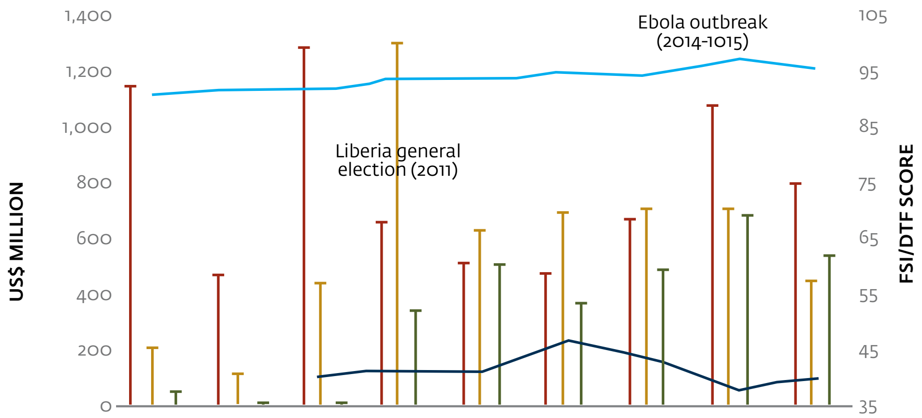
		2008	2009	2010	2011	2012	2013	2014	2015	2016
T	Net ODA received (constant 2015 US$ million)	1,595.41	2,233.82	3,204.29	4,971.19	2,594.18	2,338.63	2,175.40	2,599.04	2,124.89
T	FDI, net inflows (BoP, current US$ million)	1,726.80	-243.20	2,742.30	1,686.90	3,312.14	2,098.25	1,843.17	1,673.50	1,204.71
T	DFI commitments (US$ million)	10.25	269.73	6.77	1.50	10.00	11.94	480.18	228.60	50.39
T	Personal remittances, received (current US$ million)	14.70	19.50	15.70	114.60	12.20	33.11	22.38	141.91	15.98
—	FSI score	107.00	109.00	110.00	108.00	111.00	112.00	110.00	110.00	110.00
—	DTF score			30.00	34.00	35.00	35.00	38.00	35.00	37.00

A. Cross-Border Financial Flows and DFI Commitments in Four FCS Countries

In all four case study countries, ODA is one of the most significant sources of cross-border financial flows.

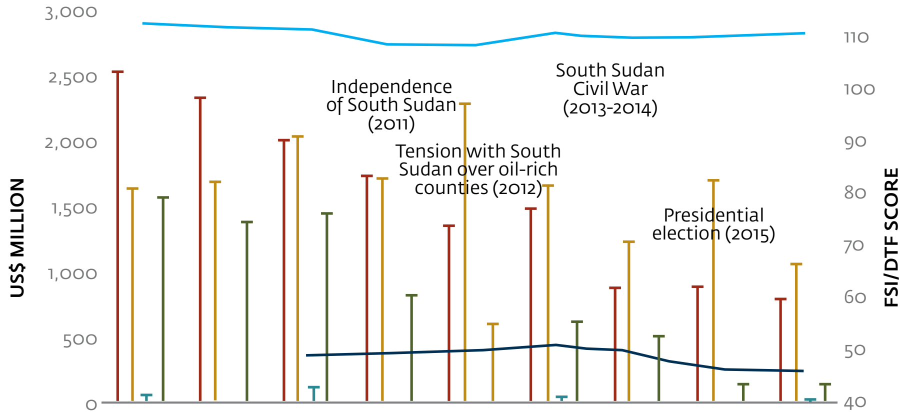
Figure 5 illustrates that DFI commitments are much smaller than other major cross-border financial flows such as personal remittances or FDI. The only exception was CDI, which recorded a higher volume of DFI commitments between 2008 and 2016 vis-à-vis other case study countries.

LIBERIA: Net ODA, FDI inflows, personal remittances and DFI commitments vis-a-vis FSI and DTF scores (2008-2016) (GDP in 2016:2,101 US$ million)



	2008	2009	2010	2011	2012	2013	2014	2015	2016
Net ODA received (constant 2015 US$ million)	1,158.46	483.51	1,294.66	674.98	523.31	488.58	680.58	1,094.43	809.59
FDI, net inflows (BoP, current US$ million)	283.54	127.80	452.34	1,312.75	646.60	700.27	720.08	721.03	809.59
DFI commitments (US$ million)	136.54	12.01	42.58	104.00	27.47	12.47	43.66	23.41	38.17
Personal remittances, received (current US$ million)	58.12	25.12	31.44	359.99	515.79	383.41	505.67	640.78	548.78
FSI score	91.00	91.80	91.70	94.00	93.30	95.10	94.30	97.30	95.50
DTF score			41.05	41.94	41.94	46.58	43.75	38.59	40.43

SUDAN: Net ODA, FDI inflows, personal remittances and DFI commitments vis-a-vis FSI and DTF scores (2008-2016) (GDP in 2016: 95,584 US$ million)



	2008	2009	2010	2011	2012	2013	2014	2015	2016
Net ODA received (constant 2015 US$ million)	2,556.00	2,352.00	2,025.00	1,742.00	1,369.00	1,507.00	874.70	899.80	810.40
FDI, net inflows (BoP, current US$ million)	1,653.12	1,726.29	2,063.73	1,734.38	2,311.46	1,687.88	1,251.28	1,728.37	1,063.77
DFI commitments (US$ million)	556.80	3.00	115.80	5.00	0.00	10.00	0.00	0.00	10.00
Personal remittances, received (current US$ million)	1,590.62	1,394.40	1,455.54	824.22	595.84	619.51	506.56	151.39	153.41
FSI score	113.00	112.40	111.80	108.70	109.40	111.00	110.10	110.80	111.50
DTF score			48.79	48.95	49.39	50.98	49.36	45.92	45.39

Hornberger et al analyzed 30 empirical studies focused on developing and transitional economies between 2000 and 2010 to understand the factors influencing FDI inflows. They point out that over 50 per cent of these studies show that market size and potential are significantly associated with FDI inflows[22].

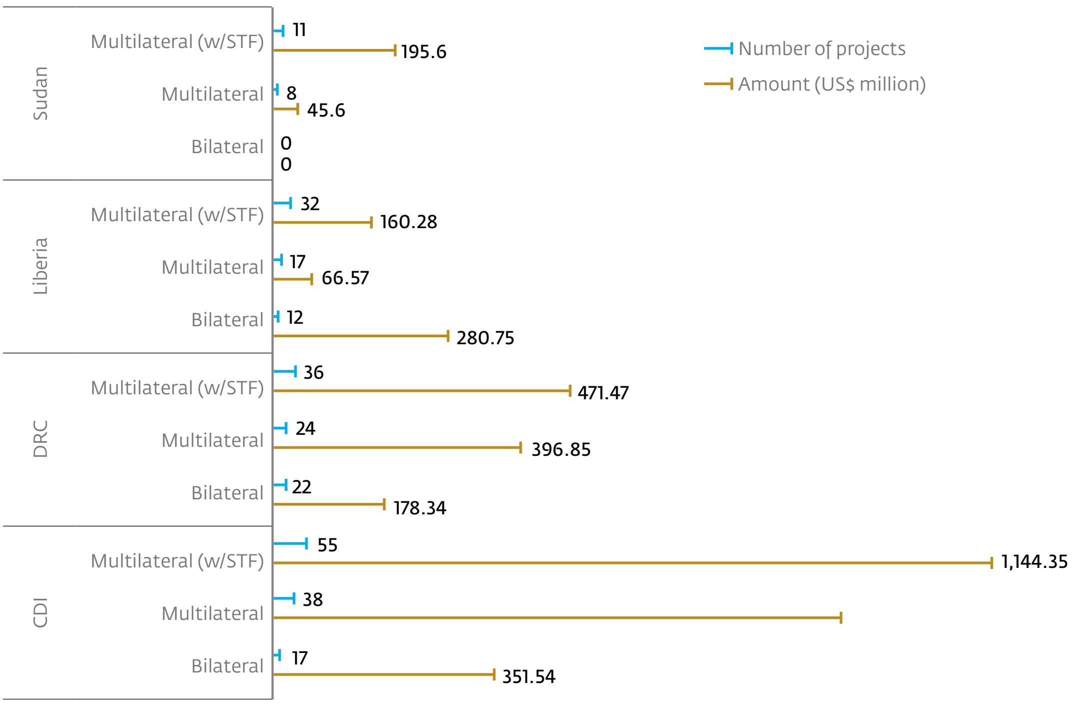
shows that FDI inflows are greater in countries with large economies. When comparing Liberia with the DRC, it appears that DFIs as well as private investors are willing to expand their presence in contexts which are experiencing high fragility and/or sub-optimal investment climate conditions because they see commensurate opportunities stemming from their economic size and market potential. However, DFI commitments are not only affected by the size of the FCS economy.

While DFIs made more commitments in CDI and the DRC vis-à-vis Liberia with a better Doing Business Distance to Frontier (DTF) score, Sudan (with the larger economy than the other three countries) received few investments, largely because of international sanctions. Certain broader political realities such as economic sanctions play a role in deterring DFI investment flows into a country, even when it has a sizeable population and GDP, as in the case of Sudan.

B. DFI Portfolio in Four FCS Countries

Figure 6[23] indicates that, except for Liberia, multilateral DFIs made more commitments in the four FCS case study countries between 2008 and 2016, both in amount and project number, than bilateral DFIs. As Figure 7 illustrates, much of the multilateral commitments were made by IFC in CDI, the DRC and Liberia, while Sudan's multilateral commitments were made by the Islamic Development Bank and the OPEC Fund for International Development (OFID).

Figure 6: Multilateral and Bilateral DFI Commitments in Four Case Study Countries (2008-2016)



The commitments of the Overseas Private Investment Corporation (OPIC) were largest in Liberia, in volume[24]. In each case study country, certain bilateral DFIs have made more significant commitments than the multilateral DFIs; this appear to be linked to their historical legacy. For example, PROPARCO of France was the largest bilateral DFI in CDI, BIO of Belgium has made more commitments in the DRC vis-à-vis other FCS countries, and OPIC has made significant commitments in Liberia.

[22] Hornberger, Kusi, Battat, Joseph and Kusek, Peter (2011). Attractive FDI: How Much Does Investment Climate Matter? Viewpoint: Public Policy for the Private Sector; Note No. 327. World Bank, Washington, DC.

[23] This figure includes STF projects only for multilateral DFIs. No bilateral DFIs published STF projects.

[24] One of the biggest investments OPIC made in Liberia was a loan to Buchanan Renewables. After controversy around its due diligence and political interference in terms of the approval process surfaced, Buchanan Renewables paid back the loan, and in March 2013, OPIC sent a letter to the NGOs that filed complaints, informing them that Buchanan was no longer an OPIC project and that specific concerns could be relayed to the Embassy in Monrovia.

Figure 7: Individual DFI Commitments in Four FCS Countries (2008-2016)

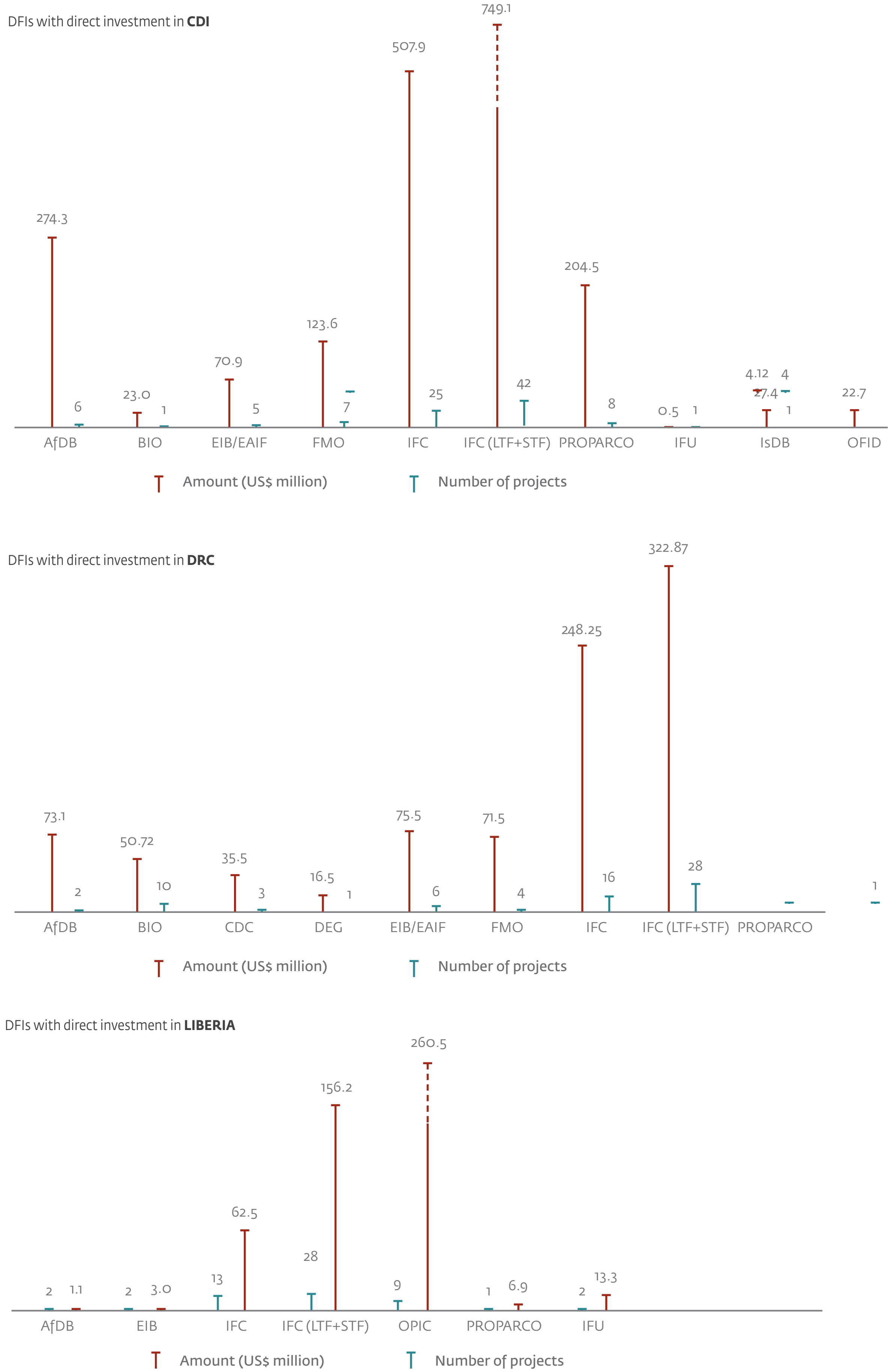
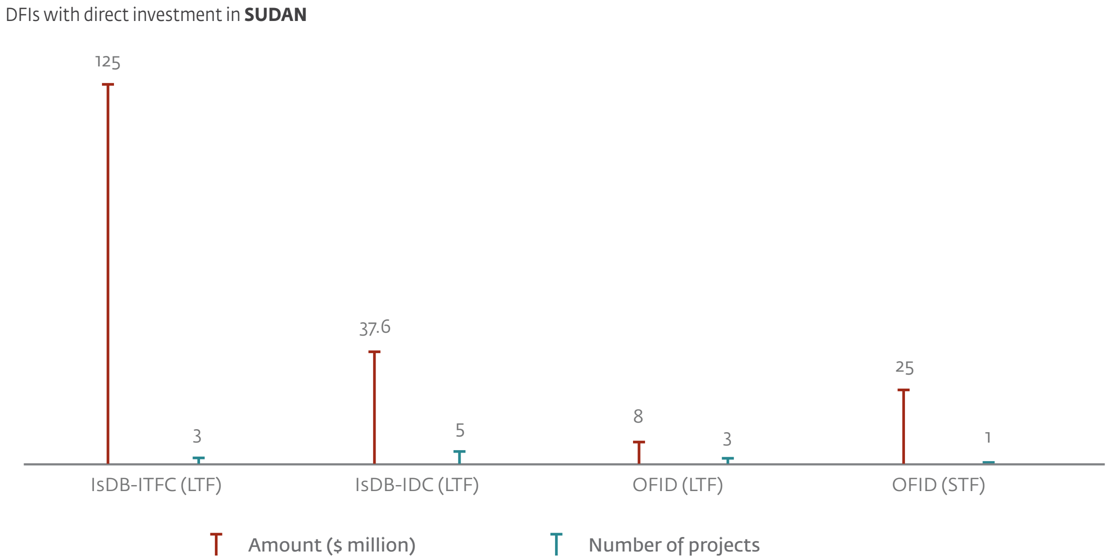
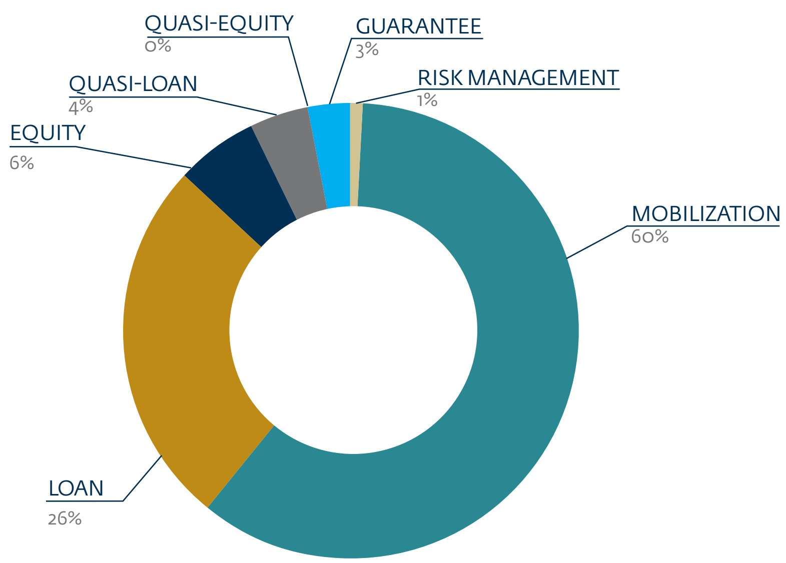


Figure 7: Individual DFI Commitments in Four FCS (2008-2016) (continued)



IFC's recent review of its commitments in FCS globally indicates that 40 per cent of its efforts were made through its own account, and 60 per cent of its efforts between 2014 and 2018 enabled mobilization of additional resources from other investors. Within IFC's investment for its own account, loans were the most commonly used financial product (see Figure 8).

Figure 8: IFC Commitments in FCS by Instrument (2014-2018; US$ million)[25]



The review of IFC commitments in African FCS between 2014 and 2018 (see Figure 9) and the investments of 12 DFIs in CDI, the DRC and Liberia between 2008 and 2016 (see Figure 10) illustrates the same trend – that loans are the most frequently used financial instrument. DFIs make much fewer equity investments, at less than 1 per cent of their direct investments.

[25] IFC data provided by Thought Leadership Unit; the data are part of its forthcoming paper "Private Enterprises in Fragile and Conflict-related Situations".

Figure 9: IFC Commitments in African FCS (2014-2018; US$ million)[26]

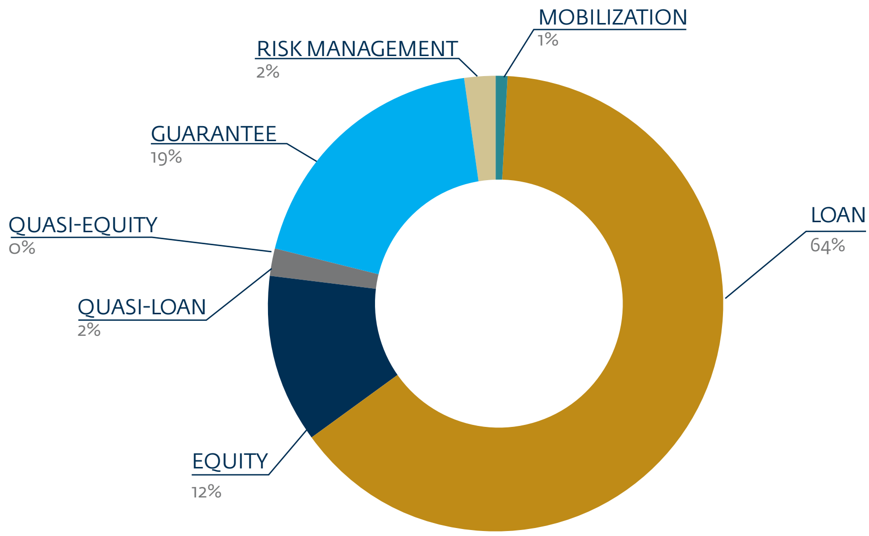
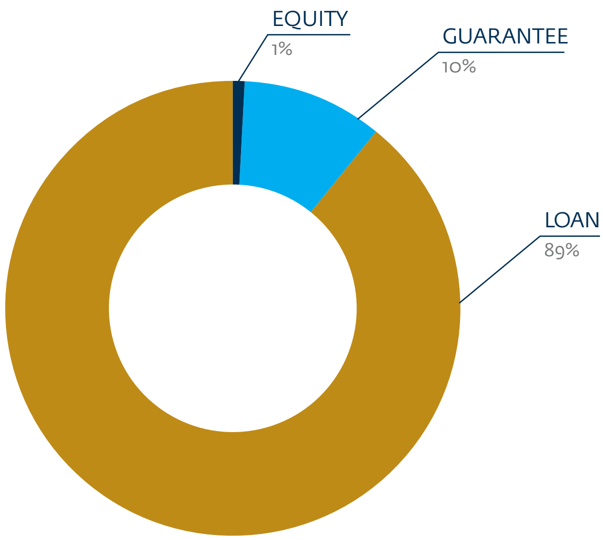


Figure 10: 12 DFI Commitments by Investment Instruments[27]

DFI commitments in CDI, DRC and Liberia (excluding IFC, 2008-2016; US$ million)



[26] IFC data provided by Thought Leadership Unit; the data are part of its forthcoming paper "Private Enterprises in Fragile and Conflict-related Situations".

[27] Ibid.

C. DFI Investees in Four FCS Countries

As outlined in Figure 11, in CDI and Liberia, DFIs made the largest commitments in companies in the INFRA sectors, while in the DRC, DFIs' largest commitments went to companies in the MAS sectors. In Sudan, the largest volume of investments was made through trade finance, which is considered an STF product.

Figure 11: DFI Investments per Sector in Case Study Countries

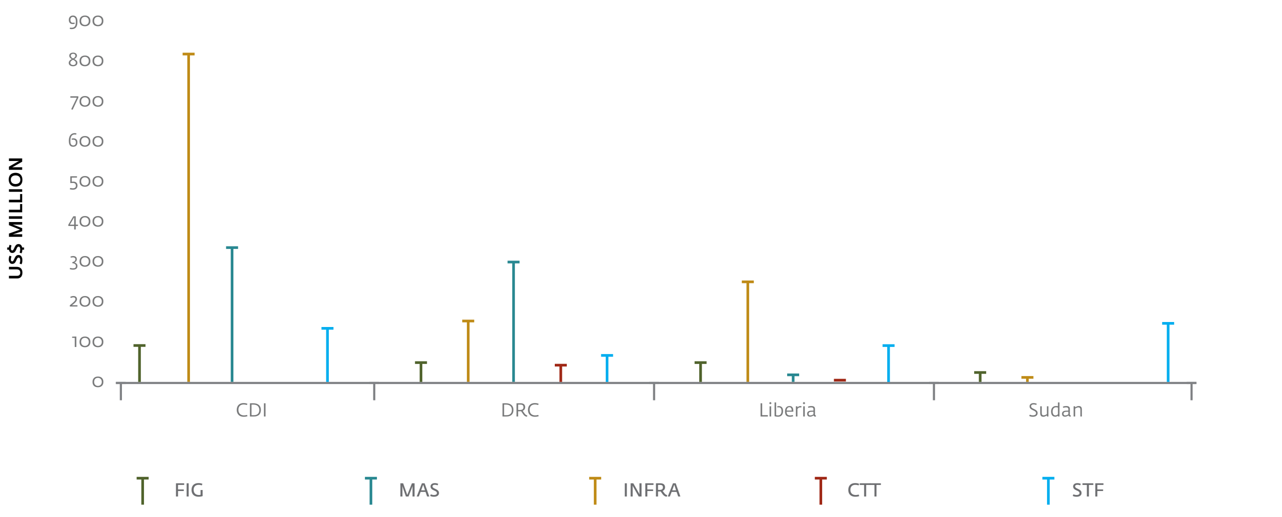
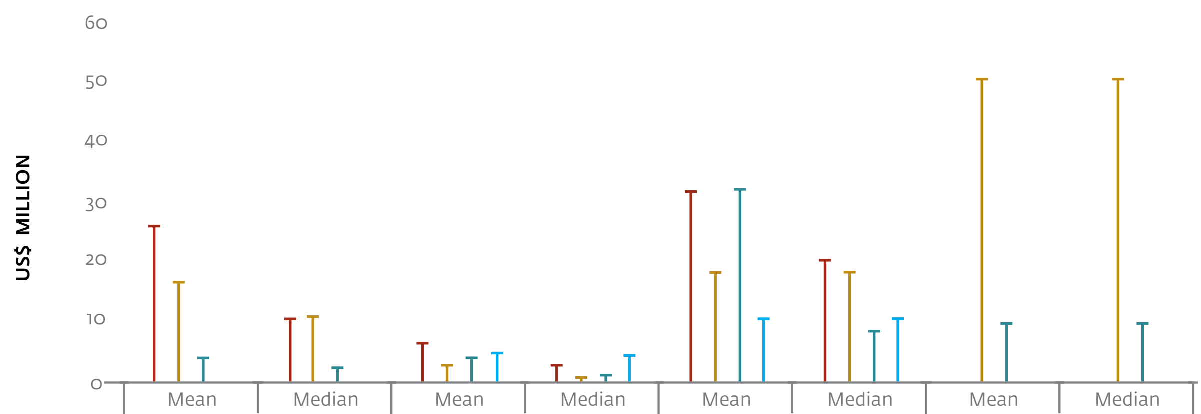


Figure 12 suggests that DFI commitments in the Financial Institutional Group (FIG) are smaller than those in other industry sectors across case study countries. In addition, Liberia, which has the smallest economic size among the case study countries, tends to have smaller transaction sizes across sectors. For example, compared to the DRC, the median size of a deal in the MAS sector is four times smaller in Liberia.

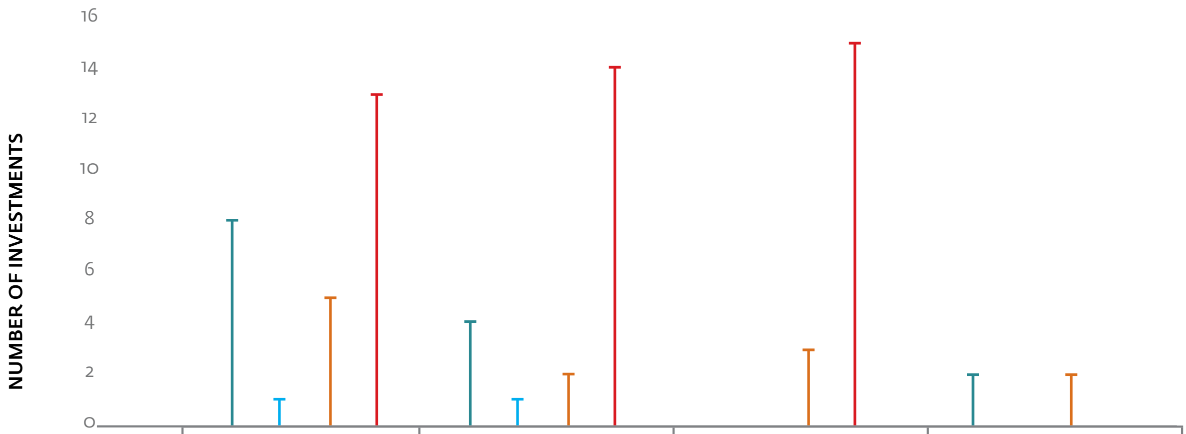
Figure 12: Mean and Median Size of DFI Commitments in Four Case Study Countries, per Industry (2008-2016)



	MAS		FIG		INFRA		CTT	
	Mean	Median	Mean	Median	Mean	Median	Mean	Median
CDI	25.68	10.67	6.34	2.65	31.49	20.33		
DRC	16.48	10.87	2.94	1.1	17.99	17.95	50	50
Liberia	4.02	2.5	4.16	1.15	31.87	8.27	10	10
Sudan			4.97	4.4	10.4	10.4		

The major shareholders of many investees working with DFIs are predominantly located in OECD Development Assistance Committee (DAC) countries (see Figure 13). An exception to this observation is Sudan where companies with links to OECD-DAC countries are impacted by US sanctions. DFIs also invested in local and regional companies from neighboring countries between 2008 and 2016.

Figure 13: HQ Location of DFI Investees' Major Shareholders



	CDI (n=27)	DRC (n=21)	Liberia (n=18)	Sudan (n=2)
Local	8	4	0	2
EM	1	1	0	
Regional	5	2	3	2
OECD-DAC	13	14	15	

D. Factors Influencing DFI Entry to FCS Countries

While DFIs have broader high-level strategies to guide whether to enter a particular FCS market, the choice to pursue a specific project is more opportunistic and pragmatic. During interviews, DFIs and their financial intermediary private investors emphasized that a significant criterion to pursue a specific investment opportunity was the assessment of the individual sponsor or project. A DFI interviewee explained that there was no specific exclusion of an investment because an investee was operating in fragile situations – rather, the decision was very project specific and based on finding the 'right investee'.

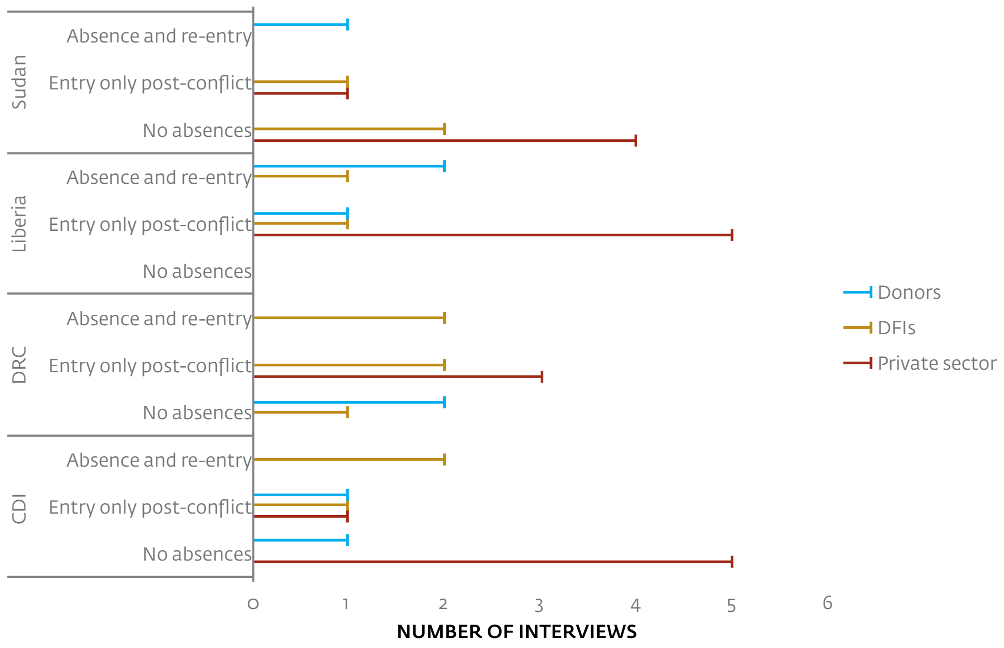
> *"The DRC economy is way larger than the Liberian or Somali economy. In DRC you can look at 50-100 million investments, but in Liberia 5-10 million is lucky. So, this is an important element in our decision to engage in a given country. It costs as much internally for a 1 million offer or 100 million offer, so investment officers gravitate to larger deals." (DFI interviewee)*

A DFI interviewee explained that another important element was the size of the potential investment. Several DFI interviewees noted that the existing incentive structures for investment officers resulted in a tendency toward larger deals as opposed to smaller projects.

Figure 12 shows the average and median size of DFI transactions per industry sector in each case study. As highlighted by one of the DFI interviewees, DFI investments in Liberia tended to be smaller, although OPIC made sizeable investments in energy projects between 2008 and 2011. CDI and the DRC have generally presented investment opportunities for larger size projects.

Fragility is not an exclusionary criterion when pursuing specific investment opportunities, but interviewees indicated that security and instability did influence investment choices because of difficulties experienced in properly monitoring projects. For example, a DFI interviewee in the DRC said that their investee could not expand its business to rural areas because of security risks to staff. Interviews also highlighted that active violent conflicts influenced DFIs' decision on physical presence of their offices or on-the-ground staff presence. The initial entry of DFIs, private investors, and PSD donors in each of the case study countries is illustrated in Figure 14, drawing from key informant interviews. Far fewer stakeholders were absent during the conflict in CDI and Sudan compared to the other case study countries. However, in both cases, the majority of those who were present throughout the active violent conflict period were local private investors rather than donors or DFIs. In Liberia, stakeholders from each of the groups interviewed were only present after the cessation of active conflict.

Figure 14: Timing of Entry vis-à-vis Conflict/Fragility Incidents by Stakeholder Groups



Source: Interviews

E. DFIs utilize a range of entry strategies to increase their footprint

Working with financial intermediaries to reach SMEs: IFC and other DFIs are operating as funders of funds, providing capital to private investment funds which can then on-lend to SMEs and/or take equity positions. This can help close the 'missing middle' financing gap between commercial finance and microfinance, as well as help sponsors whose deals are too small for DFIs (see Figure 12 for the average transaction size). They generally offer longer-term finance than local banks and may offer larger amounts (depending on the fund, investment limits might range from USD 250,000 to USD 2.5 million)[28].

> *"In CDI, IFC did an SME deep dive in 2012, to learn about the barriers and opportunities for SMEs after a period of active conflict. This research informed IFC's TA, as well as its country strategy and investments in the sector. The country office now has the largest concentration of risk-sharing facilities for SMEs of any IFC portfolio in Africa." (DFI interviewee)*

TA projects: DFI interviewees suggested that TA projects help understand the market, providing business intelligence and identifying potential clients. However, it should be noted that technical assistance projects have not been offered by all DFIs. Publicly available annual reports and DFIs' websites indicate that the following DFIs offer technical assistance projects: AfDB, BIO, DEG, EIB/EIAF, FMO, Finnfund, IFC, IsDB, Proparco, OPIC, OFID, and Swedfund. Except for one DFI, the top three largest DFI investors in each case study country (two in Sudan) offer a TA program.

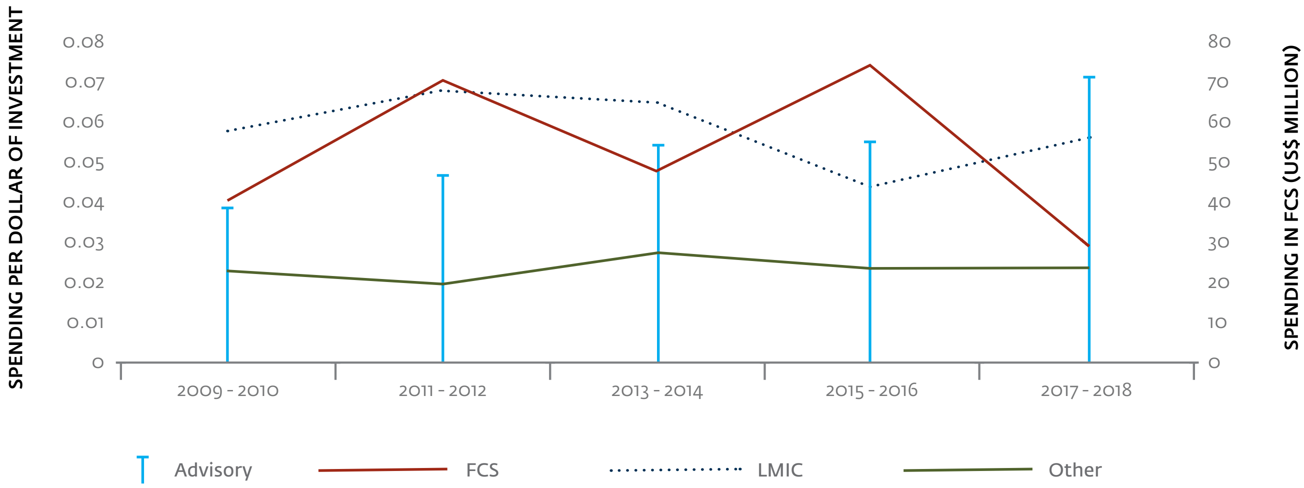
[28] For more details on financial intermediaries, review the report, IFC SME Ventures: Investing in Private Equity in Sub-Saharan African Fragile and Conflict-Affected Situations.

Table 1: Three Largest DFI Investors in Case Study Countries and TA Offering

CDI		DRC		Liberia		Sudan	
DFIs	TA	DFIs	TA	DFIs	TA	DFIs	TA
IFC	Yes	IFC	Yes	OPIC	Yes	IsDB	Yes
AfDB	Yes	EIB	Yes	IFC	Yes	OFID	Yes
PROPARCO	Yes	AfDB	Yes	IFU	No		

When doing business in FCS, DFIs understand the importance of leveraging TA. For example, IFC's own analysis illustrates that it spends twice the time on TA projects in FCS countries vis-à-vis other developing countries in which it invests (see Figure 15).

Figure 15: IFC Advisory (TA) Spending per USD of Investment Committed



Although it is difficult to generalize due to fluctuation on an annual basis, IFC still spends more on TA projects in African FCS countries – in certain years such as 2009-2010 and 2015-2016, two to three times more in terms of financial resources were dedicated to implement TA projects in African FCS vis-à-vis non-African FCS (see Figure 16). However, the data suggest that there needs to be a more systematic effort to integrate TA projects into investment operations.

Figure 16: IFC TA Spending per US$ of Investment Committed in Africa

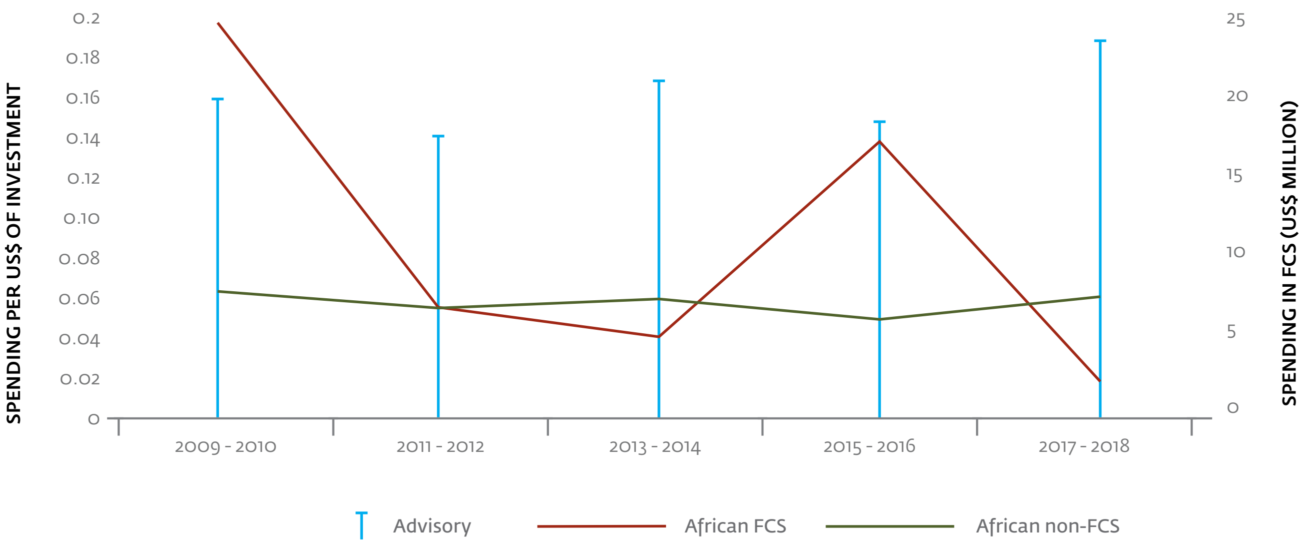


Table 2: Observation – DFI Entry Strategies

When entering FCS markets, DFIs tend to employ the following strategies:

- Implementing technical assistance projects (e.g. investment climate reforms, sector-specific market creation, and market intelligence studies)
- Hiring (or deploying) staff on the ground (e.g. networks and business development)
- Leveraging existing relationships with regional transnational firms, and emerging market and OECD-DAC multinational corporations (MNCs)
- Working on invitation from host governments, donor agencies, or development banks to:
    - Manage donor concessional funds
    - Engage in PSD partnerships with donors
- Piloting investment on a potentially viable project (likely with donor funding)
- Working with financial intermediaries specializing in high-risk frontier markets
- Engaging regional and local financial institutions for STF projects.

03. How DFIs Are Navigating Operational Risks and Conflict Sensitivity

A. Managing Financial Risks for DFIs and Offering De-Risking Tools

Diversification: During interviews, strategies for managing financial risks were clearly articulated by many DFI representatives and private investors. These include reducing initial exposure in FCS by making smaller initial investments and diversifying across multiple countries to spread risk. A DFI interviewee in Liberia shared that they tend to explore investing in companies based in more stable neighboring countries that were seeking to expand into more fragile markets such as Liberia and Sierra Leone. Another DFI explained that their diversification approach was to invest in a variety of SMEs in different sectors. Several private investors took a similar approach, diversifying either across different country contexts or across sectors, having limited concentration but many clients.

Local currency: DFI investment instruments are generally denominated in USD or EUR, yet FMO's MASSIF fund offers local currency lending in low-income and fragile contexts by absorbing the foreign exchange risk to their investees. Between 2008 and 2012, the average percentage of local currency debt out of total debt for the MASSIF portfolio was 71 per cent. FMO does not hedge currency risk, largely because many of the local currencies cannot be hedged; instead, management focuses on spreading this risk across many markets through a diversified portfolio. Similarly, to reduce risk to private companies that borrow money from DFIs, IFC has increased its capital allocation for local currency financing for FCS under the International Development Association 18 Private Sector Window (IDA-PSW).

Co-investments[29]**:** Co-investment is used as a form of risk management for some DFIs. Several DFIs have made co-investments in the four FCS countries. In CDI, 27 (out of 55), in the DRC, 23 (out of 47), in Liberia, eight (out of 29), and in Sudan, five (out of eight) projects are identified as co-invested projects. Interviewed bilateral and multilateral DFIs indicated their preference to work jointly with IFC to reduce their exposure to political risk and participate in sizeable projects. DFIs also noted that co-financing with IFC enables them to access other support, such as more extensive due diligence and environmental and social risk assessment, as well as its capacity to deploy TA projects.

[29] Kennedy et al (2018). noted that co-financing represents a small slice of total investment for IFC and revealed that 35 per cent of the co-financing deals their research identified took place in Sub-Saharan Africa.

Table 3: List of Co-Invested Projects in Four FCS

Country	Co-invested projects	Sector	Co-Investors	Total Number of DFIs
CDI	MicroCred Côte d'Ivoire	FIG	IFC, EIB, AfDB	3
	Advans Côte d'Ivoire	FIG	IFC, Proparco, FMO	3
	CIPREL	INFRA	IFC, AfDB, Proparco, FMO	4
	Azito Energie	INFRA	AfDB, BIO, OPIC, Proparco, IFC, OFID	6
	OLAM	MAS	Proparco, FMO	2
	Henri Konan Bédié Bridge (toll bridge)	INFRA	AfDB, FMO	2
DRC	Advans	FIG	IFC, AfDB	2
	Nyumba Ya Akiba cement plant	MAS	AfDB, EIF, IFC	3
	Plantations et Huileries du Congo SA – Feronia	MAS	EIB/EIF, FMO, DEG, CDC	4
	Helios Towers	INFRA	EIB/EIF, FMO, BIO	3
	Rawbank	FIG	IFC, EIB	2
Liberia	Access Bank Liberia	FIG	EIB, AfDB, IFC	3
Sudan	Arab Leasing & Investment	FIG	IsDB, OFID	2
	Byblos Bank Africa	FIG	ISDB, OFID	2

B. Non-Financial Risks and Conflict Sensitivity

DFIs are much better able to navigate financial risks in FCS than broader contextual risks. This is a finding echoed in an independent evaluation of AfDB assistance in FCS[30]. Most interviewees recognized that beyond standard due diligence practices, they did not have a separate risk assessment or approach towards FCS versus non-FCS markets; mitigating reputational risk in FCS contexts is therefore challenging. DFIs leveraged TA to strengthen an investee's capacity in these areas.

A conflict-sensitive approach is new to DFIs and not systematically applied to DFIs' investment and technical assistance projects[31]. In general, there was more understanding of the conflict-sensitive approach among donors than DFIs or businesses. DFIs struggle to assess and mitigate fragility risks adequately. DFIs are much better able to put forward risk mitigation strategies to deal with the potential financial risks in FCS, while broader contextual risks such as fragility risks are given less emphasis in risk assessments. These are viewed as largely outside of the control of the project and difficult to mitigate despite their ability to affect the reputation of DFIs more substantially.

When DFIs considered fragility factors as part of their risk assessments, their analysis of fragility drivers often lacked local-level dynamics, which were likely to have an impact on project outcomes. Because of this, mitigation strategies were often vague or not included. Several DFI interviewees discussed the importance of having a nuanced understanding of the private sector within a broader political economic framework. Even donors who have taken more proactive approaches indicate that their process is still a work in progress. DFIs do not generally have well-formulated conflict sensitivity strategies despite some evidence of recent innovation.

[30] AfDB (2012). Evaluation of the Assistance of the African Development Bank to Fragile States, OPEV: Tunisia.

[31] Emerging in the 1990s, conflict sensitivity centers on the understanding of two-way interaction between the project and the context in which one operates. This practice focuses on identifying and mitigating the potential negative impacts of the projects on conflict and fragility factors, and attempts to mitigate risks through strategic program development and active monitoring of negative impacts through an ongoing reiterative process.

C. Latest Efforts on Conflict Sensitivity

Efforts are being made by DFI professionals on the ground to incorporate conflict sensitivity. While there is no systematic use of the fragility lens in project development and implementation, interviews revealed insights on how they have navigated to avoid intensifying conflictual dynamics.

DFIs' Conflict-sensitive Practices

The EIB is making head way on conflict sensitivity. It offers guidance to its investment teams on the conflict-sensitive approach, and established a conflict sensitivity help desk in 2017.

IFC FCS Africa introduced a fragility lens for advisory service projects in 2015 to help assess and mitigate the two-way interaction between projects and operational contexts. The team is also piloting a conflict analysis process for an investment project, with the intention to develop a practical mitigation plan.

Learning by doing: DFIs are learning about conflict sensitivity through their operational experiences in FCS. DFI interviewees indicated that they became familiar with the conflict-sensitive / do-no-harm approach when they started working in FCS contexts. For example, a DFI interviewee shared that in the early days when the organization entered the DRC, it focused more on promising business opportunities in various sectors, including forestry and agribusiness, without considering conflict risks affecting these industries. When a few projects fell through due to conflict risks, the interviewee became more attentive to the do-no-harm principles. Another interviewee mentioned undertaking a sector-specific conflict analysis when considering an agribusiness project in Sudan because of the concern that the project might intersect with land governance issues. However, there is limited evidence that this learning is driving institutional practices on conflict sensitivity or implementing a do-no-harm approach.

Negative/exclusionary screening: Some of the DFIs and donor agencies that participated in interviews indicated that their organizations adopted an exclusionary screening strategy against extractive industries to mitigate conflict risks. This is a common strategy utilized by a growing number of socially responsible investors who would exclude certain sectors or companies involved in potentially controversial activities. However, a private sector company asserted that DFIs' engagement in the extractive sector could bring about positive development impacts for local populations who are highly dependent on extractive industries and have few alternatives for their livelihood.

Investor-sponsor-government dialogue: A DFI interviewee indicated that instead of excluding a controversial project from their portfolios, they actively pursued a policy dialogue approach. Specifically, together with their investees, they had organized a policy dialogue, bringing the company, investors (including other DFIs who jointly invested in the project), and government counterparts together to increase relevant stakeholders' understanding of the project.

Project-level ESG impact assessment: All DFIs interviewed highlighted a range of processes that their institutions incorporated to identify and mitigate non-financial risks. Heightened business integrity due diligence, extensive environmental and social impact assessment, and scrutiny over development impacts were cited as their efforts to mitigate harm in FCS contexts. Some DFI investment projects also provided technical assistance to their investees on environment and social risk mitigation.

Table 4: Observation – DFIs' Risk Mitigation Strategies and Conflict-Sensitive Practices

- Offering FCS relevant products to lower financial risk exposure for investees
  - Local currency products (e.g. FMO's MASSIF and the Local Currency Facility of the IDA-PSW, managed by IFC)
  - Leveraging donor concessional funds (e.g. blended finance products such as the Smallholder Finance Facility of FMO and IFC Global Agriculture and Food Security Program's Private Sector Window).
- Client-specific TA projects (with an emphasis on client capacity building)
- Making a small pilot investment for quick demonstration effects for internal buy-in
- Making co-investments together with other DFIs
- Leveraging local presence for security monitoring, networking, market intelligence, situational assessment, and prompt response and support for investees
- Negative screening and exclusion criteria to minimize financial exposure to politically sensitive and controversial sectors such as extractive industries
- Enhanced integrity due diligence, conducting political economy analyses and/or undertaking conflict assessments (with assistance from development agencies and conflict experts)
- Rigorous environmental and social impact assessments and supporting investees' capacity building on environmental and social issues; corporate social responsibility activities for community relations
- Relationship management with host governments (maintaining friendly, but not too close, relationships, and focus on building relationships with technocrats, not with political appointees).

04. Sequencing of DFI Interventions

This study was interested in three types of sequencing. The first relates to the sequencing of types of interventions, especially if there is a preference for business climate reform and market development TA projects take place before DFIs make direct investments. The second relates to the PSD activities vis-à-vis fragility contexts; more specifically, whether there are any preferred types of PSD activities depending on fragility contexts. The third relates to the sequencing of practical actions that DFIs take to finalize investment decisions in a private company.

To this end, the research has drawn inspiration from two main schools of thought on sequencing of private sector development: the systemic approach, which encourages the prioritisation of indirect support through investment climate reform[32] and improving the enabling institutional environment for the private sector; and the interventionist approach, which encourages direct intervention into markets through providing direct financial and technical support to private sector entities[33]. Those advocating for an exclusive focus on reforming the institutional environment argue that interventionist approaches have largely failed, while proponents of the interventionist approach argue that political will for reform is often lowest in FCS, that the systemic approach will therefore have limited success, and that even where reforms are passed, this will not necessarily translate into their effective implementation[34].

There is a balance to be struck in considering the correct timing and type of investment climate reform approaches. On the one hand, introducing such reforms in the early phases after active conflict and political crisis where institutional structures are in the early process of being rebuilt provides a window of opportunity to push through change[35]. It is also viewed as important when one considers that investment climate reforms at a later stage can be challenging as vested interests begin to emerge and enthusiasm for reform wanes[36]. On the other hand, creating a positive investment climate in the phase immediately after active conflict may not be a pressing priority for the country's government[37], and there are risks in developing overly ambitious reform plans that are slow to implement and do not cement government commitment for reform[38].

A. Investment Climate Reform, and Technical Assistance Projects versus Direct Investing

Striking the balance between investment climate reforms and direct investment seemed to vary across the focal countries, depending largely on the relationships of DFIs with the country government, and the willingness of government to implement reform. A review of TA projects, with a focus on IFC's advisory portfolio, including its joint work with the WBG, suggests that **TA projects are a common entry point for IFC** when re-engaging or newly entering an FCS country after a political transition (see Figure 18).

[32] For the purpose of this study, we utilise a broad definition of the investment climate, drawn from the IEG's (2015) Independent Evaluation of WBG Support to Reforms of Business Regulations, namely: 'the support for policy, legal, and institutional reforms intended to improve the functioning of markets and reduce transaction costs and risks associated with starting, operating and closing a business'.

[33] MacSweeney, N. (2008:52). Private Sector Development in Post-Conflict Countries: A Review of Current Literature and Practice, Cambridge: DCED.

[34] Channell (2010), in Datzberger and Dension (2013). Private Sector Development in Fragile States, EPS PEAKS Helpdesk Request, LSE Enterprise

[35] See MacSweeney (2008), Bray (2007), Kusago (2005).

[36] Mills, R. and Fan, Q. (2006). The Investment Climate in Post-Conflict Situations, World Bank Policy Research Working Paper 4055: The World Bank Institute.

[37] Haufler, V. (2007). The Private Sector and Governance in Post-Conflict Societies, in Brinkerhoff, D (ed.) Governance in Post-Conflict Societies: Rebuilding Fragile States; Oxon: Routledge.

[38] Mills, R. and Fan, Q. (2006). The Investment Climate in Post-Conflict Situations, World Bank Policy Research Working Paper 4055: The World Bank Institute.

Projects focusing on investment climate and other systematic approaches were pursued aggressively after the transition by both DFIs and other PSD stakeholders such as donors and development banks (see Table 5). There is a common appreciation for the effects of investment climate reform on private sector investments, including the role of a business-enabling environment to support and facilitate the potential impact the investments could have. However, there is no evidence that DFIs made specific investments based on sequencing strategies. Across all case studies, it appears that direct investment activities and investment climate reform TA projects are pursued simultaneously.

Table 5: List of Investment Climate-Related TA in Four Countries

Country	Organization	Year	Project Title
CDI	WB	2008	EITI Implementation
	WB	2008	Governance and Institutional Development
	WB	2010	Small and Medium Enterprise Revitalization and Governance Project
	IFC	2013	Investment Climate and Business Regulation
DRC	WB	2005	Private Sector Development
	DFID	2007	Mining Sector Reform
	IFC	2008	Developing a Framework for Special Economic Zones in the DRC
	WB-DFID	2011	Growth in Mineral Sector
	DFID	2012	Private Sector Development
	IFC	2015	Improving DRC's Investment Climate at National and Provincial Levels
Liberia	IFC	2006	Liberia Business Environment and Investment
	WB	2008	Economic Governance and Institutional Reform Project Data
	IFC	2010	Liberia Investment Climate
Sudan	IFC	2007	Administrative Barriers Reform Program
	WB	2009	Revitalizing the Sudan Gum Arabic Production and Marketing

The growth of the private sector itself may provide incentives for government to support reform, for instance, by developing its own institutions such as revenue collection agencies and enterprise support agencies [39]. One donor noted that investments by its counterpart DFI provided useful learning in identifying where the donor might intervene to remove blockages in the investment environment.

Use of Public-Private Dialogue in Liberia

In Liberia, the government discussed the support provided by the WB and IFC on the Liberia Better Business Forum (a PPD initiative), which saw the private and public sector meeting regularly. The government cited recommendations and discussions in this forum as responsible for the review of the revenue code, as well as work to develop a collateral registry. The locally driven platform brought together opposing forces in government and the fractured private sector to create a forum. However, it has been reported that since the Ebola crisis, the forum is no longer operating, indicating that the sustainability of such platforms is difficult to achieve in volatile FCS contexts.

Public-private dialogue (PPD) is frequently utilized in FCS to support investment climate reform. Supporting and facilitating dialogue between government and the private sector, both formally and informally, was mentioned across the case study countries as an area of success. Practitioner literature suggests that PPD can foster relationships between usually conflicting or adversarial groups[40] and that implanting such trust-building measures prior to or alongside other private sector interventions can boost the likelihood of their success[41].

[39] German Development Agency (GIZ) (2015) Employment Promotion in Contexts of Conflict, Fragility and Violence: Opportunities and Challenges for Peacebuilding
[40] Schrade et al. (2017). 'Is there a Case for Private Sector Development Interventions in Contexts of Open and Sustained Violence?' GIZ Discussion Paper.
[41] Mercy Corps (2011). Evaluation and Assessment of Poverty and Conflict Interventions – Conflict and Economics: Lessons Learned on Measuring Impact.

"In FCS, when looking at investments, you often need to start with advisory to prepare the ground. You might get one or two companies that are ready without TA, but for IFC to have a sustainable deal flow you need advisory. What works is accompanying IFC investments with advisory services. This has worked in banks and the mining project. Many of these firms have particular technical gaps, which are identified during the investment process, and we can then help build the necessary skills." (DFI interviewee)

While the dataset does not capture the detailed use of TA projects to help a company becoming eligible for DFI investment, DFI and private investor interviewees indicated the important role that TA projects play in FCS countries, given the weak capacity of business entities as well as the difficulty experienced in navigating the global standards that DFIs require from prospective investees.

Table 6: Observation – Use of Technical Assistance Projects by DFIs

Enabling Environment and Host Government Capacity Building

1. Identify a few key sectors which will benefit from market-based solutions
2. Engage host governments for sector reforms (policies and government capacity building)
    - PPD to involve business leaders and other stakeholders in the reform process.

(It is assumed that potential business opportunities and investors may emerge/be identified during these processes.)

Sector-Specific Market Creation Approach

1. Identify a focus sector and map enabling conditions requiring interventions
2. Potentially build partnerships with other institutions or large MNCs with a significant role in the FCS economy
3. Choose specific activities which can help build the sector and enhance its competitiveness and sustainability
    - Value chain
    - Financial access (frontier market PE or MFI)
    - Human capital development
    - Support industry sectors (i.e. services, logistics, etc.).

(It is assumed that potential business opportunities and investors from the targeted sector may emerge/be identified during these processes for further scale-up.)

Direct Investee Support Approach

1. Identify potential investees (regional/local actors) (e.g. feasibility studies, sector assessments, and other analytical activities)
2. Assess their capacity to determine their investment-worthiness
3. Identify the gaps that can be addressed within a 12-24 month horizon through the building of investees' capacity/skills (i.e. marketing skills, accounting, corporate governance, community engagement, sustainability standards, etc.)
4. Undertake training, provide financial support (or help mobilize financial resources to cover the cost) and offer expertise and advice
5. Work with clients to be ready to be qualified for DFI investment.

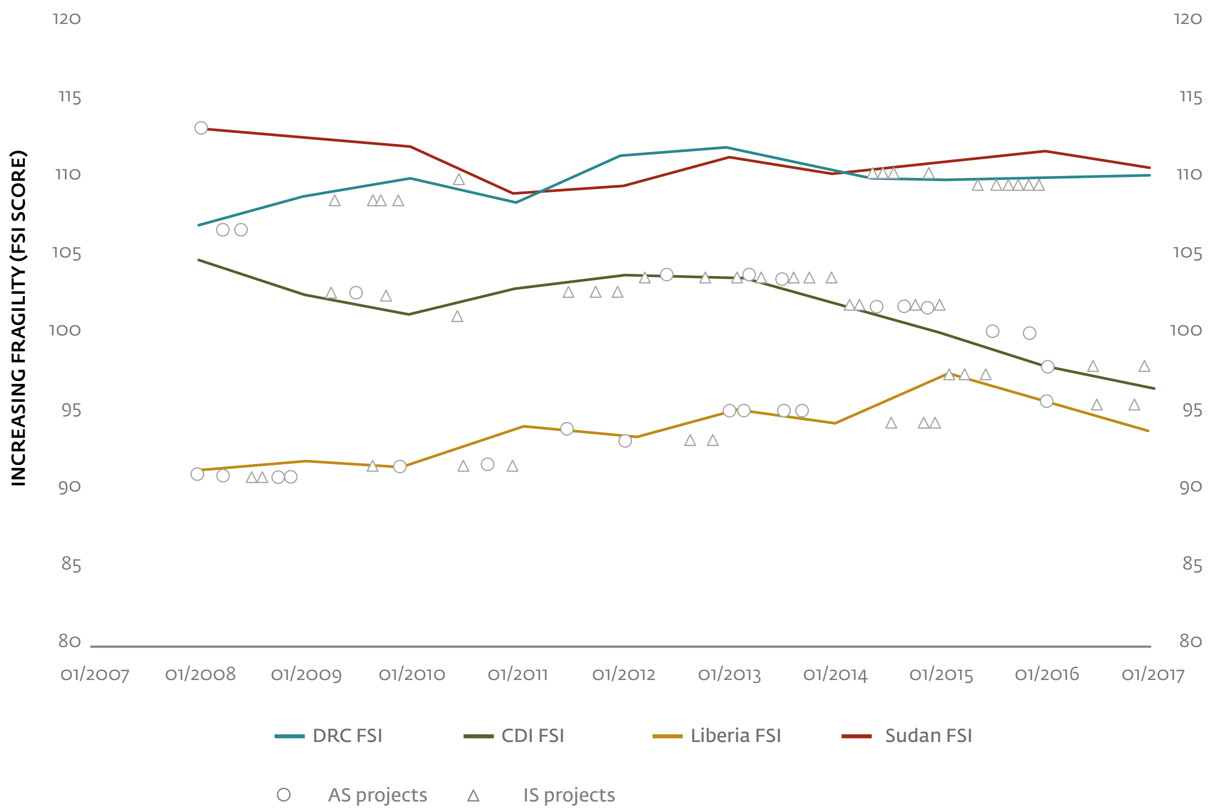
B. Timing of Interventions vis-à-vis Fragility

Figure 17 displays the sequencing of IFC interventions relative to the FCS contexts across the focal countries. The figure seems to indicate that **both investment and TA projects have occurred across the varying levels of fragility in each country between 2008 and 2016. There does not appear to be any intentional sequencing in relation to fragility.** Figure 17 is designed to illustrate both the relative fragility of each of the focal countries, and the sequencing of IFC's TA and investment commitments (IS) projects relative to fragility. As the FSI score is only calculated annually, the line drawn between the years is an approximation. As a result, intervention points do not sit precisely on the line as these are mapped according to their precise start dates during a year, and therefore correspond to the single FSI score for that year.

C. Sequencing of Intervention Types

A World Trade Organization (WTO) report notes that trade finance facilities offered by international finance institutions including IFC are risk mitigation instruments when reaching clients in the poorest developing countries[42]. Similarly, the Independent Evaluation Group of the World Bank indicated the secondary benefit of IFC's trade financing program in helping IFC enter difficult markets[43]. In addition to DFIs, trade finance is assessed to be a relatively low-risk activity for commercial banks in Africa, according to a survey the AfDB published in 2017, and the estimated default rate on trade finance transactions in 2011 and 2014 were 4 per cent and 5 per cent respectively, compared to 9 per cent and 12 per cent non-performing loan (NPL) rations for all bank asset classes[44]. The report attempts to understand whether DFIs (especially IFC) utilize STF products prior to making LTF investments.

Figure 17: IFC TA and IS versus FSI Scores



[42] WTO (2016). Trade Finance and SMEs: Bridging the Gaps in Provision. Geneva: World Trade Organization.

[43] Independent Evaluation Group (2013). Evaluation of the International Finance Corporation's Global Trade Finance Program, 2006-12. Washington, DC: Independent Evaluation Group.

[44] AfDB (2017). Trade Finance in Africa: Overcoming Challenges. Abidjan: African Development Bank.

It appears that IFC utilizes STF products involving trade finance when it begins to re-engage or newly enters an FCS country (see Figure 18). Except for Sudan, IFC offered short-term trade financing to regional and local banks in the case study countries at the early stage of its engagement. As seen in Sudan's case, other DFIs such as IsDB utilize short-term financing options when engaging with business entities in high-risk and fragile markets. However, the data do not suggest that STF engagement is a prerequisite to entering into an FCS market.

No specific sectoral sequencing strategy seems to be pursued when entering an FCS. Financial institutions tend to receive a firm-specific technical assistance projects from IFC (and other DFIs in the case of Sudan), and receive direct investment from DFIs consistently regardless of fragility scores. There are some areas of alignment between DFI sector focus and FCS business constraints. Access to finance emerged as a key constraint to business in all the case study countries, and the finance sector made up the largest share (42 per cent) of DFI projects by project count.

Figure 19 illustrates DFIs' investment in different sectors over the course of nine years. Investments by most DFIs were frequently in the financial services and microfinance sectors, even during periods of high fragility. While only one respondent indicated that the financial sector should be an early investment target after active conflict, the dataset suggests that financial sector investments are frequently an early entry point, especially for IFC into FCS countries. However, sectors such as communications and off-grid infrastructure had received few DFI investments (Figure 19). This can be partially explained by potential non-financial risks associated with large infrastructure and extractive sector projects. Such examples include a renewable energy project in Liberia and a mining project that was arbitrarily cancelled by the government in DRC.

Figure 18: Types of PSD Interventions vis-à-vis FSI Score

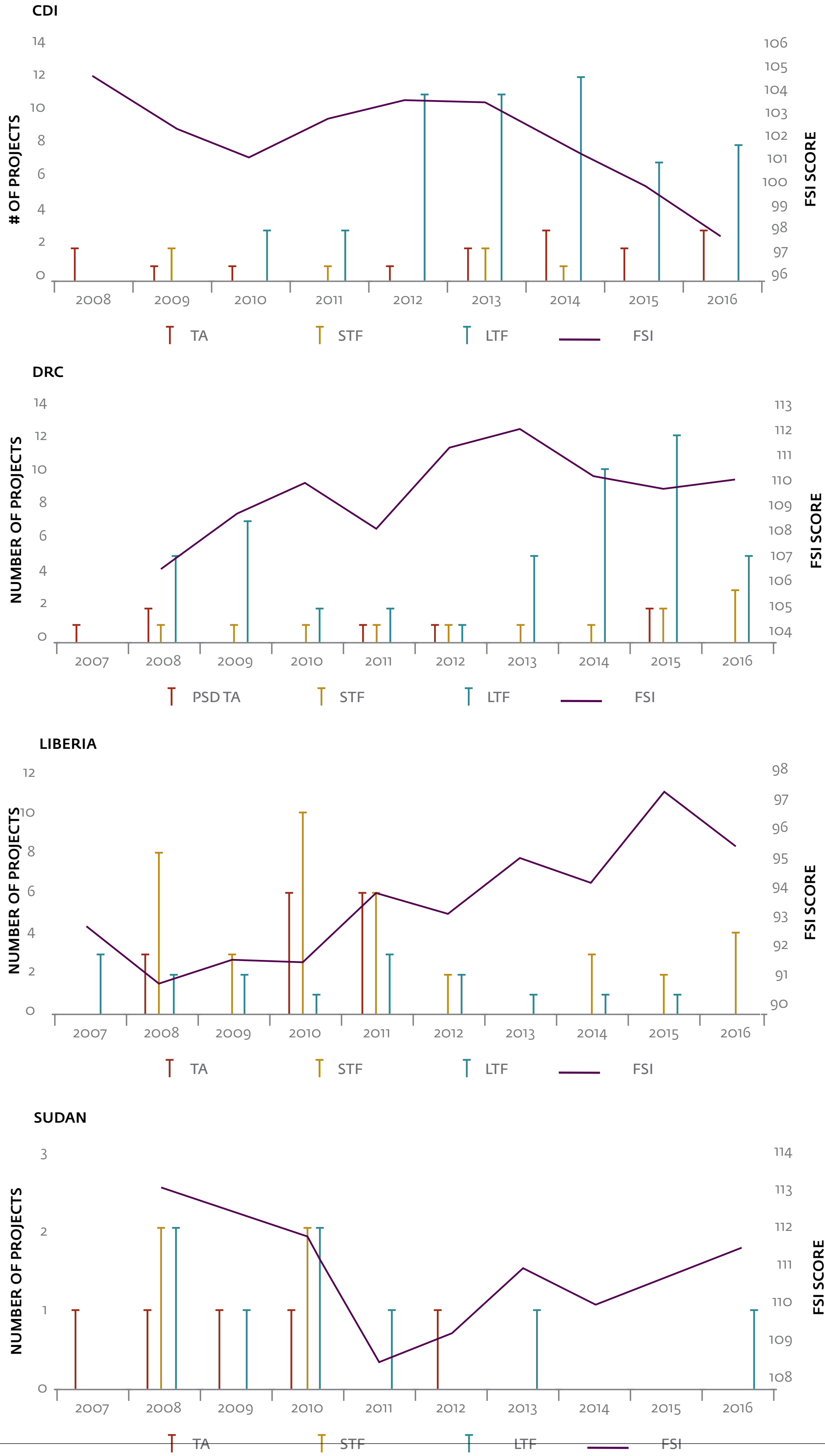


Figure 19: Sectoral Distribution of DFI Investment

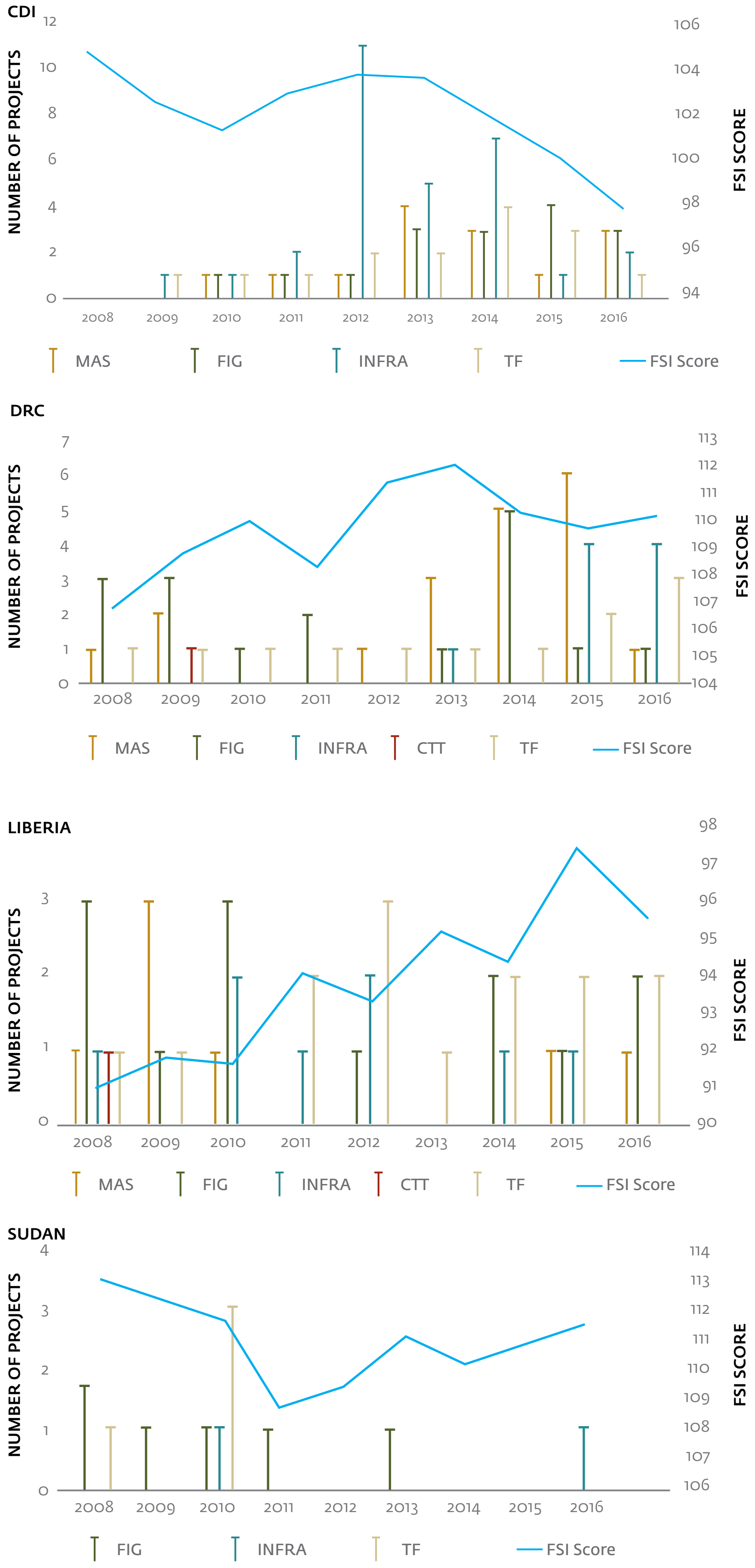


Table 7: Observation – DFI Sequencing

- TA projects focusing on investment climate were implemented at the early stage of IFC investments. Other than IFC (which works with the broader WBG), other DFIs undertake TA projects which focus on sector/value chain development or direct client capacity support.
- No sectoral sequencing vis-à-vis fragility is observed, although financial sectors received DFI investments consistently throughout the reviewed period (2008-2016).
- Trade finance (for IFC in CDI, the DRC, and Liberia, for OFID and IsDB) was utilized at the early stage of DFI engagements in the case study countries.

05. Enabling Factors and Recommendations

FCS is a challenging place to initiate and grow business, and there are several market constraints that require long-term efforts. It is not a place where usual business development and investment approach would allow DFI practitioners to land in successful transactions as the existing standard approach does not sufficiently anticipate and address non-financial and financial risks inherent to the FCS markets. The interviewees who participated in this study were fully aware of these constraints and are realistic about what can be done with their current efforts. Simultaneously, the interviewees that this study engaged shared a sense of possibility and stressed a need to remain optimistic with caution because of huge potential that these countries hold for future investment.

A. Enabling Factors in Each Case Study Country by Interviewees

Cote d'Ivoire

Human capital: "Human development is quite good relative to the region. After the crises, it created an environment that was very attractive to investors. People are very professional and there is a lot of potential - particularly compared to other countries in the region," a DFI interviewee said.

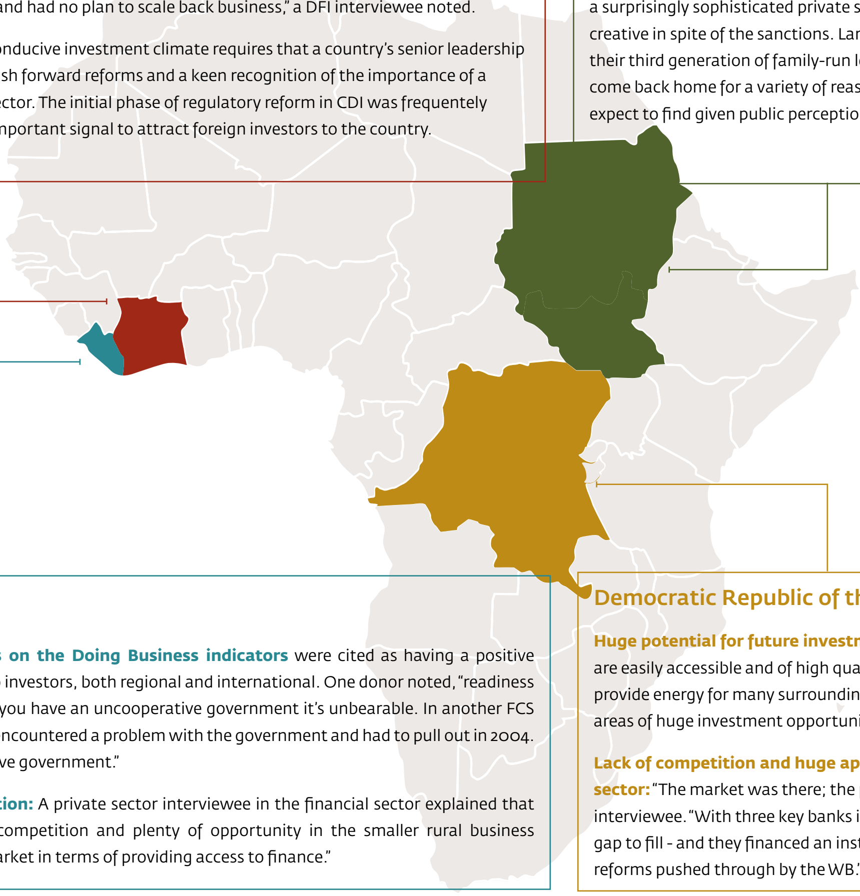
Long-term understandings of the context by existing investors: "Despite newer investors being concerned by the recent mutinies, a considerable number of investors, particularly Lebanese and French who have been operating in the country for many years, were not anxious and had no plan to scale back business," a DFI interviewee noted.

Political will: A conducive investment climate requires that a country's senior leadership has the drive to push forward reforms and a keen recognition of the importance of a growing private sector. The initial phase of regulatory reform in CDI was frequently referenced as an important signal to attract foreign investors to the country.

Sudan

Lifting of US Sanction: "Sanctions have impacted the development of Sudan. Lifting them is not the magic wand, there is a lot of work that needs to be done on policy, regulation, laws etc. There is still a lot of effort needed. It is the key to facilitating change though," a private sector interviewee noted.

Resilience and entrepreneurial spirit of the private sector: "When I first arrived in Sudan it quickly became apparent to me that there is a surprisingly sophisticated private sector. One that has become quite creative in spite of the sanctions. Largely old family-run conglomerates on their third generation of family-run leadership. Mostly educated abroad but come back home for a variety of reasons. It isn't something people normally expect to find given public perception, but it is here," says a DFI interviewee.



Liberia

Liberia's reforms on the Doing Business indicators were cited as having a positive signalling effect to investors, both regional and international. One donor noted, "readiness of government. If you have an uncooperative government it's unbearable. In another FCS country, we have encountered a problem with the government and had to pull out in 2004. You need a receptive government."

Lack of competition: A private sector interviewee in the financial sector explained that "there was little competition and plenty of opportunity in the smaller rural business segment of the market in terms of providing access to finance."

Democratic Republic of the Congo

Huge potential for future investment: Abundant natural resources that are easily accessible and of high quality, and a river with the capability to provide energy for many surrounding countrites, were cited as prospective areas of huge investment opportunity.

Lack of competition and huge appetite for support in the banking sector: "The market was there; the potential was there," explained a DFI interviewee. "With three key banks in the sector all bankrupt, there was a gap to fill - and they financed an institution to fill that gap, thanks also to reforms pushed through by the WB."

B. Recommendations for DFIs

Operating in FCS environments is not 'business as usual', and calls for a different approach from DFIs. As DFIs intend to scale up their current efforts in FCS environments, below is a summary of suggestions for consideration.

A single approach or template for sequencing of DFIs' engagement in FCS is not realistic since contexts vary dramatically, and investments are mostly opportunistic because of a limited pool of investment opportunities. **While waiting for investment climate reform to be initiated, implemented or completed, DFIs continue pursuing business development and identifying investment opportunities simultaneously**. There is no evidence to indicate that efforts to engage in investment or TA need to wait until business climate reform to be sufficiently mature. In all the case study countries, practitioners from DFIs and private investors were able to identify 'viable' investment projects a few years after (or earlier) they began operating in FCS countries. Investment climate reform takes years to take hold while there are regional, local and multinational businesses that are willing to take risks to grow their business in these countries.

Investments in FCS themselves have considerable demonstration effects and can provide opportunities to push for specific sectoral reforms, particularly in cases where DFIs have multiple investments in a single sector. Interviewees suggest that **focusing on multiple investments in a particular sector or sectors, in partnership with other DFIs, could help to build expertise and increase leverage with host governments for relevant sectoral reforms**.

DFIs could consider investing in additional effort at the origination stage of deals, for example by accompanying investments with TA projects. Since options in FCS are few, there should be more emphasis on making and shaping deals, and considerable involvement from DFIs in preparing potential sponsors. Focusing on 'upstream' activities was repeatedly highlighted by interviewees as a critical factor to develop the private sector in FCS countries. These efforts are already undertaken by IFC through its Creating Markets Advisory Window (CMAW) and FCS Africa platform in line with IFC 3.0 strategy, and PROPARCO through capacity building, venture capital, and other equity investments as outlined in its 2020 vision strategy. Even in contexts which are transitioning away from conflict and fragility, capacity remains a challenge. While not all DFIs offer a TA program, they can provide important support investees need to make the project a success and aligned with international standards. DFIs with a limited TA capacity may consider partnering with PSD specialized NGOs, PSD donors or other DFIs with TA programs. In addition to a client-focused TA, consider utilizing PPD platforms as an early entry point into FCS after active conflict. PPD platforms could provide a good opportunity for DFIs to gather market intelligence with low risk and present an opportunity to forge a positive relationship with both government and private sector actors, whilst potentially having an impact on peacebuilding through fostering practical dialogue. In addition, it may help to identify the biggest barriers to reform in a country, and where there might be traction for reforms on which to build.

Given access to finance continues to emerge as one of the significant challenges of doing business in FCS, DFIs could consider capturing lessons learned from DFI investment in financial institutions in FCS, especially with a view to understanding the sector's impact on development priorities and responses to fragility drivers.

For DFIs to simultaneously pursue investment opportunities in FCS markets, **there needs a systematic measure tailored for a high-risk FCS project to help DFIs better mitigate a range of fragility drivers and non-financial risks**. Specifically, DFIs could consider developing a FCS tool such as practical guidelines or a training program, which can help investment professionals to identify, assess and respond to fragility risks that interact with certain sectors or business-related issues. These efforts will need to be based on conflict sensitivity which help assess the two-way interaction between a project and fragility on the ground, along with a deep understanding of local contexts. At the time of this research, there was limited evidence on the use of conflict/ fragility sensitivity by DFIs or the systematic incorporation of political economic analysis. One of the first steps could be for DFIs to **undertake a systematic fragility assessment for the private sector** since existing conflict assessments in FCS countries are often conducted for donors and international finance institutions to guide their engagement with host governments and civil society actors.

Conflict sensitivity is a preventive measure which helps investors and companies identify and mitigate negative externalities that a private sector transaction in fragile environments could bring about. Because FCS governments lack institutional capacity to effectively support companies to mitigate the private sector induced fragility risks, DFIs may consider stepping up their responsibilities to offer conflict sensitivity support to investees they work with. Although efforts have been initiated by a couple of DFIs, they are still new to the concept and operationalization of conflict sensitivity. DFIs may benefit from benchmarking PSD donors such as UK Department for International Development (DFID) and U.S. Agency for International Development (USAID) which mainstreamed conflict sensitivity in their operation as to assess what capacity need to be developed in-house and which efforts could be leveraged through their partnership with PSD donors. This exercise can be supplemented by the review of multinational companies with operations in FCS, particularly extractive sector companies, and institutional investors with a portfolio of companies operating in FCS as to design their conflict sensitivity program to be better aligned with global market trends.

Systematic effort to increase local contextual understanding and operationalize conflict sensitivity can range from a project/sector-specific political economic analysis, private-sector focused fragility assessment, project-level conflict analysis and mitigation, client/value chain capacity building on conflict-sensitivity, and ongoing operational support through in-house expertise. All these require additional time, budget, and human resources. For DFIs to make concerted efforts, there is a need for DFIs to allocate adequate resources and identify areas to work in partnership with PSD donors and others with existing expertise. Furthermore, DFIs may consider collaborating to develop a common approach to operationalizing conflict sensitivity at the country or regional level as to avoid disadvantaging private sector investees working with DFIs with more rigorous processes.

Annex 1: Data and Methodology

The main report's key findings are drawn from the case study of four countries representing different levels of fragility and economic sizes – Côte d'Ivoire (CDI), Democratic Republic of Congo (DRC), Liberia and Sudan. Each case study used a mixed methods approach, combining both quantitative and qualitative data gathered through desk-based research – a literature review, data and IFC internal documents – and primary research – conducting key informant interviews with 116 individuals through field visits and remotely.

A. Data Collection

Quantitative Data through Desk Review

The research team utilized historical country-level data, provided by World Bank (ODA Net Received, FDI Flows, Doing Business Indicators, Enterprise Surveys), Organization for Economic Cooperation and Development (OECD) (Bilateral ODA Sector/History), UN Conference on Trade and Development (UNCTAD) (FDI Bilateral Flows), Transparency International (Corruption Perception Index, CPI), and Fund for Peace (Fragile State Index, FSI). Table 8 summarizes the three most frequently used scores in this report.

Table 8: Brief Overview of Three Frequently Used Scores in the Report

Doing Business Distance to Frontier (DTF)

A country's distance to frontier is reflected on a scale from 0 to 100, where 0 represents the lowest performance and 100 represents the frontier. Thus, a score of 60 represents that the country was 40 percentage points away from the frontier. (Source: World Bank)

Corruption Perception Index (CPI)

The index, which ranks 180 countries and territories by their perceived levels of public sector corruption according to experts and businesspeople, uses a scale of 0 to 100, where 0 is highly corrupt and 100 is very clean. (Source: Transparency International)

Fragile State Index (FSI)

The index measures states' vulnerability to conflict or collapse by ranking the state based on the total scores of the 12 indicators. The sum of the 12 indicators is on a scale of 0-120. Countries with the score above 90 are classified as alert, and less than 29.9 as sustainable. Higher FSI scores indicate more intense fragility.

Source: *Fund for Peace*

In addition, the study reviewed 138 long-term financing projects and 48 short-term financing projects that DFIs committed between 2008 and 2016 and identified 49 technical assistance (including IFC's advisory service) projects on the private sector development. Table 9 summarizes the overview of the project-level dataset.

Table 9: Number of Projects and Related Entities Reviewed for the Research Paper

	LTF Projects		STF Projects		Assistance (TA) Projects	
Number	LTF Projects	Investees	STF Projects	Investees	TA Projects	Implementing Organizations
CDI	55	27	17	4	16	4
DRC	46	21	12	2	9	3
Liberia	29	18	15	3	19	5
Sudan	8	4	4	1	5	2
Total	138	70	48	10	49	13

DFI Projects Dataset: The research team assembled a dataset of **186 long-term (138) and short-term (48)** finance projects identified for CDI, the DRC, Liberia and Sudan between 2008 and 2016 using publicly available data (see Table 9 for more details). For IFC, the team also utilized the information downloaded from its internal database. The dataset excluded DFI investments in intermediary funds and multi-regional projects, both of which are important efforts undertaken by DFIs. To capture the activities of many DFIs active in FCS, the dataset included the information from the following 16 DFIs[45] which disclose their investment activities through their websites or annual reports: IFC, the AfDB, Belgium's BIO, Commonwealth Development Corporation (the UK's CDC, the German Development Bank (DEG), EIB (including the European Investment Fund (EIF)), Finnfund of Finland, FMO, the Danish Development Bank (IFU), the Islamic Development Bank Group (ICD and ITFC), Norfud, OFID, Overseas Private Investment Corporation (OPIC) of U.S., Proparco of France, and Swedfund of Sweden. Table 10 shows which DFIs are identified as having (or having had) long-term financing projects in which of the four case study countries between 2008 and 2016.

Table 10: DFIs with Active/Past Long-Term Finance Projects in Case Study Countries (2008-2016)

Number of LTF	AfDB	BIO	CDC	DEG	EIB	FMO	Finnfund	IFC	IFU	IsDB	Norfund	OFID	OPIC	PROPARCO	Swedfund	Sub-Total
CDI	6	1			5	7		25	1	1		1		8		55
DRC	2	10	3	1	6	4		16						4		46
Liberia	2				2			13	2				9	1		29
Sudan										5		3				8
Sub-Total	10	11	3	1	13	11	0	54	3	6	0	4	9	13	0	138

For each project, the research team looked for information on the amount of financing committed by the DFI (converted to USD), a sector, a financing instrument, the year of commitment, shareholders, and a project description. The information on shareholders was gathered through DFI websites, investees' websites, and media sources. Where the project-specific information was unavailable, the team manually assigned categories based on project descriptions.

TA projects: The research reviewed a total of 49 technical assistance projects supporting the private sector development in the four case study countries. The data was gathered through public websites of major private sector development bilateral donors, DFIs, and multilateral development banks such as the World Bank (mostly the IDA) and the AfDB. These technical assistance projects include IFC's advisory service projects.

Internal documents from IFC and the World Bank: The research team reviewed IFC documents which provide complementary information on the specific interventions, especially TA projects implemented in the four case study countries. These internal documents include project completion reports, project implementation plans, evaluation reports, and Development Outcome Tracking System (DOTS) data.

[45] Due to limited publicly available data, the dataset excluded the information from bilateral DFIs from China such as China Development Bank.

Field Research and Qualitative Interviews

Country visits were conducted between May and October 2017 to gather more nuanced information and specific examples for early findings coming from the secondary data collection. The first of the four country visits, to Liberia, was undertaken as a pilot mission to ensure the robustness of the methodology. Where possible as well as conducting interviews in the capital city, teams visited specific projects invested in by DFIs. This was a valuable addition to the detail provided by case study visits in Liberia and Sudan in particular.

Key Informants Interviews: Qualitative interview data was gathered with a broader set of stakeholders (N = 116) including development banks (DBs)/ DFIs, private sector investors, donors, host governments, and other stakeholders such as civil society organizations and think tanks. Figure 20 and Table 11 show how interviewees were divided into countries they operate in and organizations they work for. For those interviewees whose insights were not directly linked to one of the case study countries because they were based in headquarters or other locations, they were identified as other locations. Lessons learned from DFIs are more pertinent and practically relevant for this paper. Specifically, their views allowed the study to dig into the 'why' and 'how' around investment decisions. This approach did not however preclude the involvement of other types of investors from being engaged during the interviews. Interviewing other types of investors dealt in less detail with their intervention strategies, and instead the purpose was to gain insights into the extent to which their approaches to investing, and their experiences in the case study countries were different from or similar to those of the DFIs.

Figure 20: Interviewee Locations and Interviewees' Organizational Affiliations

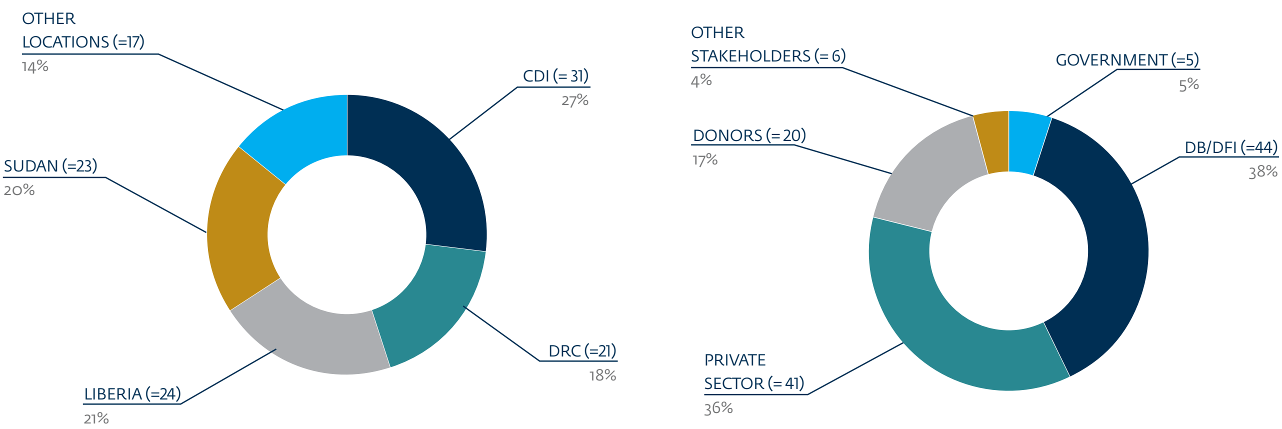


Table 11: Organizational Affiliates and Location of Interviewees

	DBs/DFIs	Donors	Host Governments	Private Sector	Other Stakeholders	Sub-Total
Cote d'Ivoire	13	5	2	11	0	31
DRC	6	4	1	9	1	21
Liberia	6	6	1	8	3	24
Sudan	6	5	1	10	1	23
Other Location	13	0	0	3	1	17
Sub-Total	44	20	5	41	6	116

B. Research Limitations

The research has several limitations which are important to recognize before a presentation of the findings:

Publicly available DFI data interpretation: There can be unintentional errors or subjective interpretation of the data, given that publicly available data do not necessarily adopt the common standard or framework. Similarly, when collecting PSD TA project information, the research team relied on publicly available information, which reveals relatively little detail on their projects.

Exclusion of financial intermediaries and multi-regional projects: While interviews include representatives from financial intermediaries, the DFI dataset does not include DFIs' investments in financial intermediaries and multi-regional projects. Including DFIs' investments in financial intermediaries can also reveal unique insights on how smaller size DFIs, or DFIs with limited operational presence in FCS contexts manage to contribute to private sector development in these environments.

Focusing on OECD-DAC DFIs and donors in selecting key informant interviews: Similarly, due to time constraints and scheduling conflicts, some of the major donors and DFIs active in these case study countries were not interviewed. Furthermore, although it is widely recognized that emerging financiers such as China and India have a growing influence in the private sector in Africa [46], it was beyond the scope of this study to specifically assess their contributions or strategies. Thus the pool of key informant interviewees appears to inadvertently favour OECD-DAC bilateral DFIs, private investors and donors. In future studies, there may be scope to understand South-South collaboration by integrating the perspectives of donors and investors from emerging markets.

Contextual challenges: Since operating in the contexts under consideration in this study is challenging and dynamic, in some cases there has not been a long history of investment or advisory projects to draw from, which means conclusions are based on relatively small datasets in most cases.

[46] AfDB (2013). Africa and the BRICS: A Win-Win Partnership?, accessed at https://www.afdb.org/en/blogs/afdb-championing-inclusive-growth-across-africa/post/africa-and-the-brics-a-win-win-partnership-12098/.

Annex 2: DFI Representatives and Interview Locations

Name	Type	Source of Capital	Case Study Country	Interviewee Location
AfDB	DFI Regional Multilateral	International	All	HQ (CDI), Liberia, the DRC and Sudan
CDC Group plc	DFI Bilateral	UK	DRC	HQ, DRC
EIB	DFI International Multilateral	European Union	CDI	CDI
Norfund	DFI Bilateral	Norway	None	HQ
FMO	DFI Bilateral	The Netherlands	None	HQ
IFC	DFI International Multilateral	International	All	HQ, Liberia, the DRC, Sudan and CDI
IsDB	DFI International Multilateral	International	None	HQ
OPIC	DFI Bilateral	US	CDI	CDI
Proparco	DFI Bilateral	France	CDI	CDI

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