MSME-led private sector development in contexts of conflict, fragility and displacement

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Acronyms

BMZ	Federal Ministry of Economic Cooperation and Development
DFI	development finance institution
FCS	fragile and conflict-affected situations
FMO	Netherlands Entrepreneurial Development Bank
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
MSE	micro and small enterprises
MSME	micro, small and medium-sized enterprises
NGO	non-governmental organisation
PSD	private sector development
SIDS	small island developing state
SME	small and medium-sized enterprises
TSF	Transition Support Fund

Executive summary

There is growing interest in and enthusiasm about the role the private sector can play in contributing to development, and how this can contribute to peace and stability in fragile and conflict-affected situations (FCS). Much of this enthusiasm is premised on the assumption that poverty is an underlying driver of conflict, fragility and displacement, and that providing more jobs and economic opportunities could potentially reduce the likelihood of war and instability.

This report, which draws on the observations that emerged from a longer report commissioned in 2021 by KfW Development Bank (Policy Division, Social Development, Governance and Peace), investigates how private sector development (PSD) in contexts of conflict and fragility can contribute to peace and stability. Based on a review of the literature and the experiences of micro, small and medium-sized enterprise (MSME)-led PSD support operations by peer development finance institutions (DFIs), the report explores how and under what circumstances PSD led by small and medium-sized enterprises (SMEs) can foster peace and stability in contexts of fragility with a view to identifying support initiatives that could be replicated and scaled.

Context, concepts and definitions

While there is no generally accepted definition of 'fragility' – a contested term, which many countries designated as such object to – for the purposes of this report the OECD definition of fragility is used. The OECD definition focuses on degree of risk exposure across a range of dimensions (economic, environment, political, security and societal dimensions) (OECD, 2020). The economies of 'fragile' and conflict-affected states typically exhibit common characteristics, including social conflict and elite competition, weak institutions and services, inadequate infrastructure, limited government, a limited and undiversified private sector, low levels of trade and per capita income, and high levels of inequality. The Covid-19 pandemic has left many of the poorest countries and regions even more fragile. The Russian invasion of Ukraine will compound existing instability in many low-income fragile countries.

MSMEs constitute a broad category of enterprises of varying size and scope. While this makes it difficult to make generalisations about their capacities, aptitudes and aspirations, in low-income and fragile contexts they tend to be small and informal, and concentrated in trade and services. Levels of female participation are typically low, notably in the small-medium category.

MSMEs face different challenges in different contexts of fragility and violence. In countries suffering widespread active conflict, MSMEs tend to be motivated by survival rather than growth or productivity, and often pay for protection from patronage networks. In situations of forced displacement, refugee entrepreneurs face challenges related to their legal status and protection extended to them by their hosts. Integration with the host community also tends to be low. In contexts of subnational conflict, enterprises in non-conflict areas may do better than those in areas of conflict, while high levels of criminal violence pose risks of theft, extortion, productivity losses, expansion constraints and loss of revenue. In the immediate aftermath of a conflict, private investment remains weak due to a poor stock of human capital, destroyed infrastructure, inefficient regulatory systems and continuing political risks.

Reviewing the evidence

Development agencies, including development banks such as KfW, increasingly see MSMEs as channels to promote employment, value chain development, innovation, economic and social inclusion, and resilience in FCS. This is premised on the prevailing assumption among governments and development practitioners that, by providing jobs and underpinning economic prosperity, MSMEs can contribute to peace, or at least create disincentives for conflict. Since MSMEs account for the largest share of employment and, sometimes, most of the economic activity in fragile situations, this dominant narrative suggests that expanding the small and medium business sector can contribute to peace.

While there are many studies looking at the impacts of PSD interventions in general, few deal *specifically* with the effectiveness of PSD interventions in FCS. Evidence supporting the notion that business activity intrinsically builds peace in FCS is, however, weak, linked to conceptual and analytical ambiguity, problems of causation (it is not clear, for example, that reducing unemployment intrinsically contributes to peace) and lack of targeted, systematic evaluations.

MSMEs interact with peace and conflict dynamics in ways that are complex, ambiguous and, sometimes, contradictory. Private sector enterprises have been shown in particular contexts and under particular conditions to make measurable contributions to moderating conflict and supporting peaceful outcomes, particularly at more local levels. If drivers of conflict are not taken into account or addressed, the overall positive impact of businesses on social and economic development and peace is at risk. Context-specificity is therefore important for MSME interventions in fragile settings. Similarly, risk and impact analyses of MSME interventions on conflict drivers are crucial to avoid negative impacts on peace, conflict and stability.

DFI support to MSME-led PSD in FCS and situations of displacement

A range of DFIs have engaged with PSD approaches in FCS, including the International Finance Corporation (IFC), the African Development Bank (AfDB), the Asian Development Bank (ADB), the European Investment Bank, the European Bank for Reconstruction and Development, the International Fund for Agricultural Development (IFAD), France's Proparco, the Netherlands Entrepreneurial Development Bank (FMO) and British International Investment, formerly CDC.

The World Bank and IFC have a long history of supporting private investment and growth in FCS, both through investment and advisory services, and there is some evidence of a positive impact for PSD interventions. At the regional and national levels, AfDB plays a key role in prioritising fragility, including through the annual Africa Resilience Forum, bringing together government, civil society, the private sector and international partners, as well as through funding specifically for PSD in 'transition' contexts. Through its private sector operations support, ADB has been involved in many engagement efforts with the private sector in FCS, including Afghanistan. IFAD works with small agricultural producers through community development and farmer organisations and cooperatives, and by establishing partnerships with private firms through supply chains and with government agencies, particularly in support of market development. Proparco's work in fragile contexts focuses on the Sahel, the Democratic Republic of Congo (DRC) and the Near and Middle East, with the aim of contributing to job creation for young people in the agriculture sector.

Operations in FCS tend to be led by financial sector specialists, who see their task primarily as financial sector development. DFIs have been slow to innovate in their products for SME engagement beyond financial intermediary lending. Yet some are developing or applying less conventional products to FCS, including integrating sovereign with non-sovereign instruments, and integrating an analysis of fragility that identifies the non-financial constraints to MSME development. DFI engagement with MSMEs has also been constrained by concerns around reputational risk, sanctions regimes and measures to counter terrorism and money laundering.

The DFIs we looked at have all developed strategies to guide their engagement in fragile contexts, albeit usually as part of broader corporate strategies, and each has earmarked special funds for FCS, usually in the form of grants. While most DFIs carry out or are committed to carrying out fragility assessments to help country programmes support PSD project design, these vary in quality, especially the extent to which they analyse political economy issues.

Conclusions and recommendations

Sustainable development and avoidance of aid dependency requires a vibrant private economy, particularly as aid volumes dwindle and fragility in low- and middle-income countries becomes compounded in the aftermath of Covid-19 and economic, commodity price and supply chain shocks created by the conflict in Ukraine.

While foreign direct investment and investment in large firms and public utilities are important too, MSMEs tend to dominate the local private sector.

Micro enterprises can be critical to resilience and helping households cope with fragility, as can SMEs, which are critical for self-employment, preserving livelihoods with dignity and preventing families and communities from sinking deeper into poverty.

Even if the sole objective of DFIs is PSD for growth/economic development, delivery on that objective can be improved. **Conflict sensitivity and risk analyses are crucial to ensure MSME interventions have positive impacts on peace and stability in fragile settings**.

Furthermore, when organised collectively, SMEs can have influence on conflict dynamics and peace outcomes. While clear-cut distinctions are not always easy to make, **conflict mapping and stakeholder analysis need to be integrated consistently into MSME interventions to enable ‘peace catalysts’ and minimise ‘peace spoilers’**. This is critical to effective MSME-led PSD support intended to promote more peaceful outcomes.

Being conflict-blind is not an option for effective support to MSME-led PSD in FCS. Conflict-blindness can reduce impact and undermine the stability on which sustainable development relies. That said, **context-specificity and adaptation of MSME interventions to local conditions is key to ensure sustainable outcomes and to leverage the contribution of private sector interventions for increasing resilience**. Because the ‘state of the art’ is nascent, each case requires analysis to arrive at credible hypotheses based on assumptions that can be tested through evaluation of the outcomes facilitated by international partners.

1 Introduction

Over the past decade, particularly since the launch of the Sustainable Development Goals (SDGs), there has been growing interest and enthusiasm in international development cooperation about the role the private sector can play in contributing to development. Initially, this centred on how it could provide the 'trillions' needed to finance the delivery of the SDGs; since then, a dominant narrative has emerged about how PSD can be an engine for job creation and economic growth, and how this can contribute to peace and stability in FCS. Much of this enthusiasm is premised on the assumption that poverty is an underlying driver of conflict, fragility and displacement, and that providing more jobs and economic opportunities could potentially reduce the likelihood of war and instability.

Theories of change commonly used by financial institutions are premised on the assumption that financial services are critical to the development of the private sector, because **financial sector projects generate system-wide effects that are necessarily positive**. **They develop and expand a country's financial infrastructure and thus give end-borrowers such as SMEs the opportunity to obtain local, needs-based financing on reasonable terms**.

The strategic primary objective of KfW Group is to transform the economy and society with the aim of improving economic, environmental and social living conditions. To achieve this, KfW, as one of the world's largest development banks, promotes and finances investments by state governments, municipalities, the private sector (businesses), financial institutions and private individuals in Germany, Europe and around the world. KfW Development Bank supports development projects around the world on behalf of the German Federal Government (mainly on behalf of the Federal Ministry for Economic Cooperation and Development (BMZ)) and the European Union, and finances programmes and projects, primarily with public-sector stakeholders in developing countries and emerging economies – from conception and implementation to final review.

Source: Dangelmaier et al. (2021).

KfW as a development bank has a long history of supporting SMEs, as well as establishing and strengthening development banks (apex institutions)[1] and financing SMEs in Germany and other non-fragile contexts. In August 2021, KfW (Policy Division, Social Development, Governance and Peace) commissioned ODI to investigate opportunities for PSD in contexts of conflict and fragility that could contribute to peace and stability, by conducting research on MSME-led PSD in fragile, conflict-affected and displacement contexts.

ODI was asked to see if there was any empirical evidence to support the dominant narrative that more PSD could be good for peace, based on a review of the available literature and the experiences of MSME-led PSD support operations by peer DFIs in situations of conflict, fragility and displacement.

The purpose was to explore how and under what circumstances MSME-led PSD could foster peace and stability in contexts of fragility, to identify initiatives that could be replicated and scaled. This included articulating a convincing theory of change, articulating the assumptions, purpose and intended impact of an MSME-led PSD approach in situations of conflict, fragility and displacement.[2]

Key research questions

- To what extent and under what conditions can approaches to private and financial sector development contribute to the prevention of crises and violent conflicts or to post-crisis stabilisation?
- What role can PSD of local MSMEs play in contexts of fragility, conflict and forced displacement to offer promise to both local communities and displaced people?
- What theory of change should inform PSD in fragile, conflict-affected contexts and situations of displacement? What are the empirical basis and underlying assumptions?
- What is scalable in terms of financial cooperation?
- How are DFIs dealing with the issue of PSD in PFF?

[1] Today, the SME portfolio of the KfW Development Bank is more than €3 billion and includes around 60 projects in 25 countries and nine cross-border funds. As of December 2021, the portfolio in FCS comprised 13 projects with a volume of €420 million (14% of the total SME portfolio). There is growing interest within parts of KfW bank in expanding this nascent support in FCS beyond the traditional focus on Iraq and Afghanistan.

[2] The work was undertaken in two phases. The first consisted of an extensive review of the literature (theoretical and empirical) and a workshop to discuss preliminary findings. The second phase consisted of key informant interviews with selected KfW staff and peer DFIs to bring to light emerging context-specific practices. Preliminary findings were presented at a joint IFAD-KfW-ODI panel at the World Bank Fragility Forum in March 2022, and at a workshop of KfW operational staff on 12 May 2022.

- What are the entry points for collaboration between the private sector and (public) financial cooperation?
- What needs to happen?
- What are the prerequisites for feasibility and success?

1.1 Outline of the report

The rest of this report is divided into the following sections.

Section 2 sets out the context for the report, clarifying what is understood by contexts of fragility, conflict and displacement. It also discusses the characteristic features of MSMEs in these contexts and explores MSME features and characteristics in different types of fragile context. Its purpose is to establish what we know about MSMEs in FCS and identify what kinds of opportunities different fragile situations present for supporting types and configurations of MSMEs and how.

Section 3 reviews the literature to assess the robustness of dominant narratives that link PSD to growth and economic development and therefore to poverty reduction and peace and stability in contexts of fragility, conflict and displacement. Many of these assumptions currently inform dominant theories of change current among financial service institutions and development banks.

Section 4 focuses on financial support for PSD in FCS by DFIs. It examines what approaches have been financed to date, with a focus on key design and implementation lessons about what works and what doesn’t, looking at what can be replicated and scaled. It describes the main prerequisites of feasibility and success. A table of the kind of projects and approaches that have been trialled (by AfDB, ADB, IFC, Proparco, IFAD, FMO and others) is presented in Annex 4.

Section 5 presents the main findings of the research and the suggested approaches for DFIs operating in FCS. It also gives the conclusions of the report.

2 MSME-led PSD in situations of conflict and fragility: what does that look like?

This section sets the context for the report, providing definitional clarity about what is understood by contexts of fragility, conflict and displacement, and what is understood by MSMEs and MSME-led PSD. It brings the concepts together to explore the characteristics of MSMEs in fragile settings. We also review definitions of MSMEs and begin to disaggregate MSMEs by size and type. We also look at how different operating environments (different contexts of fragility) shape the ecosystem in which MSMEs function, where markets tend to be small and fragmented, informal business pervasive, businesses can be controlled by political elites, large companies may have arrangements with the government, and in general there is high potential for non-transparent rules, exclusion and rent-seeking (IFC, 2019a). In these contexts, starting and operating a business can be difficult, as investors and entrepreneurs face political instability, must navigate an opaque regulatory system and face serious problems relating to basic infrastructure (including reliable access to electricity) and lack of adequate access to finance (Speakman and Rysova, 2015; Leo et al., 2012; World Bank enterprise surveys[3]). The single greatest obstacle to progress that entrepreneurs tend to highlight is insecurity (Hoffmann and Lange, 2016).

The section concludes by suggesting that, while **micro enterprises on the whole – and particularly those in fragile contexts – tend to be focused on survival** rather than growth, they can play important roles in **sustaining families and communities**, making them more resilient in the face of fragility, and that **MSMEs can play an expanded role** where there are pockets of stability in conflict settings (fintech creating possibilities for access to finance) or where they are linked to value chains/markets for growth in humanitarian settings.

[3] Based on the latest available World Bank Enterprise Surveys in FCS countries (i.e. Afghanistan, 2014; Cameroon, 2016; Democratic Republic of Congo, 2013; Mali, 2016; and Myanmar, 2014), besides political instability, enterprises expressed that access to finance is within their top five biggest business obstacles.

The section notes that MSMEs, of whatever size and scope, fit into a conflict system. External support for growth and resilience promotion needs to take full account of this, because support can either undermine or support a particular conflict dynamic/trajectory at micro and macro levels. We identify what kinds of opportunities different fragile situations create for MSMEs and suggest possible pointers for feasible financial cooperation approaches to MSME-led PSD in fragile, conflict and displacement settings.

2.1 Contexts of conflict, displacement and fragility

There is no universally accepted definition of ‘fragility’. While the g7+ group of countries use the descriptor ‘fragile’, such use remains contested. Many countries designated as fragile continue to object to the term, not least because it is perceived as a barrier to investment. Most international partners acknowledge they use the term to designate groups of countries more as tool for resource allocation and portfolio management. There is a broad consensus that fragility is related a country’s degree of risk exposure to organised, armed and politically motivated violence, even if there are often similarities and linkages between armed groups with political objectives and those engaged in organised crime (World Bank, 2011).

For the purposes of this study, we draw on the OECD’s multidimensional fragility framework (OECD, 2020), which includes 57 countries and territories – 13 of which are extremely fragile – across a range of dimensions. As of 2019, 76% of active state-based violence and armed conflict were in fragile contexts, while 70% of refugee-hosting contexts were also fragile (OECD, 2020).

FCS economies are often presumed to exhibit several common characteristics, such as social conflicts associated with the exclusion of particular groups, weak institutions and services in terms of capacity and broad-based legitimacy, the absence of a political settlement (consensus) between elites over power sharing, inadequate infrastructure, limited government or firm capabilities, limited and undiversified private sectors, low levels of trade and per capita income, and high levels of inequality. This is clearly a wide-ranging definition. Investors and some DFIs (e.g. Proparco) interviewed prefer to refer to ‘complex’, ‘frontier’ or ‘underserved’ markets or transition economies – where risks can be high (but so too can returns, notably in the extractives industries). These often overlap with humanitarian contexts, but they could also include stable but developing countries with no significant humanitarian crises (Willitts-King et al., 2019).

Fragile situations are diverse. While there are important differences between and among low-income and middle-income countries, contingent on historical and current factors, we highlight here the prevalence of risks in our experience of violent conflict.

The Covid-19 pandemic – in particular, the patterns of vaccine inequity and related economic and fiscal shocks – has left many of the poorest countries and regions even more fragile. The Russian invasion of Ukraine and its repercussions for global supply chains, food insecurity and aid allocations will compound existing instability in many low-income and fragile countries.

The United Nations’ and Global Partnership for the Prevention of Armed Conflict’s framework approach in conflict settings considers different phases of conflict, such as periods of emerging crisis, open violence, cyclical violence, low-intensity violence, post-violence, post-war or post-peace agreement (UNDG, 2016). For this study, we have similarly identified seven conflict/fragility scenarios for our discussion of MSME-led PSD.

These descriptions are necessarily limited/limiting as they reveal nothing about the underlying drivers of conflict, but they do allow us to consider what kinds of DFI interventions might be relevant:

- heightened risk of conflict
- widespread or active conflict
- subnational conflict
- transition from conflict
- communal violence
- criminal violence
- forced displacement

2.2 Defining PSD and MSMEs

There is no universally accepted definition of MSMEs. Definitions vary among development institutions and sometimes differ according to context or country. MSMEs constitute a broad category containing enterprises of varying size and scope. This makes it difficult to make generalisations about their capacities, aptitudes and aspirations, particularly when we consider the different contexts of fragility in which they operate. There is some level of agreement on definition thresholds – for example, most countries and international organisations define an MSME as having around 250 employees (Haider et al., 2019: Table 1). Official MSME definitions in 176 economies use size (number of employees, value of assets or turnover) as the most common criterion for categorising MSMEs (Haider et al., 2019). On the other hand, there are widely varying employment ceilings for defining SMEs in particular FCS countries. The maximum number of employees for an MSME can range from 15 in Syrian Arab Republic, to 29 in Iraq, 50 in Niger, 75 in Zimbabwe, 100 in Afghanistan and 200 in Mali (SME Finance Forum, 2019).[4]

[4] Based on World Bank list of FCS countries as of January 2022.

In many low- and middle-income economies, where self-employment and micro-enterprises are prominent (ILO, 2019a), ‘subsistence entrepreneurs’ are common (Schoar, 2010). In post-conflict Sri Lanka, 80% of the 205 surveyed entrepreneurs (with at least one paid worker) were ‘survivalist’ – motivated by necessity for income due to lack of employment options – rather than by market opportunity (Maddumage, 2015).

Table 1 Definitions of MSMEs by organisation

Organisation	MSME	Common categorisation and respective maximum thresholds			Other categorisation
		Number of employees	Annual sales or turnover	Total assets or balance sheet	
European Commission	Micro	<10	≤€2m ($2.4m)	≤€2m ($2.4m)	By relationship/ownership: autonomous; partner enterprises (25%–50% holding between partners); linked enterprises (>50% holdings with other enterprises).
	Small	10 < 50	≤€10m ($12m)	≤€10m ($12m)	
	Medium	50 < 249	≤€50m ($60m)	≤€43m ($52m)	
OECD	*Largely follows European Commission and country definitions*				
IFC	Micro	<10	<$100,000	<$100,000	By size of loans (e.g. between $10,000 and $2 million). By women-ownership: registered firms with 51%+ women’s ownership; loans between $10,000 and $2 million (IFC, 2014).
	Small	10 < 50	$100,000 < $3m	$100,000 < $3m	
	Medium	50 < 300	$3m < $15m	$3m < $15m	
AfDB	*Depends on country definition*				
ADB	*Depends on country definition*				
Inter-American Development Bank	Small	50–100*	$3m–$7m	$3m–$7m	*Thresholds on number of employees depend on sector and country.
	Medium	150–400*	$10m–$20m	$10m–$20m	
KfW	SME	500**	€12.5m ($15m)–€25m ($30m)**		**Thresholds on number of employee and sales or turnover depend on sector.
ILO and UNDP					By formality: registered as a business organisation with the registration office, municipality or tax authority, or owners and employers of micro enterprises that employ few paid workers.

Sources: IFC/World Bank website, AfDB (2020a), ADB (2018), EC (2016), IADB (2016), IFC (2012; 2014) and webpages of KfW’s (2022) SME Barometer and OECD’s (2022) Glossary of statistical terms.

MSMEs can also be classified according to degrees of formality (registration). The International Labour Organization (ILO) (2019b) considers an enterprise to be in the formal sector if it is registered with the relevant authorities, indicating that it enjoys protection under a legal administrative framework, or if it pays social contributions on behalf of its employees. The IFC's (2012) working definition describes SMEs as registered businesses. Of the estimated 365 to 455 million MSMEs in developing countries in 2010, less than 10% were formal SMEs and more than 90% were either micro or informal enterprises (Stein et al., 2010).[5] Yet, it is worth noting that the formal/informal distinction is sometimes unhelpful because many registered enterprises may operate with high degrees of 'informality' (IFC interview). Likewise, many so-called 'informal' enterprises may be the most dynamic part of the economy and remain in the non-registered sector, particularly in fragile environments, where institutions and legal protections are notoriously weak. Many do not seek to graduate towards formality, particularly in fragile contexts, where state authorities can be predatory.

2.3 How do contexts of fragility shape MSMEs?

The broad comparison above indicates that MSMEs in FCS have a variety of characteristics and face significantly different challenges compared to MSMEs from the same region or with a similar level of income in non-FCS economies. The nature of conflict and fragility and the level of economic development shape the evolution of MSMEs and their business models.

In low-income and fragile contexts, MSMEs have specific characteristics related to size, informality and sector concentration:

- **High numbers of micro and small enterprises (MSEs).** In low-income fragile settings, enterprises are largely micro to small – i.e. have less than 50 employees. The ILO (2019a) estimates that 54% of total employment in low-income countries is either self-employment or employment in micro or small enterprises, compared to 11% in high-income countries.[6] Based on data for 2004, over 97% of firms (about 290,000) in Yemen were MSEs with less than 25 employees (Assaf, 2013). Similarly, in DRC, 90% of firms had between one and nine employees (World Bank, 2019a).
- **Higher levels of informality.** The dominance of MSEs is associated with informal enterprises, especially in poor countries and FCS. In relation to the global south, Stein et al. (2010) use the terms 'micro' and 'informal' interchangeably. They estimate

[5] In particular, the authors indicate that micro enterprises are formal enterprises with fewer than five employees and informal enterprises are enterprises that are not formally registered.

[6] ILO (2019a) used latest available data between 2009 and 2018.

that 90% of MSMEs are either micro or informal enterprises. Informality is more pervasive in conflict and post-conflict countries: 84% of total employment is in informal enterprises, compared to the world average of 61% (ILO, 2019b). The ILO argues that conflict and informality reinforce each other, as lack of 'decent' work triggers vulnerability and fragility (ibid.). Transitions from formal to informal employment or enterprise are also constrained by weak regulatory systems and lack of trust in public institutions due to widespread rent-seeking (ILO, 2019b; Speakman and Rysova, 2015), although these may be symptomatic of the underlying political economy and a rational response by firms. This has implications for DFIs financing of MSMEs since most development partners support formal (registered) enterprises.

- **Low levels of female participation.** The literature consistently highlights low levels of entrepreneurship among women, which may be driven by multi-dimensional factors, including disproportionate difficulties faced by women compared to men when accessing finance, gender gaps in legal capacity and property rights, cultural constraints (e.g. lower intra-household bargaining position), and less time for entrepreneurial activities (e.g. due to unpaid care work and household duties) (IFC, 2011). It is not surprising that these challenges are exacerbated in conflict settings, where gender-related violence tends to increase (World Bank Institute and IFC, 2014). In Yemen, of the total estimated 600,000 MSE workers, only 5% were women (Assaf, 2013). In DRC, only 28% of all MSMEs (of all sizes) in the country were owned or managed by women (World Bank, 2019a).
- **Concentration in trade and service sectors.** In 2014, most MSMEs were concentrated in the trade and services sectors, while the manufacturing sector contains more SMEs than micro enterprises (Gonzales et al., 2014). Compared to other services, especially in rural areas in African countries, small trade businesses have lower start-up costs and require less educational investment than in other sectors (AfDB, OECD and UNDP, 2017). In fragile and conflict-affected countries in sub-Saharan Africa and in Europe and Central Asia, Speakman and Rysova (2015) find that entrepreneurs tend to be informal and concentrated in retail and services rather than manufacturing. This is partly driven by the lack of an institutional framework that would enable large-scale, job-intensive manufacturing, or by a country's relatively low openness to trade.[7]

[7] The authors argue that, in FCS countries, conflict or violent events often cause deterioration of relationships with neighbouring countries. Since neighbouring countries play an important role in accessing and facilitating trade (e.g. shared borders; landlocked countries), deteriorating relationships with neighbours often make trading difficult and international markets disappear.

On average, in FCS countries in sub-Saharan Africa and Europe and Central Asia, and controlling for levels of income (GDP per capita), when compared to non-FCS firms, firms:

- are only half the size
- start smaller (in terms of number of employees) and grow significantly more slowly or shrink over time
- produce less output, and
- are 20% less likely to innovate (in Europe and Central Asia).

Firms in FCS tend to exhibit unique characteristics (Speakman and Rysova, 2015) regardless of whether they are in low- or middle-income countries. To put this into perspective, **MSMEs would tend to have similar characteristics when they are operating under FCS, whether the conflict is in low-income Yemen or Syria, or in upper-middle-income Armenia and Azerbaijan**.

Despite this MSME-level evidence, the literature also highlights selected industries (e.g. construction, telecommunications, financial services) that were able to thrive in conflict and post-conflict settings. In Afghanistan, Guinea-Bissau, Iraq and Somalia, new opportunities in the mobile telephone industry arose and have been thriving (Speakman and Rysova, 2015). In the absence of a formal banking sector and dollarisation in Somalia, entrepreneurship and innovation led to integration of the traditional hawala system, mobile money and bank accounts through the use of mobile phones (Majoka, 2019). These industries may in turn create direct and indirect opportunities for MSME activities.

The contribution of the SME sector to newly created jobs in developing countries is particularly high, at over 60%. Data from an IFC (2014) study also shows a clear connection between SME density and per capita income in a country. In this context, the important role (potentially at least) of the local SME sector in tackling drivers of displacement and mitigating the economic consequences of displacement in host countries is significant.

The impact on conflict dynamics or peace consolidation has, however, been understudied.

The following subsection provides further nuancing on differentiated characteristics and motivations between micro, small and medium-sized enterprises under varying intensities of conflict.

2.4 How do MSMEs adapt to different contexts of conflict and fragility?

This report identifies seven contexts of conflict, fragility and forced displacement, each of which has different implications for the evolution of the MSME sector. It is important to understand the wide spectrum of states or intensities of fragility under which MSMEs operate. For example, the OECD (2020) measures fragility across economic, environment, political, security and societal dimensions.

In Table 2, each context of conflict, fragility and forced displacement has been distinguished with respect to the level or risk of violence, social and political exclusion, political settlement, nature of economic development and scope for external partner engagement. There are other dimensions of fragility, such as stresses induced by climate change, human rights abuses (which may be leading indicators of conflict risk in apparently stable countries), group grievances and economic drivers of conflict, as described in Annex 1 and summarised in Table 2.

Table 2 Characteristics of MSMEs in contexts of conflict and fragility

Intensity of conflict	General characteristics	Private sector/MSME environment
Heightened risk of conflict	Authority is imposed (in autocratic rule) but the institutional arrangements are considered illegitimate by many. There is a high level of domestic violence and suppression of political and economic opportunities for out-groups and non-elite women. There is widespread inequality, and the economy is vulnerable to domestic and external shocks. Aid levels can be high (as partners support apparent stability) or low/humanitarian (due to authoritarian regimes).	Foreign and local large firms and MSMEs may depend on political connections for survival and growth. MSMEs may face a predatory state. Can be aided or undermined by international action/sanctions regimes. Selection of partners to identify and support firms seeking to build inclusion and other conflict drivers, and to mobilise collective action, can strengthen resilience to shocks.
Widespread active conflict	There is a high level of violence between incumbent authority and challengers, affecting most parts of the country. Most civilians suffer from violence, famine, disease and forced displacement. Institutional arrangements and the financial sector largely collapse, and the economy shifts to widespread informality and illicit activities. Humanitarian actors often provide essential services.	Private investment has stopped, except for firms in the war economy. MSMEs adopt coping mechanisms for survival.
Subnational conflict	Conflict is localised, not country wide. Ruling elites are concentrated in metropolitan areas and security forces suppress dissent, often with violence. There are high levels of grievances among excluded groups, including disputes over resources (e.g. land, water). Metropolitan economy is often thriving, which deepens inequality between peaceful and localised-conflict areas.	Private investment is concentrated in non-conflict areas. MSMEs in conflict areas adopt coping mechanisms for survival.

Intensity of conflict	General characteristics	Private sector/MSME environment
Transition from conflict	Violent conflict has ceased, and a new political settlement is being established, but risk of conflict recurrence remains high. There is great improvement in human rights and women's empowerment. Vulnerability to resentment among losing groups, which may require compensatory action. Relapse is possible. Where political settlement is internationally recognised, economic growth is aid-induced, but grants tend to taper off towards concessional lending. Where settlement is de facto (not internationally recognised), humanitarian assistance is prolonged.	MSMEs start to recover and often concentrate in trade and services sectors. Can be undermined by international non-recognition of states and by sanctions regimes.
Communal violence	Chronic violence is perpetuated by ethnic, religious or kinship groups against others (micro manifestations of macro political dynamics). There is duality of public authority, traditional structures of patronage and obligations. Customary justice prevails, with limited redress to the formal system. Uneven benefits among communities from foreign investment in extractive sectors increases conflict tensions. Aid is often in the form of ad hoc grants and limited financing from multilateral development banks.	MSMEs continue to operate, but little investment or technology improvement takes place.
Criminal violence	There is organised violence, extortion and illegal activity, often extended to transnational crime (e.g. trafficking of drugs, arms and people). There are weak relations between the ruling elite and the population, weak public accountability and discriminatory policies. There are frequent human rights violations by police, security forces and gangs. There are high disparities in income and wealth. Aid tends to benefit elite interests, with charities providing services to the poor.	There is duality between large modern firms and semi-formal MSMEs. MSMEs tend to be more vulnerable to extortion ('protection').
Forced human displacement	Displacement can be due to exclusion and environmental factors. Refugees can be semi-integrated into host communities without legal rights and may create competition with hosts over jobs and resources. Displaced people often have fewer rights and are vulnerable to abuse, trafficking and work exploitation, especially women and girls. Productivity may thrive in camps or from refugees bringing new skills or	MSMEs may start up in areas with high concentration of displaced people to serve local needs, but will remain aid dependent.

Intensity of conflict	General characteristics	Private sector/MSME environment
	performing unpleasant jobs. Humanitarian action and concessional lending are often extended to hosts and displaced people.	

Source: Authors' compilation based on review and synthesis of literature. See Annex 1 for detailed conflict typologies.

2.4.1 MSMEs in situations of widespread or intensifying conflict

In countries with widespread active conflict, the political settlement is more likely to be imposed; there are high levels of violence between the incumbent authority and its challengers; there are high levels of forced displacement; constitutional and institutional arrangements tend to have collapsed; and there is a substantial increase in informality and illicit activities, such as the smuggling and black-market foreign exchange trading seen in Libya (Eaton, 2018). Businesses that participate in the war economy are labelled as 'predators' or 'peace-negative' in Ganson and Hoelscher's (2021) framework. In addition, countries with intensifying conflict are often subject to economic sanctions (e.g. bank de-risking in Occupied Palestinian Territories, Somalia, Syria, Yemen and Afghanistan; termination of duty-free access to US markets for Ethiopia, Mali and Guinea[8]). Sanctions create further impediments to already very limited access to finance, trade and investment activities, as well as to flows of external financing (including humanitarian aid, remittances and development finance), which can have grave human costs.

In such environments, MSMEs tend to be motivated by survival rather than growth or productivity, although there has been limited qualitative research on this (Hoffmann and Lange, 2016). Some notable exceptions are Afghanistan, Pakistan and South Sudan, where MSMEs have tended to serve only local markets and favour relatively safe locations over strategically better situated and more lucrative areas and to base business decisions (start-up and recruitment strategies) on kinship networks due to high social fragmentation and mistrust. In such situations, MSMEs also often make payments (not by choice) for protection from patronage networks (Hoffmann and Lange, 2016). MSMEs that tolerate conflict-reinforcing activities (e.g. paying bribes) to survive are labelled 'condoners' by Ganson and Hoelscher (2021).

MSMEs in Yemen have exhibited innovation and found market opportunities under active conflict situations. Tamween, an online grocery store, was launched at a time of intensified conflict in 2015. Tamween targets migrants who, instead of sending money to families in Yemen, could buy products and have them safely delivered by the

[8] For bank de-risking, see Gordon and El Taraboulsi-McCarthy, 2018; for termination of preferential access to US markets for Ethiopia, Mali and Ghana, see USTR, 2022.

company (Williamson, 2016). Skoolsbook is an online portal created by a Yemeni entrepreneur that enables subscribers to access Yemen school syllabuses and materials for free, with support from local educational institutions and a foundation (Hariharan, 2016). For gig work, AnaMehani has created an online platform to connect manual-skilled workers (e.g. electricians, plumbers and carpenters) with employers such as non-governmental organisations (NGOs), corporations and households, generating 264,000 jobs worth $750,000 during the period 2015 to 2018 (Wamda, 2018).

At the peak of the Yemen conflict and amid electricity scarcity in 2015, the start-up Solar Ray was launched to offer solar panel services. It received capital funding of $35,000 from an entrepreneurship foundation and new partners during the same year (Hariharan, 2016). In 2017, non-existent access to public electricity in seven cities in Yemen induced continued opportunities for solar panels (Badiei, 2018). A complex solar panel supply chain network was formed, connecting major international suppliers and local small shop dealers, main ports and overland crossing points (ibid.). Surveys conducted in 2017 indicate that 14 of 22 governorates have solar energy as the main household energy source (ibid.).

2.4.2 MSMEs in situations of forced displacement

In situations of forced displacement, refugee entrepreneurs face challenges related to their legal status and the protection extended to them by their hosts. In Turkey, Syrian refugees with valid passports can be registered under temporary protection status and can subsequently register a business. However, Syrian passports are often difficult to renew; business registrations are hindered by language barriers and high costs for small refugee businesses; there are opaque bank policies towards refugees; and travelling across the country is difficult as refugees need to get domestic travel permits outside the province in which they are registered. There is also relatively low integration with the host community. Of 130 surveyed Syrian SMEs, only a quarter sell their products to Turks, while 60% of SMEs buy from Syrian suppliers. Syrian enterprises' activities are concentrated in food products, electronics, trade and retail (50% of SMEs). Yet, Syrian refugees can bring skills into the host communities: more than a third of Syrian refugee entrepreneurs previously owned businesses in Syria and more than 40% participated in international trade (INGEV, 2019).

Refugees in more fragile environments experience harsher obstacles to entrepreneurial activities. In Eastleigh in Nairobi, Kenya, issuance of refugee status for Somalis was limited and largely stalled; certificates that gave refugees the right to work were rare. There were reports of public xenophobia, where Somalis were linked to terrorist activities. This induced the exit of larger Somali businesses, while two-thirds of the refugees who stayed remained in the informal sector as small retail traders (INGEV, 2019). Somali women entrepreneurs who had fled to Eastleigh without their husbands became breadwinners and were mostly involved in petty trading (e.g. stalls for selling textiles, cosmetics and food products) with very low profits. Lacking legal documents, they were harassed by local authorities and were fined arbitrarily. A notable coping mechanism was the formation of a Somali women's group to provide social support, with some NGO support for micro-grants and vocational training (Ritchie, 2014).

2.4.3 MSMEs in situations of subnational conflict and criminal violence

In situations with subnational conflicts, opportunities for enterprises may deepen inequalities between enterprises in conflict and non-conflict areas. For instance, among non-farm enterprises in Uganda, labour productivity is highest in Kampala (capital) and central regions, and is lowest in the Northern region, which has a history of violent conflict (Nagler and Naude, 2017).

In situations of high levels of criminal violence, SMEs incur a disproportionately higher burden than larger firms in the private sector and are less equipped to cope with theft, extortion, productivity losses, expansion constraints and loss of revenues. For example, in Medellín, Colombia, businesses' responses to organised crime and violence range from going out of business, to participating directly with violence, spending on security measures (or paying off criminals) and advocating against violence. In Jamaica, which had a murder rate in 2009 among the top five for countries globally, small firms spent a higher share of their revenues (17%) on security compared to large firms (0.7%) (Goldberg et al., 2014).

However, small firms may benefit from collective actions against criminal violence. For example, Pronaf (a neighbourhood in Ciudad Juarez, Mexico, next to the US border) saw 7,000 deaths between 2007 and 2009 caused by drug cartels. In 2010, an entrepreneur organised the neighbourhood's 40 SMEs to coordinate with municipal, state and federal government to establish security checkpoints. The SMEs also utilise traditional media and social media to coordinate efforts to monitor gang activities, prevent crime and file complaints directly with the federal police. These initiatives contributed to a 50% fall in violent crime and increased the number of SMEs to 175 (up 338%) in 2011, transforming Pronaf into a high-end entertainment area (ibid.). SMEs that adopt these strategies and use public–private collective action to actively resist conflict and violence are labelled 'catalysers' by Ganson and Hoelscher (2021).

2.4.4 MSMEs in situations of post-conflict

In the immediate *aftermath of a conflict*, private investment remains weak due to the poor stock of human capital, destroyed infrastructure, inefficient regulatory systems and continuing political risks. Investment in natural resources may take place faster than in other sectors in post-conflict settings, such as in Angola, but typically with limited linkages to smaller businesses and the broader economy (UNDP, 2008). Those industries that were able to grow and forge links with local enterprises were assisted by donors, had a dominant role in the economy, or had strong links to or incentives from the authorities. For instance, Braudi, a beer company, which contributes 30% of total tax revenues and is the single largest employer after the government of Burundi, was able to stimulate local supply chains for sorghum from farmers with the help of training and financing by donors and NGOs (McKechnie et al., 2018).

Mobile telecommunications are almost always successful in post-conflict situations, and even during conflict, for reasons unique to the industry. Communications infrastructure can facilitate financial services amid weak formal financial institutions and create opportunities for MSMEs, such as mobile money and e-commerce. For example, in Somalia, a fragile environment with a weak banking system, Dahabshil, the dominant company in international money transfer in the country, has been an important service provider for humanitarian cash transfer and civil servant payments and has offered integrated financial services (e.g. mobile money) throughout the Somali regions (McKechnie et al., 2018). Other country-specific examples that illustrate the possibilities for MSME creation and subsequent value chain expansions in post-conflict settings include sunflower oil in South Sudan and macadamia nuts in Rwanda (World Bank, 2019b; AFR100, 2022).

Summary

This section has set out the context for the report, providing definitional clarity on contexts of fragility, conflict and displacement, as well as on MSMEs and MSME-led PSD, bringing the concepts together to explore the characteristics of MSMEs in fragile settings. The section concluded by suggesting that, while **micro enterprises on the whole – and particularly those in fragile contexts – tend to be focused on survival** rather than growth, they can play important roles in **sustaining families and communities**, **making them more resilient** in the face of fragility. We noted that **MSMEs can also play an expanded role** where there are pockets of stability in conflict settings (fintech creating possibilities for access to finance) or where they are linked to value chains/markets for growth. These findings were illustrated by numerous examples from FCS settings.

3 Reviewing the evidence for theories of change in the literature

Development agencies, including development banks such as KfW, increasingly see MSMEs as channels to promote employment, value chain development, innovation, economic and social inclusion, and resilience in FCS (IEG, 2019; UNDESA, 2020).[9] This is premised on the prevailing assumption among governments and development practitioners that, by providing jobs and underpinning economic prosperity, PSD can contribute to peace, or at least create disincentives for conflict – the assumption being that the scarcity of jobs and economic opportunity is an underlying driver of fragility, conflict and displacement and migration.

Since MSMEs account for the largest share of employment, and sometimes for most economic activity, in fragile situations, this dominant narrative suggests that expanding the small and medium business sector can contribute to peace.

Yet, what does the evidence from the literature review actually say about the role of private development itself in contributing to growth, economic development, poverty reduction and, by extension, peace and stability in contexts of fragility, conflict and displacement?

In this section, we build on the definitional questions explored in Section 2 and review the evidence from the literature on the links between PSD and peace, honing in on MSMEs in particular. We use this evidence to test the assumptions that inform prevailing approaches to financial cooperation, current among DFIs and development banks such as KfW, to assess whether their underlying assumptions are supported by the evidence.

[9] BMZ has, to date, tended to emphasise short-term jobs in ‘nexus’ countries (where two-year transition-support instruments tend to be used). Yet short-termist jobs (cash for work/public works) may not address structural features of many FCS: widespread underemployment and unemployment. Although the BMZ Marshall Plan with Africa (BMZ, 2022) focuses on trade, private sector investment and job creation, it does not target those contexts that are least conducive to such investments (i.e. in the most fragile environments), even if 53% of Germany’s ODA to fragile states is allocated to Africa (https://www.oecd-ilibrary.org/sites/6b15d09f-en/index.html?itemId=/content/component/6b15d09f-en#chapter-d1e9471).

3.1 What evidence cannot tell us: limitations

While there are many studies looking at the impacts of PSD interventions in general, there are only a few that deal specifically with the effectiveness of PSD interventions in FCS. After reviewing the available literature, it appears that the evidence base regarding the effectiveness of PSD interventions in FCS is not very strong.

Also, the evidence supporting the notion that business activity intrinsically builds peace in FCS is weak. Critical scholars have long cautioned against assumptions that ‘development brings peace’. This includes Hoffmann (2014), who observed that ‘the empirical evidence of how businesses have influenced state- and peacebuilding processes remains marginal and at best anecdotal’.

There are several reasons why relevant evidence is so hard to come by:

- **Conceptual and analytical ambiguity**. The literature addresses several interconnected yet analytically distinct phenomena, making comparisons difficult across studies, bodies of data and theories of change. ‘Peace’, ‘stability’, ‘decreased fragility’, ‘diminished conflict’ and ‘reduced violence’ are some examples. The same goes for the definition of ‘the private sector’, which varies across the literature.
- **Evidence of causation.** The literature on fragile states highlights a link between unemployment and political instability. Much of the thinking and policy relating to PSD in FCS is informed by this assumed link. But correlation does not mean causation. The existence of a link between high rates of unemployment and instability does not *necessarily* indicate that reducing unemployment reduces instability, and there is little, if any, evidence to support such a causal relationship (Holmes et al., 2013). Within the peace-building field, evaluating the impacts of discrete initiatives on peace outcomes is known to be notoriously difficult. Establishing reliable indicators, measuring outcomes, disaggregating various conflict factors and their importance, and distinguishing between contribution and attribution are all challenging propositions in complex conflict systems. In statistical analyses, there is a further need to avoid attributing causation to correlation, an error that appears frequently in the business and peace literature.
- **Paucity of targeted evaluations.** Systematic evaluations of the impact that PSD initiatives have upon conflict and fragility (or their related or proxy concepts, as mentioned above) (Grayson and Bertouille, 2020) exist but do not show any clear evidence of measurable positive impacts. However, evidence was found showing that PSD interventions had a positive impact when conflict sensitivity analyses were applied, including a peacebuilding or ‘do no harm’ approach.

- **The dearth of evidence.** It is not unheard of for employment-generation projects to assert peace outcomes based solely on their theories of change, with no monitoring and evaluation activities to capture peace outcomes (Grayson and Bertouille, 2020). The dearth of evidence raises the question: if the causal link is so robust, then why do relevant initiatives so rarely provide evidence of it?

3.2 What evidence can tell us

3.2.1 Impacts of PSD on economic growth and job creation in FCS

Over the past ten years, there have been a limited number of studies looking at the impacts of PSD on growth and job creation in FCS. Other studies have looked more specifically at the impacts of PSD on stability and peace, and their main conclusions are summarised below. (It should be noted that the focus was sometimes, but not always, on MSMEs.) The findings of the different studies have some common features.

An earlier systematic review by ODI of the literature on the impact of job creation on stability and poverty in FCS found only seven relevant studies, of which only one presented evidence on impacts of employment programmes on stability (Holmes et al., 2013).

Datzberger and Denison (2013) substantiate ODI's findings, noting that the link between job creation and stability in fragile states remains weak. The authors conclude that PSD programmes are often evaluated against economic measurements, with little mention of their effect on stabilisation. Where stabilisation is a feature of an evaluation, causal inferences are generally weak, and based on unclear methodological approaches. This is largely because PSD programming in conflict-affected areas is a new strand of programming, with little evaluation to date (Datzberger and Denison, 2013).

Similarly, a meta-evaluation carried out for IFC by Liu and Harwit (2016) concluded that fewer than half of all PSD interventions in FCS were successful in terms of achieving planned outcomes and impact – in job creation or investment generation, for instance. Also, there was no clear evidence that the reviewed PSD interventions contributed directly to peace and stability. At the same time, the study concluded that conflict and vulnerability sensitivity analyses that included a peacebuilding or 'do no harm' approach seemed to improve positive results and the effectiveness of projects or programmes overall (Liu and Harwitt, 2016).

3.2.2 Impacts of PSD on stability and peace in FCS

Based on the existing literature, Ganson (2017a, 2017b) concluded that the evidence shows that **exceptional private sector enterprises can and do make a measurable contribution to moderating conflict and supporting peaceful development, particularly at more local levels**.

The potential role of local businesses in peace-building is emphasised by Miklian et al. (2018). They conclude that there are several explicit or implicit examples of how local business has contributed to peace objectives. Local business leaders are uniquely positioned to navigate conflict economies as well as to transform them into peace economies.

The reverse has also been found, however. Bardouille et al. (2014) conclude that not every well-intended corporate initiative contributes to peace. **When businesses contribute to social and economic development, it will not have a discernible impact on peace if key drivers of conflict are not addressed. Context-specificity is also important.**

According to Ford (2016), there is probably no necessary connection between (a) facilitating greater commercial interest and activity, and (b) building sustainable peace. Therefore, **external actors need to be more responsive to the particular dynamics of individual settings if they are to seek to ensure that actions to promote prosperity also promote peace**.

Similarly, Miklian et al. (2018) concluded that despite the aspirational elements of business engagement in peace-building, this commitment has yielded few positive impacts in those conflict-affected areas where it is most needed. **In fact, business 'doing good for peace and development' can spiral into local conflict, proving to be worse than if nothing had been done at all.**

In a similar vein, Ganson (2021) concluded that PSD interventions often undermine peace-building, state-building and human development goals. In many conflict contexts, the private sector results from, and further enables, patronage politics merged with corruption. This compounds state fragility and vulnerability to internal and external shocks.

PSD interventions can have perverse impacts when governments, bilateral donors, DFIs and other international actors ignore the predictable impacts of PSD on conflict drivers, such as inattentiveness to the informal sector, inter-group inequality, ethnic exclusion, elite enrichment, the abuse of the state security apparatus for economic gain, or impunity for the negative social and environmental impacts of companies' operations. Ganson (2021) concludes that despite explicit intentions to deliver a 'peace dividend', approaches to PSD often fail to achieve their objectives and instead exacerbate conflict.

Few efforts have been made to systematise evidence across FCS, with some exceptions (e.g. Anderson and Zandvliet, 2009). **But the literature is perhaps now robust enough that it may support a degree of generalisation that may be useful to develop strategies and policies for addressing conflict and fragility through private sector interventions.**

3.2.3 Evidence on MSME impacts on stability and peace in FCS

Datzberger and Denison (2013) note that SME development programmes in fragile settings show, at best, mixed results, and that there is no evidence base for impacts on the ground.

The evidence of a World Bank evaluation (2014) found ‘surprisingly little evidence and guidance on what types of targeted SME support works, either for direct beneficiaries or, more broadly, for markets and economies’.

Emerging qualitative, context-focused research on MSMEs (and larger firms) in FCS provides some empirical evidence of how MSMEs interact with dynamics of conflict and fragility in specific settings. Situating specific private sector actors within specific contextual dynamics allows for detailed explorations of the patterns of interaction between businesses and a range of local actors and factors that drive conflict and fragility.

In aggregate, this body of evidence suggests that MSMEs, their owners and their business associations are constrained by and responsive to the risks, threats, incentives and opportunities inherent in FCS (Mayer et al., 2020). In this respect, they are not dissimilar to other actors in FCS. MSMEs both participate in and benefit from dynamics of conflict and fragility, yet at the same time are also impeded by and struggle against them. For all these reasons, **MSMEs interact with peace and conflict dynamics in ways that are complex, ambiguous and, sometimes, mutually contradictory**.

3.3 Conclusions from the evidence: considerations for development support

The following broad conclusions emerge from the evidence that DFIs need to consider when seeking to support MSE-led PSD in fragile environments:

- **MSMEs are not all the same and not all MSMEs have transformational potential.** Many MSMEs (and their owners) may be less interested in growth, expansion, innovation, market disruption or other transformational effects. Instead, ongoing research in Medellín and San Salvador suggests that **most business owners perceive their businesses primarily as sources of income and employment for themselves and their families**. This is of considerable value on its own: particularly **in contexts of fragility, resilience in the face of uncertainty (political, economic, social) is key**.

- **MSMEs may not be loyal to a given sector or industry. Instead, they can change industries to reduce extortion risk** and to ensure reliable income. Some business owners in El Salvador decline to grow out of fear that it will expose them to greater extortion demands from criminal groups. Successful business owners in Medellín, meanwhile, grow by expanding the number of their business premises. **Operating dispersed, small shops under different business names makes it more difficult for criminal gangs (and the local tax authorities)** to associate a shop with a specific family or holding.
- ‘**Informality’ is a deliberate coping strategy.** Owners perceive that this tactic reduces their exposure to extortion and kidnap risks in an environment in which both are common; it also becomes feasible to close a location without undue consequences for the owner if the location comes under too much pressure.
- **Illegal groups such as criminal gangs often establish legal, registered, tax-paying businesses** that operate in the formal sector, returning profits to the gang (Rettberg and Miller, forthcoming; José Martínez d’Aubuisson, 2022). Businesses that are otherwise legal may routinely buy and sell stolen goods, launder money (perhaps particularly when they are under pressure from illegal actors), enter the informal sector, or make unreceipted transactions to avoid taxation (in some instances passing savings on to consumers). Such actions may tie businesses to value chains that depend, at least in part, on violence or illegal activity or involve actors that are illegal or violent, or both (World Bank, 2005; The New Humanitarian, 2014; Daghar and Okumu, 2021).
- **For historical and survival reasons, firms may tend to recruit employees and contractors from their own ethnic groups**, clans, and religious groups, even in locations where there is significant diversity. This may appear to reinforce exclusion and may exacerbate conflict under some circumstances. MSME may display patriarchal and chauvinistic tendencies as per the cultural norms in which they are embedded, as recent research on Kenya and Somalia has shown (International Alert, 2022). Similarly, **women and young people tend to be excluded from senior roles in SMEs and have diminished access to capital and business networks, which inhibits their ability to establish themselves in the private sector as entrepreneurs**.

- **MSMEs may be invested in the conflict/fragile economy, which may generate market niches that SMEs fill opportunistically** (Mayer et al., 2020; Ingiriis, 2020; Bradbury and Healy, 2010). For instance, Somali companies providing water and electricity services have occupied a market niche that was created by the collapse of the Somali state in 1992 and is sustained by the absence of functioning public utilities. **Businesses selling goods and services to refugees or internally displaced persons, similarly, may have a consumer base and a market opportunity that was generated by conflict and displacement.** They may provide vital services that would otherwise not be available to people in need, but this does not prevent them from having a business interest in the persistence of conflict or insecurity. MSME business models may be threatened by efforts to establish peace.
- **MSME engage with local and national political elites, warlords or armed militias, and criminal actors or organisations for a range of purposes** (International Alert, 2022) to help them secure de facto monopolies, obtain government contracts and otherwise benefit from forms of nepotism, public corruption or other dubious preferential treatment (Banfield et al., 2006). In Medellín, for instance, entrepreneurs can acquire land from criminal gangs that 'sell' untitled plots in areas under their control, sometimes going so far as to bribe authorities to secure legal titles later, as a 'service' to the purchaser.
- **MSMEs can benefit from access to informal, illicit power financially, but this can also impede their business activities and cut into their profits.** Businesses may be attractive targets for militias, criminal gangs and, in some cases, armed groups associated with violent extremism (El Taraboulsi-McCarthy et al., 2017). Businesses that yield to these pressures may feel that the alternative is too risky, but in acquiescing they may sustain corrupt practices or contribute to the financing of violent armed groups.
- **In FCS, evidence suggests that SMEs themselves in some cases engage in, or incite others to engage in, acts of violence against persons and/or property.** The police and formal justice systems are often absent or can be manipulated through bribery or political interference.

3.3.1 So what? What can we conclude from the literature?

- The proposition that MSMEs generate increased employment and growth, thus contributing to peace, appears based more on faith than on evidence.
- This is not to say that investment in MSMEs, if selective and focused on 'catalysers', cannot support peace-building under

certain conditions. Rather, there is a lack of systematic evaluation of existing programmes and projects and the piloting of new ones that systematically monitors impacts and considers attribution. Furthermore, investment in MSMEs might be justified for other reasons, especially when it can be demonstrated that this reduces poverty or enables poor families to cope at times of crisis.

- The evidence indicates that private sector SMEs are no more or less responsive to and constrained by conditions of conflict and fragility than other actors.
- **Smaller businesses may have greater risk exposure than larger firms and thus have little choice** but to be highly sensitive to the risks and opportunities that conflict and fragility present. The evidence suggests that their responses to these risks and opportunities may limit or increase their potential to influence the contexts in which they operate and may sustain conflict and violence.
- **More research is needed to understand which SMEs resist coercion** or perverse incentives, how they do so, under what conditions they find it possible and advantageous to do so, and what kinds of efforts to do so are effective.
- We note the **considerable diversity within MSME sectors and the range of conflict typologies within which they operate**. Several key studies cited are based on certain kinds of enterprises operating in specific types of conflict and fragility: while the findings of these studies are worth considering in designing policies and approaches, this limits the scope for extrapolating them to other situations, without investing in much-needed context-specific analysis**.**
- Despite this diversity, some **research indicates that MSMEs in FCS contexts share common characteristics**, which are shaped by the FCS environment and may differ in terms of incentives, objectives and behaviour from firms operating in more benign environments.
- **Peace outcomes – and development outcomes as well – are typically not systematically evaluated**, particularly when MSMEs are funded through financial sector intermediaries. Generating such knowledge would enable a more granular approach to development assistance that reduces the risks of violence.

Summary

This section explored what the evidence from the literature actually says about the role of PSD in contributing to growth, economic development, poverty reduction and, by extension, peace and stability in contexts of fragility, conflict and displacement. It has weighed up this evidence against many of the assumptions that currently inform approaches to financial cooperation current among DFIs.

The section also showed that MSMEs in fragility, conflict and forced displacement settings are always part of a conflict system. This needs to be considered because support can either undermine or reinforce a particular conflict dynamic/trajectory at the micro or macro level. Although there is limited evidence on the links between MSME support on peace and stability, what is clear is that MSMEs interact with peace and conflict dynamics in ways that are complex, ambivalent and, sometimes, contradictory. We concluded that the complex characteristics of MSMEs need to be born in mind by DFIs seeking to use them as vehicles to support PSD.

4 DFIs and support to MSME-led PSD in FCS and situations of displacement: empirical evidence

This section considers financial cooperation on PSD in FCS by other DFIs in different kinds of fragile situation. It contributes to an emerging body of work on DFI support to PSD in FCS.[10] It looks at what approaches have been financed to date, the key design and implementation aspects of such programmes, and – most importantly – what lessons have been learned so far that have the potential to expand or deepen KfW's portfolio. It describes the main prerequisites for using these approaches; in particular, what design and implementation aspects must be considered. The section showcases operational experiences (case studies) of note across DFIs. It focuses on the types of projects these actors implemented: how they are designed to foster PSD in FCS, the targeted beneficiaries, and how transitions from short- to long-term are managed.

This review of DFIs is illustrative and not exhaustive.[11] The study has looked at the PSD approaches in FCS of the International Finance Corporation (IFC), the African Development Bank (AfDB), the Asian Development Bank (ADB), the European Investment Bank (EIB), the European Bank for Reconstruction and Development, the International Fund for Agricultural Development (IFAD), Proparco (the French DFI) and the Netherlands Entrepreneurial Development Bank (FMO). This section and Annex 4 examine DFI experiences at strategy, portfolio and project levels, what the challenges are, and what lessons have been learned.

[10] The Federal Republic of Germany and UN Peacebuilding Support Office's Innovative Financing for Peace Conference 2022 (investingforpeace.org) and the DFI Fragility Forum (www.theigc.org) sponsored by LSE and the International Growth Centre (IGC) are two of a growing number of examples.

[11] This study does not cover British International Investment (BII), formerly CDC (CDC Group plc, Commonwealth Development Corporation, and prior to that Colonial Development Corporation). BII is the DFI of the UK, of which the Foreign and Commonwealth Office is the only shareholder. BII has been active in the IGC sponsored DFI Fragility Commission and the Africa Resilience Investment Accelerator, set up by G7 DFIs in 2021, which aims to 'unlock investment in fragile states' (www.bii.co.uk).

4.1 International Finance Corporation, World Bank Group

The World Bank Group and IFC have a long history of supporting private investment and growth in FCS – through both investment and advisory services. Although there is no solid evidence on to what extent this has led to more peace and stability, evaluations have shown evidence of a positive impact for PSD interventions when conflict and vulnerability sensitivity analyses were applied, and which included a peace-building or ‘do no harm’ approach.

4.1.1 Examples

The IFC provided post-conflict support to Indonesia in the late 1960s and to countries in the Balkans in the late 1990s and early 2000s. In 2008, IFC created the Conflict-Affected States in Africa (CASA) programme, which adopted a ‘fragility lens’ to analyse both the political risks associated with implementing an advisory project in a fragile state and any harmful effects a project might have upon the overall fragile situation on the ground (IFC, 2019b).

This fragility lens was applied in the cotton and cashew nut sectors in the north of Côte d’Ivoire, a relatively fragile area that would greatly benefit from economic support. The lens allowed the IFC project team to articulate more clearly how the project could address two conflict drivers: ethnic divisions and regional disparities. These disparities were particularly linked to the country’s established agriculture sector, notably cash crops such as cocoa and coffee, which historically have been concentrated in the southern part of the country. This unbalanced regional agricultural development created grievances and intense competition for resources. By applying the fragility lens and analysing two-way interactions between the project and conflict, the project team emphasised bringing different ethnic groups together for training and focusing on the project’s contribution to job creation in the north.

4.1.2 Best practices

IFC published **seven key principles for engaging with the private sector in FCS** (see Box 1) (IFC, 2019a), based on its own experience and synthesised for DFIs, governments, impact investors and private companies who want to expand the private sector in FCS in ways that have a positive impact. Some of these principles that are especially relevant for KfW are as follows:

- Be conflict sensitive every step of the way.
- Avoid the dilemma of choosing between short-term and long-term impact.
- Stick to standards but be flexible on the timing.

Box 1 The Seven Principles in Action: IFC's solutions in FCS

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

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

3. Act fast during transitions but remain engaged during setbacks. Development institutions and other investors can take more risk early on, identify and engage in those areas where private operations are possible, signal the feasibility of investments, and empower firms that can drive change.

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

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

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

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

Source: IFC (2019a).

4.2 African Development Bank

Especially at the regional and national levels, AfDB plays a key role in addressing fragility. The **Africa Resilience Forum** is an annual AfDB event which brings together key stakeholders across government, civil society, the private sector and international partners to reflect on the continent's conflict prevention, peace and state-building initiatives.

AfDB has established the **Fund for Private Sector Assistance** (FAPA), a multi-donor initiative that provides grant funding, technical assistance and capacity-building for PSD. FAPA is jointly funded by the AfDB, the Government of Japan, the Government of Austria and the Austrian Development Bank. The FAPA portfolio aids the strengthening of regional and national infrastructure, relevant for facilitating commerce and trade. Although FAPA does not provide grant assistance to MSMEs, it enables business owners to access loans through financial intermediaries and fosters an inclusive business environment for MSMES.

AfDB has also a well-established **Transition Support Fund** (TSF), financed through grants that provide finance targeted at FCS. Interviews with AfDB staff found that the bank wishes to increase the range of financial products offered by the TSF and their application to MSME development.

4.2.1 What did not work?

An evaluation by AfDB of its private sector engagement noted the following:

- Non-sovereign financing had **uncertain development effectiveness for SME beneficiaries** because of limitations in the way outcomes were monitored and evaluated.
- **There was no suggestion that peace outcomes were included in AfDB operations**. Inadequate tracking of lines of credit and inadequate enforcement led to large businesses rather than SMEs becoming beneficiaries of AfDB funding, even though SMEs constitute the majority of Africa's private sector.
- Explicit theories of change for PSD were absent and measurement of outcomes (job creation, private investment and productivity) were inadequate.
- There were inadequate sovereign resources available through the concessional African Development Fund (ADF) window, a scarcity of private sponsors and the Bank's limited risk appetite in such countries for non-sovereign lending.
- Sovereign–non-sovereign linkages are particularly important if AfDB is to play a larger role in PSD in fragile contexts (AfDB 2020b).

4.2.2 Best practice

In the AfDB's new strategy for addressing fragility and building resilience in Africa, lessons from its 20-year engagement in tackling fragility in Africa included the following (AfDB, 2022):

- The need to consider 'prevention' as a core principle guiding the Bank's engagement in fragile settings and to integrate preventative interventions across all sectors and contexts.
- AfDB should work selectively in the areas that best harness its comparative advantage, while cultivating partnerships with other actors across the humanitarian, development and peace spheres.
- Fragile contexts are dynamic and call for agile operational mechanisms and flexible financial instruments.

4.3 **International Fund for Agricultural Development**

IFAD's approach in general involves mobilising small producers through community development or farmer organisations and cooperatives and establishing partnerships with private firms through supply chains and with government agencies, particularly in support of market development. IFAD mostly adopts a country-level and issue-based investment approach and implements PSD through diverse models.

4.3.1 Examples

- An IFAD seed supply project for smallholders in Sudan was implemented through private seed producers and providers of other inputs and services, with market enabling reforms implemented with the government.
- A similar approach was implemented in Solomon Islands. This involved organising small producers through community development groups which developed social infrastructure and providing grants and blended finance to small firms supplying agricultural inputs and agribusiness, plus support for disaster recovery. Local farmers participated in seed programmes through community development cooperatives also financed by IFAD.
- In conflict-affected northern Nigeria, IFAD assisted smallholders transitioning from subsistence farming to sustainable agribusiness. In the Nigerian case study, funds were channelled through an impact investor which linked farmers to supply chains.

4.3.2 What has worked?

IFAD has shown some innovation in its approaches to financing small rural enterprises, including mobilising diaspora remittance flows (IFAD, 2020a, 2020b). IFAD has also worked to provide microinsurance and leasing/microleasing facilities, as well as climate and agricultural risk insurance (IFAD, 2021, 2020c). IFAD has also facilitated investment by social entrepreneurs in fragile situations such as Nigeria and Madagascar.

4.4 Proparco

Over the past two years, Proparco has pivoted to working in fragile contexts – especially the Sahel, DRC and the Near and Middle East. This was a departure from classic contexts and the approach focused on 'transactions' and has obliged Proparco to work with others, including AfDB, IFC and World Bank, and to move from its role as a finance provider to being a development practitioner – using different tools and different human resource capacity. Proparco has benefited from French governmental support, which enabled it to shoulder the risk in these fragile contexts.

With Choose Africa, AFD Group and Proparco make tools available to African start-ups and MSMEs to provide finance and assistance at the various stages of their development. By the end of 2021, €3 billion of financing – including €780 million under the Resilience component – had been committed for the benefit of more than 26,000 MSMEs and tens of thousands of micro entrepreneurs. Nearly 2,500 companies will receive technical assistance (Proparco, 2022).

MSMEs in the agricultural sector in FCS are targeted, mainly through microfinance institutions that bring together enterprises that are likely to generate the most employment (30 or more employees).

The aim is to contribute to job creation, stability and resilience, to give young people incentives for not signing up to jihadist movements that are income generating opportunities for them. Proparco builds on the existing dynamics where jobs are already being created. The approach is to target agricultural businesses – entrepreneurs or networks of entrepreneurs – rather than small producers or producer networks. Specifically, Proparco tries to address two identified needs for MSMEs: (1) access to microfinance and mesofinance; and (2) access to energy, via decentralised off-grid services (solar panels).

4.4.1 Examples

- In DRC, Proparco invested €1 million in the company Nuru. Created in 2015, Nuru (formerly Kivu Green Energy) develops and operates urban solar hybrid mini grids in the North Kivu province. A 1.35MW mini-grid deployed by Nuru is one of the main mini grids in sub-Saharan Africa. This fits within Proparco's broader goal of improving access to clean and accessible electricity for households and businesses in fragile countries.
- In Burkina Faso, Proparco provides support to Société General. This includes lines of credit to four SMEs, guarantees to lend to micro enterprises and loans for renewable energy infrastructure (solar). This is an example of how Proparco provided guarantees to banks to lend to SMEs affected by the Covid-19 pandemic.

- In Mali, support is provided to Banque Atlantique, consisting of a €760 million portfolio guarantee that allows the bank to increase financing activity for SMEs that are mainly owned by women. It demonstrates the priority given to supporting the private sector in fragile countries, particularly in high-impact sectors.

4.4.2 What worked?

- Training for SME leaders.
- Working with external providers for conflict analysis (e.g. MercyCorps).
- Use of AfD intelligence and analysis.

4.5 What other DFIs have learned and done

- DFI operations in FCS tend to be led by financial sector specialists, who see their task primarily as financial sector development. This is predicated on the observation that surveys of enterprises identify a shortage of finance as a critical constraint, and that with experience in evaluating and managing the risks of lending to SMEs, local banks will scale-up their own financing for the sector after development finance tapers off. The validity of this assumption has not been systematically evaluated; doing so would involve analysis well after the project was completed.
- DFIs have been slow to innovate their products for SME engagement beyond financial intermediary lending, although some are developing or applying less-conventional products to FCS. There has been recent integration of sovereign with non-sovereign instruments and linking them to analysis of fragility that identifies the real constraints to MSME development, including the interactions with the political economy, and identifies where there is political traction for changes, including solving project-level regulatory barriers to MSME development.
- Project-level evaluation of MSME financing tends to focus on outputs, such as number and size of loans made to types of sub-borrowers. Sector and thematic evaluations by DFI evaluation departments have been critical of the lack of monitoring and evaluation of the development impacts of lending to final borrowers (e.g. incremental firm output, productivity and employment attributable to the financing), although there are signs that this might be changing. There is an almost total lack of monitoring of conflict and fragility impacts of MSME financing.
- While there has been success in mobilising small business into associations to achieve development impacts, the potential for these associations to shape broader social outcomes and negotiate changes in the regulatory environment and distribution of value in supply chains has been underexploited.

- DFI engagement with MSMEs has been constrained by reputational risk concerns arising from potential association with conflict actors and governments and private entities who have been compromised during conflicts. This is further complicated by issues of international recognition of de facto governments, sanctions, and compliance with anti-money laundering/countering terrorism financing (AML/CTF) conventions. This sometimes makes it difficult to engage with MSMEs at scale or finance larger enterprises with the potential for growth. These considerations can pose a dilemma for DFIs that traditionally work in partnership with governments and financial intermediaries.
- Due to the high transaction costs for international financiers and lack of local market knowledge, finance for MSMEs is provided through financial intermediaries, typically local banks, but sometimes microfinance apex institutions or managed funds. Although commercial banks are not government institutions, the issue of lack of public trust for governments and domestic banks can be interconnected.
- Conflict analysis at the project level is undertaken as a ‘do no harm’ endeavour to manage risks, rather than by identifying opportunities where some changes in project design might support peace. Risk management often means risk avoidance through choosing project locations where conflict risks are low; while this may sometimes be justified to avoid putting the lives of staff, contractors and counterparts at peril, it can also mean that additional peace benefits in addition to conventional development outcomes are forgone.
- We found no evidence that impacts on peace, levels of violence or trust in government or other communities were being systematically evaluated in MSME financing projects, although there is evidence of impact evaluation from other sectors, including community development. Again, there are signs that this might be changing – e.g. for gender and youth employment – especially when these are explicit DFI corporate objectives.

4.6 What DFIs have changed

- The DFIs included in our mapping are all engaged in PSD in fragile contexts and have developed strategies to signal this, guide staff and provide assurance to shareholders. The fragility dimension of PSD is usually embedded in broader documents that set out overarching corporate strategies, strategies for engagement in FCS, or as part of a PSD strategy. The IFC’s seven principles (see Box 1) have been specifically developed to shape thinking and practice among DFIs and other stakeholders.
- Each DFI has earmarked special funds for FCS, usually in the form of grants that can be blended with other sovereign-

guaranteed or non-sovereign financing instruments to support both private and public sector investment.12

- All DFIs carry out or are committed to carrying out fragility assessments to support country programmes in PSD support project design. These vary in quality, especially the extent to which they analyse political economy issues that staff might perceive to be outside organisational mandates or to complicate relations with governments.

4.7 Emerging good practice principles from DFI mapping

- Avoid the dilemma of choosing between short-term and long-term impact.
- Include ‘prevention’ as a core principle guiding engagement and integrate preventative interventions across all sectors and contexts.
- Work selectively in the areas that best harness your comparative advantage, while cultivating partnerships with other actors across the humanitarian, development and peace spheres.
- Stick to standards but be flexible on timing. Invest in agile operational mechanisms and flexible financial instruments because fragile contexts are dynamic.
- Develop a new theory of change to address inadequacies of standard operating procedures.
- Create differentiated approaches to FCS to improve responsiveness of standard existing processes, procedures and practices.
- Increase institutional capacity for operations in FCS.
- Invest in enhancing institutional understanding of FCS contexts.
- ‘Innovate, innovate, innovate’: consider mobilising diaspora remittance flows; provide microinsurance or climate and agricultural risk insurance.
- Train SME leaders even if you do not provide financial services to them.
- Acknowledge that this is difficult to implement.
- Just do it! Do conflict analysis at every step of the way. Outsource if necessary to external providers (e.g. MercyCorps/Proparco), or use internal intelligence and analysis.

[12] A sovereign-guaranteed financing instrument is where a government (almost always central government) provides a lender (such as KfW) a guarantee that it will be repaid in event of a default. Non-lending instruments, such as guarantees issued by the lender for the benefit of a private entity, can also involve sovereign financing, such as a counter-guarantee issued by the government to cover a political risk event. Non-sovereign finance, including sovereign lending, is where there is no explicit government guarantee to repay if the borrower, often a private or non-government entity, were to default, so that the risk is borne by the lender.

Common features among DFIs in their approach in conflict and fragile contexts

- High-level commitment to fragility and conflict
- Formal fragility and conflict strategy
- Country programmes supported by analysis of drivers of conflict
- Special emphasis on the gender dimensions of fragility and conflict
- In some cases, special funding windows for fragile contexts
- In some cases, streamlined procedures and application of safeguard policies for FCS
- Non-sovereign financing instruments for non-state beneficiaries
- Support mostly through financial intermediaries
- Increasing the capacity of skilled staff in country offices in fragile contexts and providing technical assistance to beneficiaries
- Improving incentives for staff to work in fragile contexts

Summary

This section has assessed the approaches of some DFIs to PSD support in FCS, looking at what approaches have been used and the lessons learned so far. A number of common features among DFIs in their approaches in conflict and fragile contexts have been identified. The section showcases operational experiences and emerging good practice of note across DFIs which require more widespread socialisation, and consolidation through effective explicit monitoring and evaluation of attendant impacts on peace/resilience outcomes. Most DFIs focus on indirect support, e.g. through financial intermediaries, although there are some interesting examples of direct support to MSMEs in fragility, conflict and forced displacement settings, including solar power in the DRC, microfinance for women in the West Bank and Gaza, a seed supply project for smallholders in Sudan and support for the cotton and cashew nut sectors in the north of Côte d’Ivoire. In the latter example, IFC’s fragility lens was applied, which is a highly useful tool for analysing both the political risks associated with implementing projects in fragile states and any harmful effects a project might have on the overall fragile situation on the ground.

5 Main findings, suggested approaches and conclusions

5.1 Main findings

There has been limited systematic collection of data on non-financial impacts of support to MSME-led PSD and PSD more broadly in situations of conflict, fragility and displacement. The evidence on how MSME-led PSD shapes conflict dynamics and peace outcomes is patchy. Currently, we know the following:

- There is no automatic link between MSME-led PSD and economic growth.
- There is evidence that MSME-led PSD can drive resilience, cohesion, even if localised and higher-level peace outcomes are difficult to achieve.
- MSMEs when organised into associations for collective action can shape outcomes – not just for their members – and are more likely to be able to shape security/peace dialogue if their businesses are at risk. The extent to which this is achievable is contingent on the context.
- Mainstreaming conflict analysis and working with others to pool risk and plan strategically is critical for effective engagement by DFIs for PSD in FCS contexts.
- There is a need to develop new theories of change for engaging with MSMEs in FCS contexts to support resilience, social cohesion and seek opportunities to build peace, additional to traditional development objectives.
- Such theories of change must be tailored to country context, build upon the body of evidence and research that exists and be rigorously evaluated, to be adjusted, scaled-up and inform future engagements. Where the path forward is unclear, pilot projects offer a means to evaluate theories of change and test pathways to achieving multiple development and peace objectives at scale.

But evidence remains patchy. There has been very limited systematic collection of data on the role of MSMEs in different fragile contexts, both with respect to growth/economic development and in relation to broader social goals (stability, resilience and peace). What we have is some theoretical literature and context-specific evaluations and limited anecdotal evidence, rather than a systematic database. Such data can come from a systematic introduction of these criteria into impact evaluations of MSME development support.

5.2 Suggested approaches for DFIs operating in situations of conflict, fragility and forced displacement

DFIs generally have had an uneven track record in supporting MSMEs in fragile contexts. However, there appears to be an increasing awareness among some DFIs of the need for greater investment in understanding the context of their investments, the need for selectivity in investment targeting based on conflict sensitivity, an acknowledgement of the need for long-term DFI staff presence on the ground, and greater sustained investment in monitoring and learning if MSME-led PSD support is to achieve the desired results.

DFIs reviewed insist on the following approaches for DFI seeking to support MSME-led PSD in FCS:

- Avoid the dilemma of choosing between short-term and long-term impact.
- Include ‘prevention’ as a core principle guiding engagement and integrate preventative interventions across all sectors and contexts.
- Work selectively in the areas that best harness your comparative advantage, while cultivating partnerships with other actors across the humanitarian, development and peace spheres.
- Stick to standards but be flexible on the timing. Invest in agile operational mechanisms and flexible financial instruments because fragile contexts are dynamic.
- Develop a new theory of change to address inadequacies of standard operating procedures.
- Create differentiated approaches to FCAS to improve responsiveness of standard existing processes, procedures and practices.
- Increase institutional capacity for operations in FCS.
- Invest in enhancing institutional understanding of FCAS contexts.
- Innovate, innovate, innovate: consider mobilising diaspora remittance flows; provide micro-insurance or climate and agricultural risk insurance.

- Train SME leaders even if you do not provide financial services to them.
- Acknowledge that this is difficult to implement.
- Just do it! Do conflict analysis at every step of the way. Outsource if necessary to external providers, or use internal intelligence and analysis (in wider family).

5.3 Conclusions

Sustainable development and avoidance of aid dependency requires a vibrant private economy, particularly as aid volumes dwindle and fragility in low- and middle-income countries becomes compounded in the aftermath of Covid-19 and economic, commodity price and supply chain shocks created by the conflict in Ukraine.

While foreign direct investment and investment in large firms and public utilities are important too, MSMEs tend to dominate the local private sector.

Micro enterprises can be critical to resilience and helping households cope with fragility, as can SMEs, which are critical for self-employment, preserving livelihoods with dignity and preventing families and communities from sinking deeper into poverty.

Even if the sole objective of DFIs is PSD for growth/economic development, delivery on that objective can be improved if conflict sensitivity is built into the implementation approach. It is imperative to minimise the risk that project outcomes are disrupted by unintended consequences of conflict and forestall reputational risk.

When organised collectively, SMEs can have influence on conflict dynamics and peace outcomes. While clear-cut distinctions are not always easy to make, because SMEs can be both peace catalysers and peace spoilers as part of the conflict system. Understanding whether they are predominantly one or the other (spoilers or catalysers) is critical to effective MSME-led PSD support intended to promote more peaceful outcomes.

This means that conflict-blind investments are not an option for effective support to MSME-led PSD in FCS. Conflict-blindness can reduce its impact (through a risk of disruption due to conflict generated by support) and undermine the stability upon which sustainable development relies.

The relationship between MSME development, fragility and conflict is highly context-specific and each case requires conflict-sensitive political economy analysis to arrive at credible hypotheses based on assumptions that can be tested through evaluation that explicitly measures conflict/peace-related outcomes and impacts.

There is no intrinsic link between an MSME-led private sector and peace. Conflict sensitivity and context-specific analysis needs to be built into the design, evaluation and monitoring of project impact. This is a must rather than a nice to have. Greater efforts need to be made to incentivise the adoption of these sorts of approaches in operations and performance management. This is currently not systematically the case across because financial criteria (‘securing deal that are profitable’) tend to be prioritised over anything else. Without changes in approaches, the risks of doing harm are considerable as are the risks of undermining rather than contributing to peace, and of undermining the longer term economic viability of DFI investments.

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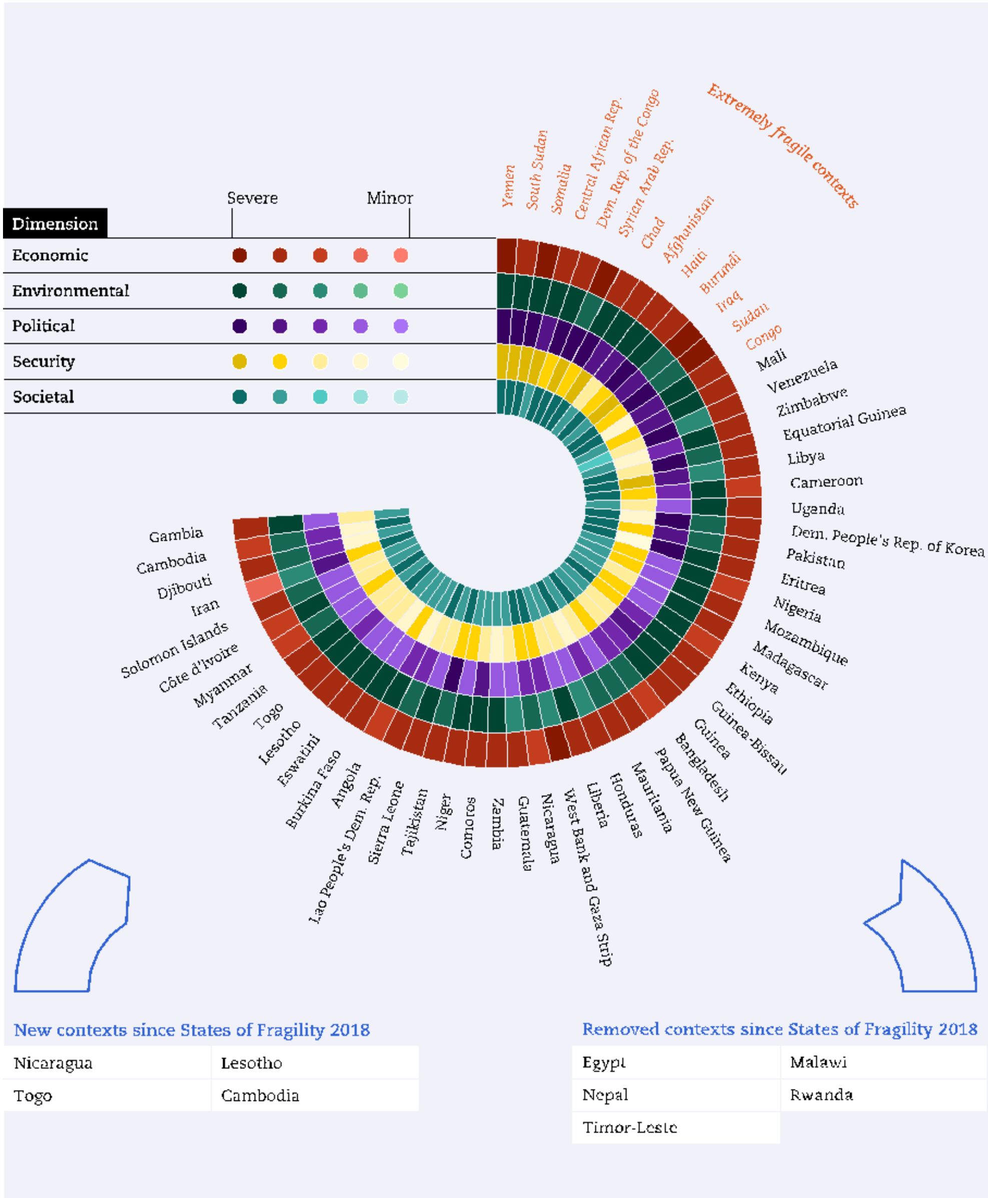
Annex 1 Conflict typologies (political settlement, conflict/fragile situations, private sector)

Conflict typologies								
	Heightened risk of conflict	Widespread active conflict	Subnational conflict	Transition from conflict	Communal violence	Criminal Violence	Forced human displacement	Development state
Political settlement	Favours ruling elites, seen as exclusive by others, manages differences with difficulty. Authority is imposed but constitutional/ institutional arrangements considered illegitimate by many. Vulnerable to a wide range of shocks to which the state may be unable to meet public expectations to respond.	Broken down. Constitutional and other institutional arrangements have failed to manage grievances. New order likely to be imposed or grown after violence subsides.	Favours elites and metropolitan areas and areas of country with affiliation to ruling elites who benefit from their patronage. Areas of country excluded and discontented and prone to rebellion.	New political settlement established where new actors assume power. Can grow from peace agreement that may be built on compromised or from victory of a coalition in war.	Duality between formal constitutional arrangements and traditional structures of patronage and obligations that may be under environmental or other stress.	Elite based with weak relations between elites and population. Policies favour elites with order imposed by discriminatory laws and security forces with weak public accountability. Gangs may provide protection from violent state and reinforce pre-migration identities.	Refugees can be semi-integrated into host communities without legal or political rights, and competition with hosts over jobs and resources. Or displaced in camps under UN or other governance.	Stable inclusive constitutional arrangements. Government subject to rule of law and accountability, e.g. through legislature and media, or party discipline. Independent judiciary and civil service. Apolitical security sector. Transparent regulatory arrangements.

Conflict typologies								
	Heightened risk of conflict	Widespread active conflict	Subnational conflict	Transition from conflict	Communal violence	Criminal Violence	Forced human displacement	Development state
Private sector	Range of foreign and local large and MSMEs. Firms may depend on political connections for survival and growth. Regulatory and tax system used to reward and punish firms. MSMEs may face predatory state and state sponsored firms.	Investment has stopped, except for firms capable of profiting from war economy. MSMEs in survival/coping mode.	Private investment concentrated in non-conflict areas. Local MSMEs in conflict areas in survival/ coping mode.	MSME investment starting to recover and often concentrated in trade and services.	MSMEs continue to operate but not much investment or technology improvement takes place.	Duality between large modern firms and semi-formal MSMEs. MSMEs more vulnerable to extortion in exchange for protection. Risk of kidnapping.	MSMEs may start up in areas with concentration of displaced people to serve local needs, but economy aid-dependent.	Growing business sector that is adopting new technology with professional-ising management.

Annex 2 OECD (2020) list of countries with severe fragility



Source: Figure downloaded from OECD statlink: https://doi.org/10.1787/888934168265

Annex 3

Table A1 Guidance documents and tools for businesses on how to operate in a conflict-sensitive and peace-promoting way

Name of the standard/tool	Developed by	Short description
Voluntary Principles on Security and Human Rights (VPs) (2000)	A group of extractives companies, governments and NGOs	The VPs comprise of a set of principles to guide companies in maintaining the safety and security of their operations while respecting human rights. Developed in response to allegations of human rights abuses committed by private security providers contracted by extractive industries. Source: https://www.voluntaryprinciples.org/ An Implementation Guidance Tool for the VPs has been developed by the Geneva Centre for the Democratic Control of Armed Forces (DCAF) and the International Committee of the Red Cross (ICRC). Source: https://docs.wixstatic.com/ugd/f623ce_087e0c0d878c4576800779c69dcb60a1.pdf
Conflict-Sensitive Business Practice Guidance for Extractive Industries (2005)	International Alert (IA)	The IA guidance consists of guidance on doing business in societies at risk of conflict for field managers working across a range of business activities, as well as headquarters staff in political risk, security, external relations and social performance departments. It provides information on understanding conflict risk through a series of practical documents, including an introduction to conflict-sensitive business practice, a screening tool for early identification of conflict risk and Conflict Risk and Impact Assessment tools. Source: https://www.international-alert.org/publications/conflict-sensitive-business-practice-guidance-extractive-industries-en

Name of the standard/tool	Developed by	Short description
Guidance on Responsible Business in Conflict-Affected and High-Risk Areas (2010)	UN Global Compact and Principles for Responsible Investment (PRI) initiative	The UN Global Compact and PRI guidance helps companies and their investors to implement responsible business practices in conflict-affected and high-risk areas in concert with the UN Global Compact Ten Principles. The guidance is voluntary and aims to complement applicable national and international laws by promoting international good practice. Source: https://www.unglobalcompact.org/docs/issues_doc/Peace_and_Business/Guidance_RB.pdf
Guidance on Enhanced Human Rights Due Diligence in Conflict Affected and High-Risk Areas (2016)	Swisspeace	The guidance integrates conflict-sensitive business practices into standard human rights due diligence procedures. A total of 17 steps are identified through which companies can enhance their standard human rights practice in order to meet the specific challenges in conflict-affected and high-risk areas. These steps complement all aspects of corporate human rights procedures – including commitment, assessment, addressing and remedy, reviewing and reporting. Source: http://www.swisspeace.ch/fileadmin/user_upload/Media/Publications/Essentials/swisspeace-Essential_5_2016.pdf
Toolkit for Addressing Security and Human Rights Challenges in Complex Environments (2016)	Geneva Centre for the Democratic Control of Armed Forces (DCAF) and the International Committee of the Red Cross (ICRC)	The Toolkit is a compendium of concrete good practices to security and human rights challenges aimed at companies, security providers, civil society, national regulators and other practitioners. It was developed in response to a number of challenges that stakeholders are facing: an overload of resources, duplication of information, and knowledge gaps. The primary audience for this Toolkit is any kind of company facing security and human rights challenges in complex environments. It will be useful for company staff working in a wide range of functions, in particular those dealing with security, government relations, business and human rights, corporate social responsibility, community relations and legal issues. Source: https://www.securityhumanrightshub.org/toolkit
Guidance on human rights due diligence (HRDD) in conflict-affected settings (2018)	International Alert	This guidance aims to enhance human rights due diligence (HRDD) in conflict-affected settings by drawing on knowledge and lessons learned in the field of peace, conflict and human rights, and providing additional considerations for companies and practitioners. More specifically, the guidance will do the following: • Help companies from the extractive sector understand any conflicts in their operating context and identify the implications these have for HRDD. • Provide tools, case studies and recommendations to help companies and other practitioners conducting HRDD in conflict-affected settings. • Contribute to ongoing debates on business, human rights and conflict sensitivity. Source: https://www.international-alert.org/publications/human-rights-due-diligence-conflict-affected-settings

Name of the standard/tool	Developed by	Short description
Framework and policy guidebook for Deals and Development in Fragile and Conflict-Affected States (2021)	United Nations University – WIDER	This framework utilizes business interests and the distribution of political power to understand the episodic nature of economic growth in fragile and conflict-affected states. Conflict, state capacity, and legitimacy are analysed alongside the business environment and structural transformation to explain when growth episodes arise and when those growth episodes have positive, or negative, feedback on the country's political economy and state fragility. The guidebook is designed to help advisers working with development agencies to analyse country context and design interventions with the goal of enabling positive growth episodes that reduce fragility. Source: https://www.wider.unu.edu/publication/deals-and-development-fragile-and-conflict-affected-states
Good Practice Note on Contextual Risk Screening for Projects (Draft for Public Consultation - April 2022)	International Finance Corporation (IFC)	This Good Practice Note outlines an approach for systematically analyzing country risks to identify the highest risk areas and translating them into potential E&S risks at the subnational and project level and/or at the sector-level. The results of the analysis can be used to develop programmatic measures and actions to address the potential risks of a given business activity. At the center of this approach is the Contextual Risk Framework (CRF), comprised of nine thematic dimensions covering a broad range of cross-cutting issues: 1. Security and Conflict; 2. Political Risk, Governance, and Civil Liberties; 3. Labor and Workforce; 4. Health and Population; 5. Biodiversity, Ecosystem Services, and Climate Change; 6. Land and Access to Natural Resources; 7. Social Cohesion; 8. Gender; and 9. Reprisals. The audience is practitioners working in the area of PSD, which may include DFIs, financial institutions, E&S consultants, and private sector companies, as well as civil society organisations. Source: https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/sustainability-at-ifc/external-peer-review_gpn-contextual-risk

Table A2 Repositories for key literature and guidance materials for businesses in FCS

Name of the repository	Developed by	Short description
Security and Human Rights Knowledge Hub	Geneva Centre for the Democratic Control of Armed Forces (DCAF) and the International Committee of the Red Cross (ICRC)	As part of the development of the Toolkit for Addressing Security and Human Rights Challenges in Complex Environments (see Table A1), DCAF and the ICRC have also developed a Knowledge Hub. This is an interactive tool that brings together practical guidance for governments, civil society and companies on business, security and human rights. Source: www.securityhumanrightshub.org
Repository of literature on business and peace	Principles for Responsible Management Education (PRME) Working Group on Business for Peace (B4P)	The PRME Working Group on Business for Peace (B4P) is a community of academics and practitioners who aim to advance the discussion and further academic research on the private sector's role in cultivating the conditions that enhance sustainable peace and inclusive development. It has created a repository of all available literature on business and peace. Source: http://unprmeb4p.org/resources/
Repository of literature on PSD in FCS	Donor Committee for Enterprise Development (DCED)	This page brings together key resources on the challenges and opportunities of PSD approaches in fragile and conflict-affected environments (FCAEs). Source: https://www.enterprise-development.org/implementing-psd/psd-in-fragile-and-conflict-affected/

Annex 4 What have DFIs done?

Development finance institution	Approach to PSD in FCS	Recommendations/lessons learned	Cases/examples of best practices
World Bank Group (WBG)/ International Finance Corporation (IFC)	Since the beginning of the millennium, WBG country strategies in FCS have stressed the development of the private sector to create jobs and secure peace and economic growth. The World Bank, IFC and MIGA came to work more closely together in FCS through financing instruments that blended IDA grants or credits with IFC loans or providing a first loss facility for MIGA guarantees. In 2020, the WBG published its first Strategy for Fragility, Conflict, and Violence,[13] in which it is explained how both IFC and MIGA will explore systematic approaches to conflict sensitivity in projects and develop new analytical-strategic tools and training, including detailed conflict assessments and due diligence screenings. This will help to identify how potential projects and sponsors interact with drivers of fragility to ensure that projects do not contribute to instability and make as positive a contribution to stability as	In a 2019 stocktaking exercise, IFC reviewed the role of the private sector in FCS, the constraints and opportunities, and IFC's own experience, and synthesised seven key principles for engaging with the private sector in FCS (see Box 1).[14] These are recommendations targeted at all stakeholders – DFIs, governments, impact investors, private companies, and others – that have a desire to expand the private sector in FCS in ways that have a positive impact. Some of these principles that are especially relevant for KfW are: • Avoid the dilemma of choosing between short-term and long-term impact. • Stick to standards but be flexible on the timing.	The WBG and IFC have a long history of supporting private investment and growth in FCS – both through investment and advisory services. Although there is no solid evidence to what extent this has led to more peace and stability, evaluations have shown that evidence was found of a positive impact of PSD interventions when conflict and vulnerability sensitivity analyses applied which included a peace-building or 'do no harm' approach (see Section 3.1). Examples of best practices include IFC's efforts to support post-conflict Indonesia in the late 1960s, and in the Balkans in the late 1990s and early 2000s. In 2008, IFC created the Conflict-Affected States in Africa (CASA) Program, which adopted a 'fragility lens' to analyse both the political risks associated with implementing an advisory project in a

[13] World Bank Group, World Bank Group Strategy for Fragility, Conflict, and Violence 2020–2025 (English), 2020, http://documents.worldbank.org/curated/en/844591582815510521/World-Bank-Group-Strategy-for-Fragility-Conflict-and-Violence-2020-2025.
[14] IFC, Generating Private Investment In Fragile and Conflict-Affected Areas, 2019, https://www.ifc.org/wps/wcm/connect/publications_ext_content/ifc_external_publication_site/publications_listing_page/201902-fcs-study.

Development finance institution	Approach to PSD in FCS	Recommendations/lessons learned	Cases/examples of best practices
	possible, such as via the creation of inclusive employment opportunities and fair use of resources. IFC's corporate strategies have given focus to FCS since 2009 and it adopted a formal FCS strategy in 2011. In 2019, a review of IFC's engagement in FCS showed that despite being a corporate priority since 2009, its FCS portfolio had remained modest at around 4.5% of global new commitments (or 7.5% of the total number of projects) and there had not been an increasing trend during the past decade. These disappointing results have not been through lack of trying; the IFC advisory window aimed at creating markets and helping firms prepare bankable projects has been concentrated more proportionally on FCS than non-FCS countries (IEG, 2019). IFC, which traditionally responded to approaches from investors for transactions, created regional funds for investment promotion such as in Africa and the Middle East and IFC country staff were collocated in Bank offices. In IFC's Environmental and Social Performance Standards, it is emphasised that in conflict and post-conflict areas, the level of risks and impacts may be greater and additional risk assessment is needed to ensure the project is not leading to further conflict.	The World Bank considers access to financial services as one of the most pressing challenges for MSMEs in FCS, which are a significant part of the private sector and relevant to inclusive economic growth. Through its diverse public and private sector investment options, the WBG is one of the largest financers of projects that support MSMEs.	fragile state, and any harmful effects a project might have upon the overall fragile situation on the ground.[15] This fragility lens was among others applied in the cotton and cashew nut sectors in the north of Côte d'Ivoire, a relatively fragile area that would greatly benefit from economic support. The fragility lens allowed the IFC project team to articulate more clearly how the project could address two pertinent conflict drivers: ethnic divisions and regional disparities. These disparities were particularly linked to the country's established agriculture sector, notably cash crops such as cocoa and coffee, which historically have been concentrated in the southern part of the country. This unbalanced regional agricultural development created grievances and intense competition for resources. By applying the fragility lens and analysing two-way interactions between the project and conflict, the project team emphasised bringing different ethnic groups together for training and focusing on the project's contribution to job creation in the north.

[15] IFC, IFC Africa's 'fragility lens', 2019, https://www.ifc.org/wps/wcm/connect/ac88404b-2784-46b4-883d-c19e2566ab20/IFC-Africa-Fragility-Lens-Factsheet.pdf?MOD=AJPERES&CVID=lC9W-as.

Development finance institution	Approach to PSD in FCS	Recommendations/lessons learned	Cases/examples of best practices
African Development Bank (AfDB)	AfDB was one of the first multilateral organisations to institutionalise the fragility agenda in the early 2000s, highlighting the Bank's longstanding engagement in addressing fragility and building resilience. Since then, it has addressed the issue of fragility in its 5-year strategies. The Bank has recently launched its new strategy for addressing fragility and building resilience in Africa (2022–2026).[16] AfDB programmes for African-based MSME are aimed at enhancing inclusive growth and promoting job creation on the continent. AfDB provides long-term liquidity, credit lines and technical assistance to financial institutions, particularly commercial banks, microfinance institutions, leasing companies and other non-banking financial institutions in Africa. AfDB does not directly fund SMEs, but its programmes are designed to enable financial institutions, effectively establish larger and high-quality loan portfolios for small businesses. AfDB also has other programmes that support loan applicants with developing their business plans, financial literacy training and understanding credit processes. AfDB prioritises financial institutions that operate in lower income countries as well as in fragile states, where MSMEs have limited financial opportunities.	An evaluation of AfDB's private sector engagement noted that non-sovereign financing had uncertain development effectiveness for SME beneficiaries because of limitations in the way outcomes were monitored and evaluated, and there was no suggestion that peace outcomes were included in AfDB operations. Inadequate tracking of lines of credit and inadequate enforcement led to large business rather than SMEs becoming beneficiaries of AfDB funding, even though SMEs constitute the majority of Africa's private sector. The evaluation noted the lack of explicit theories of change for PSD and inadequate measurement of outcomes such as job creation, private investment, and productivity. Despite innovative instruments such as a Private Sector Credit Enhancement Facility, the Bank's PSD programmes in fragile contexts were constrained by inadequate sovereign resources available through the concessional ADF window, scarcity of private sponsors and the Bank's limited risk appetite in such countries for non-sovereign lending. The evaluation concluded that sovereign–non-sovereign linkages are particularly important if AfDB is to play a larger	Especially at the regional and national level, AfDB plays a key role in addressing fragility. The Africa Resilience Forum is an annual AfDB event which brings together key stakeholders across government, civil society, the private sector and international partners to reflect on the continent's conflict prevention, peace and state-building initiatives. AfDB has established the Fund for Private Sector Assistance (FAPA), a multi-donor initiative that provides grant funding, technical assistance and capacity-building for PSD. FAPA is jointly funded by the AfDB, the Government of Japan, the Government of Austria and the Austrian Development Bank. The FAPA portfolio provides assistance for strengthening regional and national infrastructure, relevant for facilitating commerce and trade. Although FAPA does not provide grants assistance to MSMEs, it enables business owners to access loans through financial intermediaries and fosters an inclusive business environment for MSMES. AfDB has also a well-established Transition Support Fund (TSF), financed through grants that provides finance targeted at FCS. Interviews with AfDB staff found that the bank wishes to

[16] African Development Bank, Bank Group's Strategy for Addressing Fragility and Building Resilience in Africa (2022–2026), 2022, https://www.afdb.org/en/documents/bank-groups-strategy-addressing-fragility-and-building-resilience-africa-2022-2026.

Development finance institution	Approach to PSD in FCS	Recommendations/lessons learned	Cases/examples of best practices
		role in PSD in fragile contexts (AfDB 2020b). In the new strategy for addressing fragility and building resilience in Africa, the following lessons learned from its 20-year engagement in tackling fragility in Africa were noted:[17] • The need to consider 'prevention' as a core principle guiding the Bank's engagement in fragile settings, and to integrate preventative interventions across all sectors and contexts. • The Bank should work selectively in the areas that best harness its comparative advantage, while cultivating partnerships with other actors across the humanitarian, development, and peace spheres. • Fragile contexts are dynamic and call for agile operational mechanisms and flexible financial instruments.	increase the range of financial products offered by the TSF and their application to MSME development.
Asian Development Bank (ADB)	The ADB has been focusing on fragility for over a decade. This started in 2010 with an evaluation of the Bank's support to FCS, followed by an Operational Plan for Enhancing ADB's Effectiveness in Fragile and Conflict-Affected Situations in 2013.	An evaluation of ADB's portfolio performance and the development outcomes in FCAS and SIDS showed that while an overall 70% of ADB operations were successfully completed during 2018–2020, this percentage was only 50% for FCAS,	Through its private sector operations support, ADB has been involved in many engagement efforts with the private sector in FCS. Among others, ADB is financing Afghanistan's first private sector gas-fired

[17] African Development Bank, Bank Group's Strategy for Addressing Fragility and Building Resilience in Africa (2022-2026), 2022, https://www.afdb.org/en/documents/bank-groups-strategy-addressing-fragility-and-building-resilience-africa-2022-2026.

Development finance institution	Approach to PSD in FCS	Recommendations/lessons learned	Cases/examples of best practices
	In 2021, an operational approach and action plan for 2021–2025 was published on how the ADB will achieve its Strategy 2030 objectives to improve the effectiveness of ADB assistance and the development outcomes of developing member countries (DMCs) in FCAS and Small Island Developing States (SIDS) contexts, and for pockets of fragility and poverty at subnational level.[18] ADB classifies 11 DMCs as FCAS, and 16 DMCs are SIDS. ADB's decision to do so is motivated by the fact that its portfolio performance and the development outcomes in FCAS and SIDS are lower than ADB's averages (see next column). The Bank's commitment is that 60% of FCAS member countries will have completed a fragility assessment during the ADF 13 period (2021–2024). ADB has a well-developed approach to fragility and resilience, although conflict sensitivity is not embedded in its assessment framework. The new operational approach includes developing fragility and resilience assessments, knowledge analytics, and tools to improve risk-based country partnerships strategies, program planning, and project preparation and implementation in member countries.	and 56% for SIDS.[19] The key causes were as follows: • Inadequate responsiveness of standard ADB processes and procedures to specific FCAS and SIDS needs, contexts and risks. • Inadequate application of knowledge and tools, and limited internal ADB coordination across themes and sectors to respond to the specific contexts of FCAS and SIDS. • ADB institutional capacity constraints. • Developing member countries' contextual constraints in FCAS, SIDS, and in pockets of fragility and poverty at subnational level. A theory of change has been developed to tackle these issues, which is based on three pillars: • Pillar 1: improving responsiveness of standard ADB processes, procedures and practices for FCAS and SIDS differentiated approaches.	power project. The project will increase domestic power generation and reduce the import of electricity, thereby contributing to Afghanistan's long-term energy security, affordability and sustainability.

[18] Asian Development Bank, Fragile and Conflict-Affected Situations and Small Island Developing States Approach, 2021, https://www.adb.org/sites/default/files/institutional-document/699041/fragile-conflict-affected-sids-approach.pdf.
[19] Ibid.

Development finance institution	Approach to PSD in FCS	Recommendations/lessons learned	Cases/examples of best practices
		• Pillar 2: increasing ADB's institutional capacity for operations in FCAS and SIDS. • Pillar 3: enhancing understanding of DMC contexts.	
European Investment Bank (EIB)	In 2018, EIB reported that since 2012, 15.4% of the EIB's €44 billion in lending outside the EU and EFTA countries has gone to projects in fragile regions. This amounts to €6.8 billion for fragile regions, covering 116 operations. The EIB has developed a conflict-sensitive approach, which aims to reduce the risk of the conflict and fragility derailing the project, avoid the risk of conflict being exacerbated by the project; and contribute to conflict prevention and peacebuilding efforts through its investments. Since 2015, the EIB applies conflict-sensitive guidelines for projects in fragile settings, which will be updated in 2022. The objective is to guide EIB staff in making informed strategic and operational decisions, identifying and mitigating conflict risks, and assessing conflict impacts at the investment level. It is not a 'compliance policy' document, nor is it intended to make staff 'conflict experts' as such, but rather to raise their awareness and provide practical guidance in a number of relevant areas when working in conflict affected and fragile situations.[20]	In 2017, EIB launched the Conflict Sensitivity Helpdesk to provide staff in headquarters and country offices with project-specific support on due diligence mechanisms and conflict-sensitive approaches throughout the conflict cycle. Up until 2021, the Helpdesk was operated by Saferworld and swisspeace. A review of the effectiveness of the Helpdesk is currently in preparation, which will provide many interesting lessons to KfW as well.	Examples of EIB's engagement in fragile contexts include support to the reconstruction of the countries of former Yugoslavia in the 1990s, the Early Recovery Programme to support the conflict-affected areas in Ukraine, support to small businesses and water and energy infrastructure in Mali, as well as support to financing for infrastructure projects in Colombia. One of the projects supported by the Conflict Sensitivity Helpdesk is EIB's investment in a desalination plant in Gaza.

[20] European Investment Bank, Good Practice Note on Conflict Sensitivity, 2015.

Development finance institution	Approach to PSD in FCS	Recommendations/lessons learned	Cases/examples of best practices
European Bank for Reconstruction and Development (EBRD)	Since its creation in 1991 to support economic reconstruction in central and eastern Europe, the EBRD has expanded its original region of operations into new countries, including FCS such as Egypt, Lebanon, and the West Bank and Gaza. It is currently active in nearly 40 countries. EBRD has a large portfolio of finance for SMEs, with €1,266 billion of annual bank investment for SME-related projects (12.1% of total) and is involved in 2,071 advisory projects to SMEs. EBRD's Small Business Initiative is a strategic initiative integrating the tools the Bank offers to support small enterprises. It provides loans and investments through financial institutions and risk-sharing facilities, and finances small businesses directly. In addition, EBRD provides small enterprises with advice to help them innovate and grow and works with policy-makers on an enabling environment where SMEs can succeed.	The following lessons have been learned from EBRD's five years of operation in the West Bank and Gaza (see also next column): • Context matters • Good data collection and analysis is a key factor of success • Collaboration is key • Proximity makes the difference • Tailored approaches mixing investment and technical assistance work well • Concessional financing is necessary in fragile contexts With regards to the last lesson, it was noted that including concessional financing would be a way to increase the volume of operations to further support the private sector in the West Bank and Gaza.	In 2022, an evaluation of EBRD's project portfolio in the West Bank and Gaza was carried out.[21] The Bank has engaged in activities under three strategic themes, including strengthening the capacity of financial intermediaries with a particular focus on increasing access to finance for MSMEs. The key needs identified included: access to finance, supportive investment climate, and economic empowerment of youth and women. This resulted in various loans to MSMEs, including the first Women in Business (WiB) loan in the West Bank and Gaza. Another example of EBRD's work in FCS is Georgia: the support provided (together with IFC) to the banking sector helped to stabilise Georgia's economy following the Russia–Georgia conflict and the global financial crisis. Among others, this finance has helped the Bank of Georgia maintain sufficient liquidity during the financial crisis and continues to assist retail clients and SMEs.[22]
International Fund for Agricultural Development (IFAD)	IFAD has been the most prominent DFI that supports rural agriculture, smallholders, farming cooperatives and SMEs that operate in rural supply chains. By virtue of its mandate and size, IFAD has had to focus on MSMEs that operate in rural spaces. Most fragile and conflict contexts tend to be low-income countries, with high rural populations,	IFAD's approach in general involves mobilising small producers through community development or farmer organisations and cooperatives, and establishing partnerships with private firms through supply chains and with government agencies, particularly in support of market development. IFAD	IFAD mostly adopts a country-level and issue-based investment approach and implements PSD through diverse models. Some case examples include the following: • An IFAD seed supply project for smallholders in Sudan was implemented through private

[21] European Bank for Reconstruction and Development, Evaluation of EBRD's investments in the West Bank & Gaza, 2022.
[22] https://www.ebrd.com/news/2008/helping-georgias-banking-system.html

Development finance institution	Approach to PSD in FCS	Recommendations/lessons learned	Cases/examples of best practices
	low mechanised agricultural activities and limited market access. Private sector investments are needed to facilitate agricultural productivity through sustainable intensification, improve local and adaptive farming technologies and strengthen the capacity of rural farmers. IFAD grants and loans schemes enhance the participation of rural sector MSMEs and smallholders in the value chains. Most of these value chains address issues related to food supply in local markets. Attempts have also been made to link small businesses into the humanitarian action and peacekeeping supply chains. Until recently, IFAD financing to MSMEs consisted of highly concessional loans with sovereign guarantees via intermediaries and some limited grants, often from co-financing. IFAD has now established a special window for finance for countries on the World Bank fragility list and a donor financed special fund to fill a demand for non-sovereign operations.	has shown some innovation in its approaches to financing small rural enterprises, including mobilising diaspora remittance flows (IFAD, 2020a, 2020b). IFAD has also worked to provide microinsurance and leasing/microleasing facilities as well as climate and agricultural risk insurance (IFAD, 2021, IFAD, 2020c).	seed producers and providers of other inputs and services with market enabling reforms implemented with the government. • A similar approach implemented in Solomon Islands involves organising small producers through community development groups that developed social infrastructure, and providing grants and blended finance to small firms supplying agricultural inputs and agribusiness, plus support for disaster recovery. Local farmers participated in seed programmes through community development cooperatives also financed by IFAD. • In conflict-affected northern Nigeria, IFAD assisted smallholders transitioning from subsistence farming to sustainable agribusiness. In the Nigerian case study, funds were channelled through an impact investor which linked farmers to supply chains.
Proparco	Proparco is the private sector financing arm of Agence Française de Développement Group (AFD Group). Proparco provides funding and support to both businesses and financial institutions in Africa, Asia, Latin America and the Middle-East. Its action focuses on the key development sectors:	Proparco has learned that in fragile contexts, its purpose should be to contribute to job creation, stability and resilience, in order to give young people incentives for not signing up to jihadist movements which are income generating opportunities for them. It	In contexts of conflict and fragility, Proparco specifically targets MSMEs in the agricultural sector, mainly through microfinance institutions that bring together enterprises that are particularly promising in terms of employment generation (30 plus employees).

Development finance institution	Approach to PSD in FCS	Recommendations/lessons learned	Cases/examples of best practices
	infrastructure, mainly for renewable energies, agribusiness, financial institutions, health and education. With Choose Africa, AFD Group and Proparco make all its tools available to African start-ups and MSMEs to finance and assist them at the various stages of their development. By the end of 2021, €3 billion of financing – including €780 million under the Resilience component – had been committed for the benefit of more than 26,000 MSMEs and tens of thousands of micro entrepreneurs. Nearly 2,500 companies will receive technical assistance.[23] Over recent years, Proparco has pivoted to working in fragile contexts – especially the Sahel, DRC and the Near and Middle East. This was a departure from classic contexts and the approach focused on 'transactions' and has obliged Proparco to work with others, including AfDB, IFC and World Band, and to move from finance provider to development practitioner – using different tools and different human resource capacity. Proparco has benefited from French government support, which enabled it to shoulder the risk in these fragile contexts.	builds on the existing dynamics where jobs are already being created. The approach is to target agricultural businesses – entrepreneurs or networks of entrepreneurs – rather than small producers or producer networks. Specifically, Proparco tries to address two identified needs: (1) access to microfinance/mesofinance for MSMEs; (2) access to energy (from solar panels) via decentralised off-grid services. Important insights after two years working in fragile contexts is that we also need training for SME leaders, and that it is crucial to work with external providers for conflict analysis (e.g. MercyCorps), and to rely on AFD intelligence and analysis. But it remains difficult to implement.	Examples of investments in FCS include the following: • In DRC, Proparco invested €1 million in the company Nuru. Created in 2015, Nuru (formerly Kivu Green Energy) develops and operates urban solar hybrid mini-grids in the North Kivu province. A 1.35MW mini-grid deployed by Nuru is one of the main mini-grids in sub-Saharan Africa.This fits within Proparco's broader goal of improving access to clean and accessible electricity for households and businesses in fragile countries. • In Burkina Faso, Proparco provides support to Société General. This includes lines of credit to four SMEs and guarantees to lend to micro enterprises, but also loans for renewable energy infrastructure (solar). This is an example of how Proparco provided more guarantees to banks to lend to SMEs affected by the Covid-19 pandemic. • In Mali, support is provided to Banque Atlantique, consisting of a €760 million portfolio guarantee that allows the bank to increase its financing activity for SMEs that are mainly owned by

[23] https://www.proparco.fr/en/actualites/choose-africa-3-billion-euros-committed-afd-group-support-26000-start-ups-and-msmes?origin=/en/rechercher?query=choose

Development finance institution	Approach to PSD in FCS	Recommendations/lessons learned	Cases/examples of best practices
			women. It demonstrates the priority given to supporting the private sector in fragile countries, in high-impact sectors.
FMO (Netherlands Entrepreneurial Development Bank)	Overall, FMO is not specifically focusing on FCS, but its MASSIF investment fund, aiming at access to financial services for MSMEs, has a special focus on fragile countries. Investments in fragile states accounted for 14% of the committed portfolio as of end-2019. By the end of 2020, the total committed portfolio was €545 million.[24] Conflict and fragility are implicitly considered in the FMO-MASSIF application process by looking at the context in which a company will operate and by taking a risk-based approach. However, there is no explicit mention of conflict-sensitivity or of the potential risks related to doing business in FCS. In May 2022, FMO announced that it is extending the scope of its Nasira loan-guarantee programme to increase financial inclusion in fragile African states. Nasira was first set up by the European Commission in 2018 as a loss-sharing scheme between FMO and financial institutions on risky loan portfolios. It aims to extend the range of loans in developing countries that are viable for banks and microfinance lenders.[25]	FMO believes it can help crowd in private sector investment in fragile African states – provided there is a functioning and effective government, which is needed to provide an enabling environment for its programmes to work. In 2021, FMO commissioned a study on the conditions for successful investments in fragile states. The objective of the study was to identify what leads to investments with beneficial effects, adequate financial returns and limited (environmental and social governance) issues in FCS, including how FMO can better engage with stakeholders. The report is expected to be published in 2022.	FMO's MASSIF fund has considerable influence by investing in fragile states, including Cote d'Ivoire, Sierra Leone, Democratic Republic of Congo, the Palestine territories and Myanmar. For instance, in the case of Feronia, a palm oil company in DRC, FMO (together with several other DFIs) used its leverage to pressure the company to improve its sustainability standards. The Nasira Fund will be deployed in fragile African states, including the Sahel countries, the DRC and Mozambique.

24 https://massif.fmo.nl/FbContent.ashx/pub_1000/downloads/v210503140000/Annual_Report_2020_MASSIF.pdf

25 https://www-theafricareport-com.cdn.ampproject.org/c/s/www.theafricareport.com/201627/dutch-development-bank-fmo-wants-to-scale-up-loan-guarantees-in-fragile-states/amp/