Helpdesk Research Report: Incentives to the Private Sector and Early Recovery

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Query: Provide examples where donors have tried to influence the incentives facing the private sector to support early recovery. Focus particularly on direct interventions to support businesses, rather than support to the investment climate. How successful have these efforts been? Are there any general lessons about the kinds of incentives that work in particular contexts?

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1. Overview

This report assesses examples of donor interventions designed to influence the incentives facing the private sector (PS) with the overarching aim of supporting early recovery. The term ‘early recovery’ is not clearly defined in the literature, but for the purposes of this report will be understood as ‘a multidimensional process of recovery that begins in a humanitarian setting. It is guided by development principles that seek to build on humanitarian programmes and catalyze sustainable development opportunities. It aims to generate self sustaining, nationally owned, resilient processes for post crisis recovery. It encompasses the restoration of basic services, livelihoods, shelter, governance, security and rule of law, environment and social dimensions, including the reintegration of displaced populations’ (CWGER 2008, p.9).
Broadly speaking, there are two main schools of thought about how international actors can support the private sector in post-conflict or post-disaster contexts. The first argues that donors should support the PS indirectly, by creating a favourable investment climate. The second favours more direct intervention – including alliances with PS players or direct support to emerging industries

(MacSweeny 2009). This report will focus primarily on direct interventions that seek to provide incentives to the private sector or to encourage the growth of the formal sector, in order to promote growth and employment in a post-conflict or post-crisis context. The report focuses on programmes that are based on the assumption that while it can be beneficial to provide direct support to particular firms or sectors, interventions should be based on market analysis (SEEP 2007).

The need to promote PSD in early recovery contexts is now widely recognised in the PSD literature. Within this field, ensuring that donors respond to market failures and design programmes to reflect market realities are now seen as minimum standards of post-crisis recovery. In 2009, the SEEP Network published the Minimum Standards for Economic Recovery after Crisis as a complement to the Sphere Humanitarian Standards. The document emphasises the importance of market-based programming (SEEP 2009).

Donors have directly sought to influence the incentives facing PS actors to support early recovery in a number of key ways, including by:

- **Providing Financial Incentives** (providing microfinance, wider support for the financial sector, enterprise challenge funds).
- **Picking Winners** (providing firm- or sector-level assistance to business, matching grant schemes, support to the agricultural sector).
- **Practising Market-Integrated Relief** (ensuring that relief programmes support rather than distort local markets).
- **Incentivising Foreign Investment** (linking local businesses with foreign companies, providing political risk guarantees, investment roadshows, public private partnerships, providing investment support facilities)
- **Providing Capacity Building Support** (enterprise-based training, business incubator programmes)

It should be noted that there is a great deal of cross-over between these various categories. For example, programmes can include components that address both agricultural development, and market-based relief, or can shift from one focus to another over time. Many donor interventions are multi-dimensional and combine several of the components outlined below.

Donors often support integrated PS initiatives that seek to support the private sector through a combination of direct and indirect initiatives. Examples of this kind of support include the MDTF-South Sudan, which established an integrated programme for supporting PSD. This involved a 'business plan competition'; the provision of policy, technical and financial support for the establishment of the micro-finance sector in Southern Sudan; and support for the emergence of industries by providing capacity and providing business support facilities (EVD et al 2009). World Bank assistance to Timor Leste was similarly wide-ranging and included direct loans to businesses, efforts to reform the banking system, as well as initiatives to reduce the regulatory burden on businesses (World Bank 2011). The World Bank's assistance to the West Bank and Gaza followed a similar pattern. This programme aimed both to reduce regulatory barriers facing the private sector, and to provide direct support to businesses through the provision of credit and by encouraging foreign direct investment (FDI) by providing political risk guarantees (World Bank 2010).

Effectiveness

Since interventions to support the private sector in early recovery contexts are varied, it is difficult to draw any general conclusions about their effectiveness. As will be discussed in section 9, these interventions' suitability may be strongly determined by context. The report identifies a range of successful and unsuccessful examples of each different type of intervention and as such does not provide a comprehensive overview of the relative effectiveness of these different types of intervention. Nevertheless, a few key lessons about the kinds of intervention which tend to be most effective can be drawn from these examples:

- **Market Analysis:** Interventions that were based on poor market analysis tended to fail (Wilson 2002), while those that were based on good market analysis tended to be successful. A successful example comes from the Netherlands Development Organisation's support to the cardamom sector in Nepal, which decided to support groups on the basis that they would be in a better position to negotiate fair taxation policies (SEEP 2007). Similarly, a successful enterprise support programme in Sierra Leone was based on in-depth market assessment (SEEP 2007). Conversely, a Joint Programme by the UN and the Afghan Ministry of Rural Rehabilitation and Development (MRRD) failed partly because of a lack of market research (UNDP 2009). Similarly, the failure of a micro-enterprise programme in Bourgainville was attributed largely to poor market research (Scales & Craemer 2008).

- Many successful cases place a strong emphasis on **capacity building** of local institutions. MacLeod & Davalos (2008) argue that the PRODERE enterprise development programme in Central America was underpinned by good capacity-building support. USAID (2009) describes another successful example where technical training was provided to coffee growers in Rwanda. In the Palestinian Territories, a successful matching grant scheme provided support for product design and access to market information (Nasir et al 2012). Business incubators that provide business support services and opportunities for mutual support to small businesses have proven successful in Georgia (UNDP 2011) and Burundi (Specker & Briscoe 2010).

- In general there has been a lack of **monitoring and evaluation** of these interventions, which has meant that many programmes fail to keep up with rapid changes in the economic environment (USAID 2009). A programme from Sierra Leone's success was underpinned by good monitoring, which enabled the programme to identify new value chains to target as economic conditions changed (SEEP 2007).

- A **bottom-up** approach to designing incentive programmes appears to be more effective. While a scheme to support the livestock sector in Afghanistan succeeded because of a bottom up approach (USAID 2009), a UN programme in the same country to promote small and medium-scale industries failed in part because it was centrally controlled from Kabul (UNDP 2009).

- **Integrated programming** that tackles both supply and demand constraints has proved successful. A flood-recovery programme in Mozambique, for example, successfully dealt with both the lack of demand from impoverished households for goods and services and the lack of supply from businesses decimated by the flooding (USAID 2009). Similarly, a seed vouchers and fairs programme in Uganda that adopted an integrated approach was successful at strengthening rural seed markets (Miehlbradt & McVay 2006).

- Programmes that have a **flexible** design tend to be more successful (Wilson 2002). Preferences are likely to change rapidly as economic, political and security conditions improve (Wilson 2002). A small and medium enterprise development programme in Afghanistan failed largely due to a lack of flexibility in lending requirements (USAID 2009).

Measuring Effectiveness/ Success

It is important to note that most donor interventions to support livelihoods or PSD in post-crisis or post-conflict environments are poorly evaluated. Most evaluations surveyed for this report assessed programmes' potential to boost incomes or create jobs in the short term and were usually assessed at or near the end of the project.

A recent WFP multi-country evaluation on livelihoods programmes is fairly typical of this literature. It notes that '[m]onitoring of livelihoods recovery has largely focused on outputs and neglected outcomes and impact' (WFP 2009). The broader impact of PSD in post-conflict contexts has not been researched widely, due largely to fragmentary nature of the private sector in these contexts and a lack of data. One area where PSD has been looked at quite extensively is in the context of disarmament, demobilization and reintegration (DDR) processes. De Vries and Specker (2009) find that this literature shows that in this context 'PSD has proved its worth': 'the informal private sector and smaller formal entrepreneurs play an important role by providing vocational training programmes' (p.47).

There has been more systematic analysis of youth employment programmes, an area that often overlaps with PSD in early recovery contexts. A recent study found that only a quarter of documented employment promotion programmes included impact evaluations (Peeters et al 2009). The small number of evaluations that have examined the wider impact of job creation initiatives have found that their effects beyond direct beneficiaries are minimal (see, for example, GTZ 2008, NORAD 2010). These studies show the long-term structural economic impacts of these schemes to be limited. The Youth Employment Inventory found that only 15% of youth employment programmes from developing countries provided evidence of net impact.

In general, it should be noted that donor interventions in post-conflict contexts may prioritise different objectives, which are not necessarily mutually supportive. For example, one PSD programme may have positive economic outcomes, but undermine the wider recovery by exacerbating tensions between different societal groups, while another PSD programme may have a limited economic impact, but nevertheless support recovery by creating jobs in the short term.

Perverse Incentives

Donors that have tried to influence the private sector have generated a number of perverse incentives:

- The influx of cheap or subsidised inputs and services associated with international intervention may crowd out domestic private sector (SEEP 2007, De Vries & Specker 2009, USAID 2009).
- Microfinance interventions may increase competition, which can actually drive down incomes and increase the overcapacity characteristic of monopolistic competition (MacLeod & Davalos 2008).

- In the agricultural sector, rapid commercialisation can lead to large scale emigration to urban areas, which can lead to shortages in the provision of public services and contribute to instability (De Vries & Specker 2009).

This report is structured as followed. Sections 2-6 will provide examples from different categories of donor efforts to influence incentives. Section 7 will examine perverse incentives. Section 8 will highlight some of the key contextual issues facing donors that wish to influence incentives.

2. Financial Incentives

Microfinance

Donor-supported microfinance projects are a common tool for encouraging private sector recovery in early recovery contexts. MacLeod and Davalos (2008) have called them ‘by far the most popular approach to private sector employment creation’. Microfinance programmes provide incentives for small businesses to expand or move into the formal sector by addressing a lack of access to credit, which tends to be a major issue in post-conflict or post-crisis contexts (El-Zoghbi & Bantug-Herrera 2008).

A study of microfinance provision in **Angola, Cambodia, Mozambique and Rwanda** highlights a number of problems with these interventions in post-conflict contexts (Wilson 2002). First, there is a lack of clarity between grants and loans in the relief phase, which causes difficulties for future microfinance lending. In Cambodia and Mozambique, many microfinance institutions collapsed when donors shifted from relief to development. Funding requirements from development donors were more rigorous, and the microfinance institutions that emerged after conflict were not prepared. Second, the report finds that there is often strong demand for microfinance in the immediate post-conflict period, but that certain conditions must be in place for assistance to be effective. These conditions include some degree of security and locational stability of the beneficiary population. Third, formal microfinance schemes provided by donors were generally seen by borrowers as being too inflexible. Most borrowers preferred to borrow from informal moneylenders for this reason. Finally, many of the interventions examined in this report were conducted without sufficient market analysis. Microfinance institution staff rarely spoke to clients and did not fully understand their requirements. The study highlights a set of ‘ideal characteristics’ for post-conflict microfinance loans. Individual characteristics are likely to vary depending on the context:

- Small loan and saving size (e.g. < $10).
- In-kind loan products, particularly in rural areas.
- Very frequent repayment or deposit schedule (e.g. every day or even several times a day).
- Very short term (e.g. one day to one week).
- Loan use unspecified and therefore can be used for income smoothing as well as small enterprise or agriculture.
- Individual loans and savings; no group meeting and no group guarantee, except in the immediate post conflict transition.
- Wide range of loan sizes so that richer people who remain without access to formal banking services can take loans.
- Very frequent visits by lender or lender always available, thus making loans and savings very accessible.
- Instant loan decisions.
- Some flexibility in repayment schedule (Wilson 2002, no page number).

The most important of these characteristics was **flexibility**. Preferences for loans are likely to change rapidly as the situation improves. Another key lesson was the need for microfinance institutions to present themselves as businesses, rather than NGOs, from the start. Donors will need to accept that microfinance support will be more costly in the immediate post-conflict period as loans are more short-term and there are greater risks (Wilson 2002).

Peschka (2011) notes that **Afghanistan** and **Bosnia and Herzegovina (BiH)** are frequently cited as providing cases of successful post-conflict microfinance interventions. In 2002, when hostilities ended in Afghanistan, hardly any formal financial services were available. Five years later, there were 15 formal institutions and outreach to more than 400,000 clients, as well as interest from several banks to scale down into this market. In Bosnia and Herzegovina, the industry went from nascent to consolidation in under a decade (El-Zoghbi & Bantug-Herrera 2008). Success in these cases is attributed to the fact that these programmes created deliberate linkages between long- and short-term programming. El-Zoughbi and Bantug-Herera (2008) note that the institutions examined in these case studies did not rigorously measure impact, so conclusions are based on institutions' own statements about their work.

An independent evaluation of post-war assistance to **BiH** assessed the World Bank's microfinance support. The main objective of this assistance was to support economically disadvantaged and poor entrepreneurs in starting or restarting economic activities. A secondary objective was to strengthen participating microfinance institutions to make them self-sustaining and better able to service a larger group of low-income clients without remaining dependent on donor assistance. The evaluation found that these projects have assisted over 110,000 clients, about 50 percent of whom are women, and have supported employment of some 200,000 workers. Repayment rates have been extremely high. The average percentage of the portfolio at risk (payments overdue for more than 30 days) remained below 1 percent through 2003. The projects are judged to have been highly successful in meeting their primary and secondary objectives (World Bank 2004). The programme's emphasis on capacity building appears to have paid dividends (World Bank 2004).

Many microfinance initiatives have had a positive impact on employment generation. 'The ILO's **PRODERE program in Central America** is an example of rural employment generation through community investment projects partially financed by aid grants. The programme targeted the poor in rural villages in conflict-affected areas. By providing loans to local entrepreneurs, including a substantial fraction of women, this programme helped these villages to restore basic business services. Perhaps equally important, this programme was administered by local economic development authorities set up by each community. Hopefully, the training and local economic administrative capacity encouraged additional private investment in those communities; these secondary impacts have yet not been clearly documented' (MacLeod & Davalos 2008, p.21).

While some argue that microfinance initiatives can provide a very useful channel for reaching otherwise "unbanked" target populations, others have been more critical. A 2003 study funded by the DFID, for example, concluded that '…in practice, post conflict microfinance has been disappointing, with limited outreach and high delinquency rates leading to eventual collapse; and unlike microfinance in more stable contexts, there has been little field-based investigation into these problems' (Williams 2003 cited in USAID 2009).

An important deficiency with the literature on microfinance interventions has been a lack of studies that rigorously evaluate these programmes. A number of recent studies on **Sri Lanka** have sought to address this shortcoming. De Mel et al (2008) conduct a study of cash grants to small businesses of between $100 and $200 in the aftermath of the 2004 tsunami. They find these grants led to real returns to capital of 5.7 percent per month, much higher than market interest rates. Returns were highest for high ability credit constrained firms, which is consistent with the view that credit market failures prevent talented owners from getting their firms to the optimal size. The authors find that there is no difference between grants given in cash, and those given in materials (a finding supported by another recent study conducted in Mexico (MacKenzie 2010)). Another recent study found that although one time grants to business owners lead to rises in the income levels of male poor business owners, they do not lead to significant employment creation (MacKenzie 2010). Another recent study on Sri Lanka (De Mel et al 2009) shows that few of the high return microenterprises qualify for a loan from microfinance banks, which lend on the basis of physical collateral and not on whether the owner's business shows high prospects for growth.

Wider support to the financial sector

Donors can influence the incentives facing larger businesses by providing direct support to banks. The World Bank undertook a wide-ranging strategy to boost the financial sector in post-war **BiH** between 1996 and 2003, with a view to supporting PSD (World Bank 2004). This involved both indirect interventions including strengthening the legal framework, and more direct interventions such as providing lines of credit directly to private companies. An evaluation in 2004 found that 'the lines of credit were largely successful in expanding credit to the private sector'. It goes on: '[i]n most cases, enterprises receiving financing through these projects significantly increased their production, employment, and (where applicable) exports. The credits were disbursed quickly, and rates of loan repayment were high. The satisfactory performance of these lines of credit stands in contrast to Bank operations in other countries that have been less successful in disbursements or repayments. One reason for this difference may be that most of the operations in BiH had at least six co-financiers and involved relatively modest amounts of funds, so issues of over-dimensioning and crowding out were less likely to emerge. In addition, they benefited from unusually close supervision and oversight. Most of these projects also included financing for technical assistance to improve the functioning of the participating financial intermediaries. However, these projects were less successful in this aspect; especially in the early years, they had only a marginal impact on the performance of banks' (World Bank 2004, p.13).

Overall, efforts to support the banking sector were judged as moderately successful (World Bank 2004). A state-level deposit insurance fund was introduced in October 2002, and over half of the commercial banks now participate in the fund. Merger and consolidation of banks is under way; the total number of banks fell from 72 in 1998 to 37 in 2003. Privatization of state-owned banks began in 1998 and most have now been privatised (World Bank 2004).

After the fall of the Taliban in 2001, the IMF and Sida set up a fund to stabilise the financial sector by funding the Central Bank of **Afghanistan** - the Da Afghanistan Bank (DAB). 'After an initial period of offering assistance more broadly across monetary policy, accountancy, and bank re-organisation, this fund now provides more specialized assistance for training and human resources. In 2004, a detailed assessment of DAB's training needs was undertaken, and the DAB Training Facility was established as a permanent centre for staff training. The Facility provides specific courses for different departments within the bank, as well as generic training in IT, accounting, economics, central banking operations, management and English language' (MacSweeny 2009, p.62). This intervention has been judged to be fairly successful at laying the foundations for strong financial institutions in Afghanistan (MacSweeny 2009).

Enterprise Challenge Funds[1]

Enterprise Challenge Funds (ECFs) are another key mechanism through which donors have provided financial support the private sector. ECFs make matching grant funds available to business on a competitive basis. They are designed to encourage the PS to pursue activities that have explicitly pro-poor outcomes (Chilver et al 2006) and have been seen by most commentators as a useful model for post-conflict or transitional contexts (Chilver et al 2006, Whiton et al 2010).

The concept of ECFs was initiated by the US in **Eastern Europe** after the fall of communism in 1989. ECFs make matching grant funds available to business on a competitive basis. The original US programme grew from an initial investment of $300 million in two countries to $1.2 billion between 10 funds covering 18 countries, including Russia and across Central Asia. These funds are widely seen as highly successful (Whiton et al 2010, Gilpin & Swearingen 2011), although the level of success varied across the funds depending on the local political climate and the leadership team of the fund. They attracted two dollars in private investment for every dollar they invested – the US government invested $1.15 billion, which grew to $1.61 in assets, and attracted a further $2.71 billion in private capital in the region (Whiton et al 2010). The overall capital investment of these funds increased by 44 percent and many of the funds repaid all or part of their initial grants (Gilpin & Swearingen 2011). Subsequent enterprise funds faced a lack of political support. Examples include the Central Asian-American Enterprise Fund and the Slovak-American Enterprise Fund.

A review of enterprise challenge funds for AusAID by Chilver et al (2006) highlighted a number of prominent contemporary examples of ECFs:

Development Marketplace (DM) is a competitive grant program of the World Bank that funds innovative, small-scale development projects. A key aim is to encourage Bank engagement with civil society. The total funds available in 2006 were $4m, targeted at water, sanitation and energy projects. The Development Marketplace has been an inspiration for the current generation of ECFs, but differs from them in two respects: the majority of funding goes to NGOs (only around 15% goes to private companies and a similar amount to academia), and there is no matching funding requirement.

The Consultative Group to Assist the Poorest (CGAP) launched a competitive innovation fund in 2002, the ProPoor Innovation Challenge (PIC), providing up to $50,000 in grants to microfinance organisations that have developed innovative methodologies to deepen rural poverty outreach and impact. A thorough evaluation is pending, but a recent survey suggests good growth from the selected organisations.

DFID launched a **Financial Deepening Challenge Fund (FDCF) and Business Linkages Challenge Fund (BLCF)** in 2002, both with a capitalisation of £18m. Both funds are now closed. Both sought applications from private firms for grant funding with requirements for a matching investment ratio of at least 1:1.

In **Papua New Guniea**, the Sustainable Development Program (funded by dividends from shares in the Ok Tedi Mine, which BHP granted to a trust) provides grant funding to match private sector contributions for development projects in PNG, particularly in the Western Province. Projects include rural telephony, rural electrification, and technical training.

[1] This section is reproduced from a related helpdesk query Walton, O., 2012, 'Helpdesk Research Report: Trust Funds and the Private Sector', GSDRC Helpdesk Research Report.

Another fund established more recently is the **Africa Enterprise Challenge Fund (AECF)** – a $120 million private sector fund, backed by the Rockefeller Foundation and the Bill and Melinda Gates Foundation, which aims to improve agricultural productivity and small holder farming throughout sub-Saharan Africa. The two foundations created an alliance in 2006 called the Alliance for a Green Revolution in Africa (AGRA). The AECF is funded by a number of donors including AusAID, DANIDA, DFID, the International Fund for Agricultural Development (IFAD), and the Netherlands Ministry of Foreign Affairs. The Fund is managed by KPMG Development Advisory Services. KPMG are responsible for the day to day operations of the fund. The AECF was launched in mid-2008, and has since run ten rounds of its investment competition, supporting new investment in the agribusiness, renewable energy and adaptation to climate change technologies, rural financial services and media and information sectors, across Africa. Four rounds of its general competition have been followed by a series of special windows, targeting Fragile States (such as DRC and S Sudan), Zimbabwe and, most recently, Tanzanian Agribusiness.[2] A recent AusAID report finds that the AECF enabled 10 Zimbabwean companies to develop profitable projects that benefited poor Zimbabwean farmers through improved market access, transport of agricultural goods to market and availability of agricultural inputs (such as seeds and fertiliser) (AusAID 2010).

3. ‘‘Picking winners’: Firm or Sector-Level Assistance

Firm-Level Assistance

Some studies argue that it is best for donors to focus on a particular sector or individual firms to kick-start PSD during the early recovery period (USAID 2009). USAID (2009) promotes the notion of ‘anchor’ firms that, if rehabilitated, have broad impact within a sector or community. ‘In **Bosnia**, assistance was provided to VegaFruit, a juice processing company with a large supplier network. The project helped to rebuild domestic vegetable and fruit processing capabilities, supporting a large number of growers’ (USAID 2009, p.59). USAID (2009, p.59) notes that this strategy of ‘picking winners’ is ‘always risky’, but argue that ‘the short-term successes in this case seemed to justify the risk and ultimately proved to have long-term impact’. The same report argues that ‘[d]onors may find that firm-level assistance in major, traditional export sectors can have widespread impact on the population’ (USAID 2009, p.59).

Another example from **Sri Lanka** shows GTZ utilising the ‘Nucleus’ approach, whereby the donor worked with chambers of commerce and other business organizations to stimulate groups of firms serving the same market to jointly assess and address problems. Miehbrady & McVay (2006, p.50) provide the following description of the approach and the programme: ‘Problems can be addressed by individuals, by the group through joint action, by the chamber advocating on behalf of the group, or by external consultants that individuals or the group might hire. The strategy works to motivate clients to address specific problems with customized solutions, stimulates demand for business services, strengthens chambers of commerce by building their capacity to offer members a specific, value-added, customized service, and improves the BE by strengthening a channel for businesses to voice their concerns. Over a three year period, the Sri Lankan – German Economic Strategy Support Programme organized more than 70 Nuclei with some 1,400 members. An estimated 76% had procured business services to improve their businesses’.

[2] For more information on the AECF see the Fund’s website: http://www.aecfafrica.org/index.php?option=com_content&view=article&id=12&Itemid=26

Matching Grant Schemes

‘The World Bank in partnership with DFID developed the **Palestinian Facility for New Market Development** (FNMD). This matching grant scheme was designed to reduce the risk of investing in the highly uncertain environment and encourage enterprises to upgrade their capabilities, develop new products and enter new markets.

FNMD was jointly funded by the Bank and UK DIFD. The World Bank provided a grant to DFID from the Post Conflict Fund and DFID implemented the project from July 2008 through April 2011. The matching grant scheme was based on a similar project in Tunisia that supported investments in technology, business processes and skills. These included the purchase of databases, support for product design and certification and access to standards, and market information. The goal of the scheme was to promote economic growth by enhancing the ability of Palestinian enterprises to enter new markets and produce higher value goods and services. The grant scheme supported both individual firms and associated groups of companies. Individual enterprises received a maximum grant of up to 50% of their investment projects, with a cap of $50,000. Associated groups of companies were provided with up to 70% of the cost of their projects with a cap of $100,000.

By its third year, FNMD was serving 226 client companies, 85% of which employed less than 20 workers, from a broad range of sectors, led by light manufacturing [32%], IT [18%], agro-business [17%], and services [12%]. 67% of companies were located in the West Bank and 33% in Gaza. The programme had the following key outcomes:

- FNMD employed 903 new employees; 54 of which were women.
- FNMD generated new local sales far more quickly than new sales in export markets. By the end of Year 3, total incremental sales related to activities co-financed by FNMD increased by 31%, reaching USD 56.4 million. New export sales – USD 13.2 million. 8.4% of clients became first time exporters, which is less than the original target of 10%.
- 50 companies entered new export markets (22% of FNMD clients and 45% of those companies that targeted new export markets) and 134 companies entered new local markets (59% of FNMD clients and 97% of companies that targeted new local markets).
- 113 firms out of the 226 firms which benefited from FNMD developed/improved products, exceeding the original target of 30%. (Nasir et al 2012).

Sector-Level Assistance

USAID (2009) argue that support to a particular sector can be helpful since in post-conflict situations there is likely to be a high degree of concentration of economic activity in a small number of product areas. The following successful examples are presented:

Rwanda Coffee Washing Stations: ‘Rwanda had been a producer of ordinary quality coffee for more than 100 years. Following a period of internal conflict, USAID invested in developing a specialty coffee sector. The establishment of coffee washing stations and rigorous attention to quality control enabled Rwanda to establish its niche in the specialty coffee market and offer a product considered among the best coffee in the world. In 2000, there was only one operational coffee washing station in Rwanda; the country exported approximately 14,000 tons of semi-washed coffee and just 18 tons of fully washed coffee. The introduction of fully washed processing techniques could improve coffee quality and increase farmer incomes. A USAID project provided the necessary technical training, helped potential investors obtain access to financing, and, eventually, helped them reach markets.

Between 2002 and 2006, 72 new coffee washing stations were constructed, 40 of which were built with project assistance. By 2006, coffee exports had increased to 26,000 tons – 10 to 15 percent of which was fully washed. The project successfully turned the coffee sector into the most attractive sector in Rwanda for domestic investment, creating a class of entrepreneurs who launched new businesses and provided employment to thousands of rural poor' (USAID 2009, p.61).

'In **Serbia**…following the NATO bombing in the late 1990s, a USAID project worked with five key sectors to promote enterprise growth and exports. The project helped increase export revenues in these five sectors by $350 million, with nearly $50 million attributable to project interventions. A subsequent USAID project has supported the agricultural sector, with the goals of increasing agricultural exports and providing high-quality local products to replace imports from Western Europe' (USAID 2009, pp.60-61).

'MEDA (Mennonite Economic Development Associates) has been working in the fruit and vegetable sector in the Sugd Oblast of northern **Tajikistan** since March 2004. This program, funded by CIDA, is strengthening horticulture production, post-harvest handling, processing facilities and marketing capacity. In addition, in partnership with a local MFI [Microfinance Institution] partner, IMON (formerly the National Association of Business Women of Tajikistan), MEDA has provided loan capital and technical assistance for expansion of rural lending, with a focus on horticulture. In the four regions in which MEDA and IMON are collaborating, agricultural extensionists and loan officers work in close collaboration, offering each other training, advice and cross-referrals. As a result, IMON has rapidly grown a highly successful loan portfolio with no default and 100% repayment of both group and individual loans. IMON credits their success to the input of the agricultural extensionists….Thus far, the project has disbursed 5,500 loans, with 2,037 active clients and a total portfolio of more than $790,000' (Miehlbradt & McVay 2006, p.65).

'In **Nepal**, the Netherlands Development Organization (SNV) conducted a sub-sector analysis of the cardamom industry. Their analysis indicated that traders could efficiently buy from individual farmers directly. During implementation, they chose to develop time-consuming producer groups because the groups would be in a better position to negotiate fair taxation policies with the Maoist rebels and government authorities. The flexibility paid off with a successful pilot that is currently being scaled up throughout the region' (SEEP 2007, p.23).

'In **Honduras**, after Hurricane Mitch, FINTRAC and the local USAID mission confronted the challenge of accelerating the recovery of the horticulture sector and re-establishing incomes for smallholder farmers, while achieving USAID/Honduras' longer-term goal of improving the sector's competitiveness and diversifying agricultural exports. USAID proposed renewing FINTRAC's one-year funding contingent upon results in expanding smallholder production. The one-year timeframe necessitated a trade-off between long- and short-term goals. For instance, FINTRAC initially provided direct training and technical assistance to smallholders, rather than building the capacity of local exporters and input suppliers to provide this. In subsequent years, as exports expanded, FINTRAC shifted this role to local businesses, which had an interest in securing their supply lines of horticultural products to sell abroad. Today, smallholders receive inputs and information on market demand via two export companies, and agricultural exports from Honduras are growing' (SEEP 2007, p.29).

Another example of sector-specific support comes from the World Bank's assistance to **Timor-Leste**. Although the World Bank's overall strategy was ineffective, the establishment of an e-booking project, to promote tourism in Timor-Leste helped to generate considerable revenues for domestic businesses in the tourism sector (World Bank 2011).

Support to the Agricultural Sector

Programmes that support enterprises in the agricultural sector are another common area of support for donors in post-conflict contexts.

The LINKS programme in **Sierra Leone** 'targeted households engaged in farming and marginalized youth. While focusing broadly on agriculture, the programme developed targeted, value chain-specific programs to help poor people take advantage of growing market opportunities. For example, the initial market assessment identified cassava, rice, and horticulture as value chains that provided opportunities for increased profits and extensive participation by rural communities. Based on this initial assessment, broad services that were applicable to all three chains (such as techniques for improved input supply and storage techniques or business management training) were identified. Follow-up assessments helped programme staff design additional value chain-specific services, such as marketing and transport for the horticulture value chain. These assessments also led to the addition of groundnuts as another value chain with higher potential that the program activities could support. The choice of a few broadly targeted value chains with an additional high-profit chain allowed ARC and the LINKS consortia to serve a large number of farmers effectively' (SEEP 2007, p.38).

A **UNIDO livelihood support programme to conflict-affected regions in Sri Lanka** following the recent conflict was fairly positively evaluated (UNIDO 2011). One of the programme's aims was to 'strengthen the capacity of local institutions for small business development and develop community-based small enterprises in rural areas'. The programme succeeded in delivering new agricultural equipment, which was widely used. A 'women's enterprise development' component also succeeded in initiating a number of women's businesses. It should be noted that, as with many evaluations examined in the preparation of this report, while programme outcomes were evaluated positively, no long-term examination of impacts was conducted. The evaluation did not examine the long-term or broader impacts of the programme.

'**Privatizing Veterinary Services during and after Conflict in Afghanistan**: In Afghanistan, a country with continuing conflict where public services remain weak and under-funded, USAID has been supporting private veterinary services to address livestock health issues…. Privatized veterinary services emerged out of necessity during the Soviet occupation. Recognizing the central importance of animals and animal health to rural livelihoods, a number of international agencies and NGOs – most notably UNDP-OPS, the Food and Agriculture Organization (FAO), the Dutch Committee for Afghanistan, and Mercy Corps International – stepped in to provide farmers and herders with basic veterinary services. These organizations offered two to four weeks of training for basic veterinary workers and five to six months of training for para-veterinarians and established district-based veterinary field units, where field staff could obtain reliable, high-quality vaccines and medicines, report diseases, and seek advice; and, perhaps most importantly, established a fee-for service policy to cover the costs of sustaining a reliable veterinary service delivery system.

Under this system, paraprofessionals paid for their medicines at the Vetinary Field Units (vFUs), charged farmers for their services, and earned money to return to the vFUs for new supplies. Privatized veterinary services took hold in Afghanistan. Building on earlier efforts, the FAO set up a unified, national veterinary field unit system in 1994. By 2000, hundreds of para-vets and basic veterinary workers had been trained, and millions of vaccines and medicines had been delivered to farmers and herders on a fee-for-service basis. After FAO funding ended and Afghanistan suffered one of its worst droughts, USAID's Rebuilding Agricultural Markets Program (2003-2006) helped rebuild private veterinary services.

Through outreach and extension efforts, livestock owners came to understand the value of preventive veterinary interventions in reducing livestock mortality, helping replenish diminished herds, and improving incomes by increasing the number of animals that could be brought to market. It became clear that high school graduates could be effectively trained as para-vets to perform basic animal health care services, such as accurately recognizing and properly treating common livestock diseases, or to make referrals to more experienced veterinarians if necessary' (USAID 2009, p.68).

'USAID introduced an **agricultural enterprise start-up project in Mindanao, the Philippines**, to help fulfil promises in the September 1996 peace agreement between the Government and the Mindanao National Liberation Front. From 1997 to 2000, the project, which targeted ex-combatants, assisted participants with the start-up or resumption of farming activities (principally high-yield corn for local markets and seaweed harvesting for export). An evaluation and independent survey conducted at the end of 2000 found that most participants had benefited substantially from the programme. Average yields improved by about one-third for corn and by about half for seaweed harvesting, which became much more prevalent in the target area. Input subsidies ended after two cropping cycles, but 90 percent of the corn and rice farmers who continued production were using a similar set of seeds and fertilizers. Meanwhile, as indicated by the evaluators, the programme's pacification goal also was largely achieved. Livelihood from farming had become a better alternative for many former combatants' (USAID 2009, p.38).

A Joint Programme by the UN and the Afghan Ministry of Rural Rehabilitation and Development (MRRD) focused on the development of small and medium enterprises in rural areas in **Afghanistan**. The approach was criticised as being very top down, with MRRD and project staff doing some general market research, identifying potential projects and then undertaking feasibility studies—mostly organized from MRRD in Kabul. An evaluation report from 2009 states that 'It is doubtful whether private-sector ventures identified, designed and established by the government will be successful' and notes that 'a more bottom-up approach with strong ownership by local entrepreneurs, accompanied by business advice and mentoring is clearly preferable' (UNDP 2009, p.69). Another criticism is that projects are standalone and not part of an integrated programme of assistance. The programme's approach was judged to have been too inflexible: 'The approach has been to allocate block grants and to require community projects to conform to the grants provided. This has contributed to compromises on standards and specifications in order to stay within budget, reducing overall quality and compromising durability and utility. The majority of village communities that have been trained under NABDP (National Area Based Development Programme)…have not received funding for projects identified' (UNDP 2009, p.69).

AusAID evaluated its '**Bougainville Cocoa and Copra Dryer Rehabilitation Project** (BCCDRP)', which was conducted between 2001 and 2005, after the conflict between the Bourgainville Revolutionary Army (BRA) and the Papua New Guinea armed forces. This project was implemented in the context of a number of donor initiatives that were aimed at rehabilitating Bougainville's economy and providing a direct stimulus to economic activity principally by assisting cocoa and copra production and micro-enterprise. In this context, the Bougainville Cocoa and Copra Rehabilitation Project (BCCRP) was seen as playing a critical role through distributing cocoa seeds and seedlings to rehabilitate Bougainville's damaged tree stock. 'Livestock projects proved to hold logistics challenges beyond the capacity of BCCDRP or the beneficiaries to overcome. Although some of these projects are being used part-time for supplementary income or as part of the subsistence (noncash) economy, the high overall rate of failure reported points to the conclusion that the livestock part of Rural Development Trust Fund (RDTF) must largely be written off. In addition, vanilla projects have produced no returns, for reasons partly beyond the BCCDRP's control' (Scales & Craemer 2008, p.77).

The report also finds that the BCCDRP RDTF was mis-targeted and premature. 'In essence it promoted income generation from micro-enterprise consisting of local business supported by customers who had money from sale of cocoa. It did this with a sole focus on individual projects, through the trust fund. Much of the budget was wasted on commercially non-viable livestock projects. Many other businesses provided 'luxury' goods such as bread (a luxury in rural Melanesia) even when districts such as in the west coast had little income from cocoa to be able to afford such things. Thus, the trust fund was premature in districts where not all the links in the cocoa market supply chain were established' (Scales & Craemer 2008, p.92).

'In 1991, the World Food Program begin procuring food aid commodities in **East and Central Africa** to support food aid programmes in Uganda, Rwanda, Burundi, Tanzania, and Eastern Democratic Republic of Congo. Since 2000, more than 365,000 tons of food aid commodities, valued at US $86 million, have been procured in Uganda. Maize grain and meal, beans, and Unimix (a maize meal-base fortified food) have been the focus of local procurement; 80 percent of purchases are maize or maize based products. Local food aid purchases, along with cross-border exports to Kenya, have been driving the development of the Ugandan maize sub-sector, generating significant employment and income in the farming and trading sectors and benefiting a wide range of other service providers. Local procurement activities have also provided a stimulus to production and marketing of beans, and are behind the emergence of a small blended-foods manufacturing industry' (SEEP 2007, p.21).

4. Market-Integrated Relief

'Humanitarian relief activities often inadvertently distort agricultural markets and private-sector production, and often unintentionally create new vulnerabilities and dependencies. "Market integrated relief" approaches provide positive, long-term benefits, which work with market providers instead of setting up parallel relief supply channels as donors seek to work with private-sector partners in several ways. First, donors can buy relief supplies from local and regional vendors and stimulate demand for local production instead of imported supplies. Second, food donations can be channelled through market mechanisms. For example, USAID's 'PL 480 Title II' monetization program has been used to assist millers, grain dealers, and small firms to purchase U.S. donated bulk wheat to make flour and feed grain for the animal feed industry, reducing competition with local producers for the food market while reinvigorating underutilized agribusiness services. Third, donors can support community-based programs by helping wholesalers and retailers purchase rice, vegetable oil, beans, and non-food items that can be traded in local bazaars and markets' (USAID 2009, p.69). A variety of examples of market-integrated relief can be found in the literature. A selection is presented below:

'Jump-Starting Wartime Markets in Southern Sudan: Historically, southern Sudan has been underdeveloped, using a barter system of exchange. Most southern Sudanese did not handle cash and had no access to markets. During the war years, in particular, markets were limited primarily to garrison towns. All goods arrived on military flights from Khartoum and were sold mainly to Sudanese government employees. Prices were greatly distorted and markets had few linkages with the surrounding countryside. When humanitarian NGOs began relief operations in the early 1990s, their workers were paid in soap and salt; cash held no value in rural areas….[In the mid-1990s] USAID-funded NGO programmes began to open up isolated areas and stimulate local economies. NGO recovery programmes began airlifting basic consumer items such as salt, soap, blankets, buckets, and bicycles to major towns and then exchanging those items for seed and surplus grain grown by local farmers. The seeds and grain were subsequently sold to NGOs carrying out relief operations elsewhere in southern Sudan. Over time, barter exchanges gave way to cash transactions that helped establish the “right” price relationships. USAID helped to develop cash markets by selling U.S. emergency food-aid wheat in Uganda and using the Ugandan shilling proceeds to buy local grain in southern Sudan. In later years, locally initiated “Peace Committees” set up eight “Peace Markets” in greater Bahr el Ghazal. The Peace Markets enjoyed several years of relative success in the years immediately preceding the Comprehensive Peace Agreement of December 2004, because each side perceived benefits from continued trade.

Key lessons learned from the programs in southern Sudan include:

- Revitalizing farmer cooperatives can increase the effectiveness of local grain purchases by helping amass grain from individual farmers, resulting in savings for purchasers and higher unit prices for farmers
- Encouraging surplus food production is unsustainable without steady market demand, even when stimulated by NGOs during emergency and transition phases’ (USAID 2009, p.70).

The Mozambique Flood Recovery Program: ‘In Mozambique in 2001, a USAID-funded post-flood recovery program dealt directly with both the lack of demand from impoverished households for goods and services and the lack of supply from businesses decimated by the flooding. USAID replaced lost household purchasing power by providing cash grants to affected households (vouchers could be used in other situations), creating immediate demand for market-supplied goods and services. Simultaneously, a programme was established to increase access to credit for merchants and businesses in the crisis-affected areas. This enabled the businesses to finance new inventories to meet the demand created by the cash grants. Although applied in a disaster recovery setting, a similar market-integrated relief approach could also be helpful in a post-conflict environment’ (USAID 2009, p.60).

Kenya faced a major drought in 2006. Twenty-seven out of 72 districts were affected and rates of malnutrition in affected areas stood at 30 percent. Nearly 3.5 million rural pastoral and farming people, including 500,000 school children, were in need of emergency assistance. Although the overall food supply remained relatively stable, the drought led to a decline in access to food. Following five consecutively failed or poor seasons, people lost many of their savings and assets, but in Kenya as a whole, there are more than enough basic staples (including maize and beans) to feed the population.

‘In response, CRS (Catholic Relief Services) privately funded the Rapid Assistance Program (RAP). The RAP is a four-month pilot programme that increases access to food for vulnerable people through a food voucher system using existing market channels in the target areas of Kitui and Makueni. The RAP supports 2,503 pregnant and lactating women, and 3,502 malnourished children under five. CRS partners distribute the vouchers to drought-affected families through health centres on a monthly basis. Asking beneficiaries where they usually shopped generated a list of participating shops. Shop owners redeem the vouchers for cash from CRS partners on a weekly basis. A public awareness campaign on nutrition encourages beneficiaries to use the vouchers to purchase adequate stocks of maize and beans. But recognizing the substitutability of income, the vouchers can be used to purchase any goods deemed necessary. To avoid inflation, CRS undertook a mini-market chain analysis and distributes the vouchers on a rotating basis, rather than all at once, in order to smooth increased demand’ (Miehlbradt & McVay 2006, p.68)

Seed Vouchers and Fairs (SV&Fs) - Uganda: 'Seed Security Assessments reveal that the problem is frequently access to, not availability or quality of, seeds. Therefore, programmes can increase the ability of conflict-affected farmers to acquire seeds through provision of cash or vouchers. Vouchers are often combined with dedicated seed fairs that bring seed sellers and voucher holders together. CRS has found that SV&F activities are an effective way to hasten agricultural recovery from disaster, and strengthen rural markets. In Uganda, an escalation of civil conflict in the districts of Gulu and Kitgum in 2002 created an enormous emergency need and acute shortages of food and seeds. CRS/Uganda responded to the emergency with a variety of interventions including provision of food and non-food items and help for farmers to acquire seeds using the seed voucher & fair approach to boost production and increase food security. This first seed vouchers and fairs intervention targeted 13,000 households in Gulu and Kitgum with each beneficiary receiving vouchers worth US$8.33. The 13 seed fairs attracted 809 seed vendors, of which 19% were women. In 2003, 18 seed fairs were conducted attracting 1,028 seed vendors, of which 23% were women. (Selection of sites was mainly dictated by security conditions; thus, men were more likely to travel in insecure areas on bicycles with large quantities of seed to the fair sites.) The experience in Uganda shows that when seed security assessment indicates a problem of access, a combination of seed vouchers and fairs is an efficient approach to facilitate farmer acquisition of seed and an effective way to strengthen rural seed markets' (Miehlbradt & McVay, p.69).

'Food production in **Ethiopia** is characterized both by deficit and surplus production, the former mainly in the northern, eastern and partially in the southern regions, and the latter in the western and central parts of the country. The country often faces severe food shortages in one part and surplus production in the other. Lack of purchasing power has translated into market problems for surplus producers, while simultaneously those in deficit need relief assistance. The local purchase of food aid has helped address the need of both groups, creating effective demand for the former and access to staple food through relief to the latter. The surplus production in the country has often made it possible to supply up to 25% of Ethiopia's relief needs at below import-parity prices. Between 2000 and 2004, some 2-3% of the net domestic grain production (of maize, wheat and sorghum) or about 20% of its marketable surplus was purchased for food aid. Out of the total procured, WFP's share was on the average about 30% (of the total annual food aid purchases by donors) and in good production years up to 45%. This is a notable achievement. While contributing to the national benefit, WFP has also been able to buy cheaply, gaining about Birr 674 or USD 78/MT from the procurement of wheat and sorghum during 2001-2004. This allows the WFP to maintain and, when possible, expand the program' (Miehlbradt & McVay 2006, p.70).

'In **Kosovo** in 1999, as refugees returned following the NATO bombing, Mercy Corps provided cash, credit, and food commodities (vegetable oil, wheat flour) to 14 bakeries in the heavily war-damaged western city of Peja. These inputs, which allowed local bakers to restart their businesses, were repaid in the form of free or subsidized bread to over 40,000 refugees returning to urban neighbourhoods. This approach re-established traditional customer-supplier relationships, to the extent that 13 of the 14 bakeries were operating profitably two years after the close of the program. This program was funded by CORDAID and USAID' (Miehlbradt &McVay 2006, p.71).

'During the peak of a severe food security crisis in the **Horn of Africa** in 2003, Mercy Corps sought to increase demand for veterinary services while providing emergency relief to livestock herders. Mercy Corps provided emergency veterinary services and survival rations of concentrated feed to small livestock herds in Eritrea, then requested herders to pay in-kind for these services with 5% of their herds (usually 1-2 small animals, or a $500 value, per family). After one year, the herders observed the positive effects of feed and veterinary services, including improved animal health and a 30%

increase in herd survival rates. These benefits resulted in improved family income and child nutrition. Herders' willingness to pay for veterinary services increased by almost 100% and demand for locally produced, concentrated livestock feeds also increased. The increased demand for veterinary services resulted in the revitalization of for-profit, community-based para-veterinary networks in remote regions, which had been dormant since the early 1990s' (Miehlbradt & McVay 2006, p. 71).

5. Incentivising Foreign Investment

As well as providing incentives to domestic businesses to expand or move into the formal sector, donors have also focused on incentivising foreign firms to invest in post-conflict or post-crisis contexts.

Political risk guarantees

Political risk guarantees have had mixed success. Although successful in some cases such as BiH, particularly once the security situation had improved (Bray 2007), in other instances such as Gaza and the West Bank, assistance was poorly targeted (World Bank 2010). Furthermore, the due diligence and monitoring of Multilateral Investment Guarantee Agency (MIGA) has been called into question in its work on the Democratic Republic of Congo (Crossin & Banfield 2006).

The availability of commercial political risk insurance (PRI) for businesses in post-conflict context is generally limited. The MIGA is part of the private sector arm of the World Bank Group and promotes private foreign direct investment into developing and emerging markets through the provision of insurance, guarantees and technical assistance services to the private sector. Through these services and products, MIGA seeks to attract FDI to developing and post-conflict countries to speed up recovery and reconstruction. Post-conflict support makes up approximately 13% of MIGA's portfolio, and between 1988 and 2003 it issued 56 guarantees worth $1.5 billion for investments in 16 conflict-affected countries (Crossin & Banfield 2006).

'In 2007, **Afghanistan** received a major cash injection with a MIGA-backed investment in a state-of-the-art telecommunications network. The project is providing country-wide access to a range of affordable telecommunications services, including wireless cell phone, internet and satellite services, as well as public pay phones. The investor, the MTN Group of South Africa, installs, operates, and maintains a 100 percent digital GSM technology network via its Afghan subsidiary, Areeba Afghanistan LLC' (MIGA 2009, p.2). MIGA itself states that 'MIGA's support helps boost investor confidence and catalyze further investment and development in the country. Since 2006, MIGA has issued more than $80 million in guarantees in support of investments in telecommunications, banking, agribusiness, and services in Afghanistan' (MIGA 2009, p.2).

PRI in Democratic Republic of Congo: In 2005 MIGA supported its first project in the Democratic Republic of Congo (DRC). MIGA approved a $13.3 million political risk guarantee for the Dikulushi mine, covering transfer restriction, expropriation, breach of contract, war and civil disturbance. This guarantee covered both equity investment from Anvil Mining as well as loans from Rand Merchant Bank. This guarantee was contentious since Anvil Mining had allegedly provided logistical support to one of the conflict parties some seven months before this guarantee was provided. According to Crossin and Banfield (2006, p.18) 'this example seriously calls into question whether MIGA has adequate due diligence and monitoring systems in place to appraise the support of a project in a conflict-prone country'.

In 1997, MIGA established a **Guarantee Fund in Gaza and the West Bank**, with an underwriting capacity of up to $20 million to cover political risks, with contributions from the Palestinian Authority and other donors. In 2008 the Guarantee Fund's capacity increased to $30 million and changes have been enacted to its operational rules to increase its relevance in attracting private sector investment. However, although there has been some interest, to date, investors have not used the Fund (World Bank 2010). The World Bank attributes this failure to design and marketing flaws (World Bank 2010).

Investment Road shows

Investment road shows proved a particularly important tool to promote the private sector and attract foreign direct investment (FDI) in post-conflict **Northern Ireland**. 'With significant political support from London and Washington, the International Fund for Ireland (IFI) sponsored Northern Ireland investment conventions and "road shows" in the US from early 1995. These conferences were a forum for building informal relationships between parties who were not officially speaking to each other. Relationships did indeed form, and although there was some disappointment that no substantial investment immediately followed the investment conference in Washington DC in May 1995, the parties succeeded in clarifying the structural changes that would be needed to encourage such investment, including improving infrastructure and setting up cooperative bodies to facilitate trade between Northern Ireland and the Republic of Ireland. In time investment came'. (Portland Trust 2007, p.20). 'Between 1994 and 2000, just under $1.5 billion was invested in Northern Ireland by US firms. Following the 1998 Agreement, direct investment from the US increased and came to account for 10% of the jobs in Northern Ireland' (Portland Trust 2007, p.23).

Linking local businesses with foreign companies

The **Dutch government provides a Matchmaking** facility, which is available to companies in more than 40 countries in Africa, Asia, Latin America and Eastern Europe, including Southern Sudan. The facility puts those companies in touch with Dutch businesses. Small and medium-sized companies from Southern Sudan with a solid business plan that are looking for a Dutch business partner can apply for the facility through the Netherlands Embassy. The goal is to stimulate joint investment in the country. EVD will identify Dutch businesses that match the company's profile. If a suitable match is found, the company will receive a voucher worth EUR 5,000 for hiring a Dutch consultant who will explore the potential cooperation. The consultant's duties include arranging a visit for the company to the Netherlands and developing a joint action plan' (EvD et al 2009, p.25). The report notes that although there is demand for this facility in other countries, 'at this moment in time there is no demand from Southern Sudan' (EvD et al 2009, p.25).

Public Private Partnerships (PPPs)

'Public–private cooperation refers to the collaboration between public entities (state, local institutions, donors and NGOs) and private companies to realize *public* projects and objectives, i.e. with a view to benefiting the majority, not just the company. Tasks, responsibilities and risks are allocated among the partners, but the government often holds ultimate responsibility for the process. This has usually taken the form of donor governments trying to attract (international) firms to fragile states. To attract foreign companies to set up a business in sectors other than the extractive industries (such as mining or timber, which are often fraught with controversy) requires special incentives. Companies, of course, have quite different objectives from those of development agencies; they place profits and continuity above social considerations. They need to cover their investment costs and there must be some potential for growth. There are limits to risk-taking, even for large enterprises that can afford to bear a financial loss' (DeVries & Specker 2009, p.49).

Although PPPs are less common in post-conflict contexts than in other developing country contexts, they have nevertheless proven successful in a number of contexts. Examples include Mozambique, where a development corridor programme was jointly funded by the Mozambique government and a range of donors, and facilitated the establishment of a major aluminium plant and the construction of various forms of infrastructure including roads, power and ports (Schwartz et al 2004).

Investment Support facilities

To induce the private sector to invest in fragile states, donor governments may consider setting up investment facilities. For example, the **Netherlands'** government has recently adjusted its PSD-funding programmes to better suit the circumstances of fragile states. 'The Private Sector Investment programme (PSI) is a subsidy programme operating in 50 countries. It offers financial support to partnerships between Dutch and local companies, in the hope of achieving a transfer of technology and knowledge, and positive spin-off effects for local economies. In order to address the risks of investing in fragile states, the PSI was expanded with a PSI Plus programme, which offers extra facilities for risk management and insurance. PSI Plus also allows investors to deal with a wider range of local partners (such as foundations), or enterprises that are not yet officially registered as companies (this is commonly the case where there is no local chamber of commerce). However, finding suitable local partners in fragile states remains a major challenge' (De Vries and Specker 2009, p.49-50).

6. Capacity-Building Support

Donors can incentivise domestic businesses to expand or move into the formal sector by providing training or other forms of support. Capacity-building support of this kind may link directly with donors' early recovery goals.

Enterprise-based Training

A USAID (2009, p.38) report finds that 'enterprise-based apprenticeship training has proven to have a much greater likelihood to lead to sustainable employment than training in state-run vocational or other classroom institutions. Apprenticeship training is facilitated by providing financial incentives to enterprises that 'accept workers as apprentices or trainees, pay them an emolument, and hire them as full-time employees. Moreover, additional employer incentives may be needed to break other bottlenecks to the expansion of their enterprises' (USAID 2009, p. 38). Despite these advantages, there are also a number of limitations with this approach. First, the number of successful apprentice-trainees will be limited by the capacity of the region to absorb the increased number of artisans. Second, costs per trainee are likely to be higher than vocational training (USAID 2009). A successful example of enterprise-based training comes from the Mano River region, where the experience of a UNIDO post-crisis enterprise-based development training programmes conducted in the border regions of Liberia and Sierra Leone 'seems to confirm experience made by other agencies that enterprise based training can be a cost-effective method of imparting marketable skills. Furthermore, this approach contributes also directly to revitalising local businesses' (UNIDO 2010, p. 26).

Business incubator programmes

The **Burundi Business Incubator (BBI)** aims to reconnect Burundians to supply chains and technology by providing technical assistance. It serves as a central hub for entrepreneurs to gather together information and receive support to set up or continue or set up their businesses. It provides business support by facilitating the sharing of costs for services, and also provides opportunities to share risks. The BBI will have an internal training centre, which will be a private entity. The BBI will help to link clients to existing credit programmes and other relevant micro-enterprise programmes. The initiative has been supported by the Netherlands Ministry of Foreign Affairs (Specker & Briscoe 2010). It officially began in December 2010 and has not been evaluated.

UNDP established a business incubator in Batumi, Adjara province, **Georgia**. The region has one of the highest poverty levels in the country. The rate of unemployment is 25%, roughly 8% higher than in other parts of Georgia. The business incubator assists emerging small businesses to become stronger and more sustainable. According to the UNDP's Success Story Leads website (UNDP 2011), 'the Batumi business incubator supports 6 new companies that target areas important to the regional economy – trade and services, tourism, and Information Technology. Each company went through a rigorous selection process and must comply with the strict requirements of the programme. Requirements include an ambitious but realistic business plan, motivation to learn new ways of doing business, and readiness to follow business recommendations. The business incubator provides quality office space and business support services such as management assistance, strategic development, financial analysis, legal support, and fosters relationships with financial institutions. Business advisors also closely monitor the progress made by the participating companies to ensure they grow and become sustainable' (UNDP 2011, no p.n.).

7. Perverse Incentives

Donor interventions have also resulted in a range of unintended consequences, which have created perverse incentives for local business. There appears to be growing recognition of this issue in the literature (SEEP 2007, De Vries & Specker 2009, USAID 2009).

The most commonly cited issue concerns the presence of international actors such as NGOs and international construction firms during the early recovery phase. These actors often provide cheap or heavily subsidised inputs and services (SEEP 2007, De Vries & Specker 2009). The influx of international actors may crowd out a nascent or recovering private sector, drawing away talented staff, driving up salaries to levels that are unaffordable for local companies, and driving down the price of goods and services (USAID 2009). Post-tsunami relief efforts in Sri Lanka for example, drove up wages of skilled construction workers creating spot shortages and higher inflation (MacLeod & Davalos 2009). These issues are particularly problematic in post-conflict contexts such as BiH and the Palestinian Territories, where international actors channel the vast majority of their support through the state, in the form of budget support (see Portland Trust 2009, UNCTAD 2009). Perverse incentives for local business can also be created when a large donor response leads to rapid inflation or appreciation of the currency ('Dutch disease'), which can reduce opportunities for domestic exporters (USAID 2009).

By easing barriers to entry to competitive sectors within the formal and informal economy, microfinance programmes may actually drive down incomes and increase the overcapacity characteristic of monopolistic competition (MacLeod & Davalos 2009). 'As such, the success of these programmes drives down the profits of existing enterprises' (p.21). Sri Lanka provides a useful case study: Sri Lanka's transition programme. Once the village is rebuilt a local credit agency is set up to arrange loans for livelihood creation. Among the most popular in coastal villages of Sri Lanka is to finance the purchase of a new fishing boat creating immediate income for fisherman and provides a critical source of low cost nutritious food. However, with each additional fisherman the profitability (and possibly the stock of fish) declines' (MacLeod & Davalos 2009, p.21).

In the agricultural sector, rapid commercialisation can lead to large-scale emigration to urban areas, which can lead to shortages in the provision of public services and contribute to instability (De Vries & Specker 2009). Opening up markets can reinforce the interests of economic elites in certain contexts. Private sector promotion policies had this effect in Afghanistan (Lister & Paine 2004 cited in International Alert 2010a). As donors have become more aware of the issue of perverse incentives, recommendations to base interventions on rigorous market analysis have become more common (De Vries & Specker 2009).

8. Contextual

Contextual issues

The contexts in which PSD strategies to support early recovery are implemented vary considerably. Key variables for donors to consider when working through the private sector include levels of (Del Castillo 2001, Bray 2007, USAID 2009):

- Business regulation
- Foreign investment law
- Economic infrastructure (state of banking system)
- Infrastructure (esp. roads and electricity)
- Security
- Labour laws
- Economic integration
- Macroeconomic stability
- Corruption
- Human Resources (availability of skilled labour).

Interventions to support early recovery via the private sector are likely to be most effective in contexts where there is a degree of security, and where there is some underlying economic infrastructure. Interventions are unlikely to succeed if more serious **underlying constraints** are not tackled (World Bank 2011). For microfinance interventions, key pre-cursors to success include some degree of security and locational stability of the beneficiary population (Wilson 2002). Interventions to facilitate private sector activity are likely to be ineffective in contexts such as Timor-Leste, where more pressing binding constraints posed by bad infrastructure and a lack of access to credit were left unaddressed (World Bank 2011). Another important contextual constraint on the World Bank's interventions in Timor-Leste, which perhaps has wider relevance, was an 'absence of entrepreneurial tradition and skills' (World Bank 2011, p.74). Other constraints included 'the lack of any obvious areas of comparative advantage, the small agriculture-based subsistence economy, and the total destruction of all non-agricultural production facilities in 1999' (World Bank 2011, p. 74). The World Bank evaluation suggests that the Bank's strategy may have been more effective if it had conducted more rigorous market analysis and focused on removing constraints to sectors where the private sector had a realistic chance of growth such as agri-business and tourism (World Bank 2011).

In certain contexts, where the **post-conflict recovery is fragile**, donors may have to adopt a more **flexible** approach. This was the case in the Palestinian Territories, where the World Bank's PSD strategy was disrupted by the intifada in 2000 (World Bank 2010). The resumption of conflict does not necessarily mean that PSD strategies should stop. Practical Action in Darfur found that their market development programme, conceived during a period of stability, could continue to function after the conflict broke out because the markets continued to function (SEEP 2007).

Bray argues that political risk insurance is **most useful 'in cases where the post-conflict environment had improved** and investors had already identified attractive opportunities. In those circumstances, PRI could help tip the balance between risk and opportunity in favour of going ahead with the investment'. In the case of BiH, PRI support from MIGA 'made the greatest difference in the early 2000s, by which time this tipping point was in sight, rather than in the mid- to late 1990s, when the overall environment was too risky, or the mid-2000s, by which time many of the worst problems had already been solved' (Bray 2007, p.23).

It may be more difficult to support early recovery via the private sector in contexts where there is **strong political opposition to business**. In Nepal, for example, Maoists and their supporters have seen the private sector as a 'class enemy'. During the conflict, Maoists targeted the business sector for extortion and sabotage (International Alert 2006).

Donors can find it more difficult to influence the incentives facing businesses in contexts such as Bosnia and Herzegovina where **state-owned enterprises** continued to play a dominant role in the post-war period (World Bank 2004).

Private sector growth can have a greater stabilising effect in contexts where key export sectors are labour intensive. In Mozambique, for example, a growth in agricultural exports created wide-scale employment opportunities for poor people, and particularly for former fighters (MacLeod & Davalos 2009).

9. References

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10. Additional information

Key websites:

Conflict Research Unit – Clingndael Security and Conflict Programme (CSCP)
http://www.clingendael.nl/

The Donor Committee for Enterprise Development (DECD)
http://www.enterprise-development.org/

ILO
http://www.ilo.org/global/lang--en/index.htm

International Alert
http://www.international-alert.org/

Multilateral Investment Guarantee Agency (MIGA)
http://www.miga.org

SEEP Network
http://www.seepnetwork.org/

UNDP
http://www.beta.undp.org/undp/en/home.html

UNIDO
http://www.unido.org/

World Bank Independent Evaluation Group
http://ieg.worldbankgroup.org/content/ieg/en/home.html

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