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CRU Policy Brief

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Promoting diaspora investment in fragile settings

The case of Somalia

This policy brief analyses the extent to which diaspora investment can support economic development and livelihoods, with a particular focus on fragile settings. Using the case study of Somalia, the brief explores some of the main advantages and risks associated with this tool. On the one hand, diaspora investment can channel finance into productive activities in the diaspora's country of origin, supporting the creation of revenue streams, while also generating returns for diaspora investors. On the other hand, particularly in fragile settings, these investments can also undermine social cohesion and even increase the likelihood of violent conflict, especially if they are channelled along identity lines. On the basis of this analysis, the brief offers the following recommendations to donor governments interested in promoting diaspora investment in Somalia and beyond: (i) to ensure effectiveness, donors should gather comprehensive, in-depth data on the needs and preferences of both potential investors in the diaspora and investees in the country of origin; (ii) to avoid exacerbating tensions and conflict, donors should be as inclusive and transparent as possible in their engagement with stakeholders, most notably in the selection of beneficiaries; (iii) any efforts to promote diaspora investment in fragile settings should be grounded in a thorough understanding of the specific context in which they are implemented, in order to understand both the economic and political implications of such investment.

Introduction

Over the last few decades, there has been a wave of optimism about the contribution that diaspora members can make to economic development in their countries of origin.[1] In many instances, the focus has been on whether and how remittances, i.e. the money sent by diaspora members to their families in their countries of origin, contribute to development and poverty

1 Naujoks, D, 2022. 'A Transnational Research Agenda on the Determinants, Policies and Diaspora Direct Investments', *Research in Globalisation*, (4), 1-11. Diaspora is hereby defined in the following way: "The diaspora includes the descendants of migrants over more than one generation, that is, all people living (on a temporary or permanent basis) outside the country of their birth or ancestry, who maintain affective (religious, ethnic or national) and/or economic ties with their birth/ancestral country, or who could be encouraged to develop such ties" (Gelb, S., et al. *Diaspora Finance for Development: From Remittances to Investment*, EU Joint Research Center Technical Report, 11).

reduction in the receiving countries.[2] More recently, however, there has been growing attention to the role of diaspora investment, i.e. the channelling of finance from the diaspora into productive economic activities in their country of origin.[3] This shift in the debate has elicited the attention of many donor governments, as it aligns with their efforts to leverage private capital in support of achieving the sustainable development goals (SDGs), while also promising to deliver benefits to diaspora-owned businesses based in the donors' own economies.[4]

With a view to informing such debates, this policy brief explores the extent to which diaspora investment can support inclusive economic development and livelihoods in the diaspora's country of origin, with a particular focus on fragile settings. The first section introduces diaspora investment and explores its potential as a development tool, shedding light on the main advantages and risks associated therewith. Mindful of the need to adopt a context-specific approach, the second section delves into the case study of Somalia, a country with a particularly large and economically active diaspora. The brief explores in more detail the ways in which diaspora investment can support the Somali economy, but also the ways in which it can exacerbate societal tensions and conflicts. Based on this analysis, the brief offers a number of recommendations for policy makers in donor governments who are willing to promote diaspora investment in Somalia and beyond, offering suggestions on how to maximize the benefits of this tool, while minimizing the associated risks.

Diaspora investment as a tool for development

Among the many ways in which the diaspora can contribute to development in their country

2 De Haas, H. 2007. ''Remittances, Poverty, and Inequality' in: *Remittances, Migration and Social Development: A Conceptual Review of the Literature*. Geneva, United Nations Research Institute for Social Development, 10-14.
3 Gelb, S., et al. *Diaspora Finance for Development*, op. cit.
4 See, for instance: Government of the Netherlands, 2022, *Policy Document for Foreign Trade and Development Cooperation: Do what we do best.*

of origin,[5] sending money is a prominent one. Diaspora members are often expected to give financial support to their families and communities back home, channelling to them part of the money that they earn by living abroad. These flows of money – usually referred to as remittances – have increased significantly over the past two decades, reaching an estimated USD 790 billion globally in 2022.[6] Remittances have come to play an important role in the economy of the receiving countries: as of 2021, they accounted for over 10% of GDP in 29 different countries all over the world, supporting the livelihoods of large swathes of the population and helping to relax foreign exchange constraints for the economy at large.[7]

Remittances vs. diaspora investment

The growth in remittance flows over the last decades has led to a great deal of debate about whether and how such flows can be leveraged to promote economic development.[8] As part of these discussions, recent years have witnessed a growing focus on the potential of diaspora investment.[9] The basic principle underpinning this focus is that money from the diaspora can be channelled into productive activities that generate future output and value in the country of origin.[10] By doing so, receivers can develop their own independent revenue streams, avoiding the risk of becoming dependent on the regular inflow of money from the diaspora.

This specific usage of diaspora funds for productive activities is often put in contrast with the assumption that remittances are used primarily for basic consumption expenditures (e.g. food, water, shelter, healthcare, education, etc.), which are considered less productive and hence less conducive to stimulate economic growth and development.[11] In reality, making a neat distinction between remittances and diaspora investment is extremely difficult.[12] In many cases, for instance, recipients use a share of the money they receive for investment purposes, such as to support small-scale family businesses.[13] Moreover, even when the money is used for consumption purposes, using remittances for basic needs may free up other resources to be invested in more productive activities. Finally, some expenditures, most notably education, are traditionally considered as consumption expenditures, although de facto they have an investment function, as they generate returns in the long run (e.g. via better employment).

The clearest difference between remittances and diaspora investment arguably lies in the expectations of the sender. While remittances

5 These include not only financial contributions (e.g. remittances, investments), but also non-financial ones (e.g. return migration and participation in politics, civil society, etc.). For an overview of the debates regarding the diaspora's role in promoting development in their countries of origin, see: De Haas, H. 2021. 'Migration and Development: A Theoretical Perspective.', *International Migration Review*, 44(1), 227-264.

6 Ratha, D. et al. 2022. 'Remittances Brave Global Headwinds.' *KNOMAD-World Bank*, November, 1. Remittances are defined as "the sum of international personal transfers, compensation of employees and capital transfers between households" by the World Bank, or as "inter-personal financial transfers between migrants and their countries of origin" by Gelb, S., et al. *Diaspora Finance for Development*, op. cit., 12.

7 Gelb, S., et al. *Diaspora Finance for Development*, op. cit., 9-10. Many fragile states face foreign currency shortages, which can complicate their efforts to purchase basic commodities such as food and fuel from international markets.

8 For an overview of such a process, see: Bakker, M. *Migrating into Financial Markets: How Remittances Became a Development Tool*, Oakland: University of California Press.

9 See, for instance, the double focus on remittances and diaspora investment by the UN-led Global Forum on Remittances, Investment and Development (GFRID). *Global Forum on Remittances, Investment, and Development (GFRID)*, International Fund for Agricultural Development, Rome 2023.

10 Gelb, S., et al. *Diaspora Finance for Development*, op. cit., 1-12. Diaspora investment is here defined as the set of "asset-producing financial instruments through which diasporas (migrants and their descendants) can invest in organisations in their country of origin".

11 Gelb, S., et al. *Diaspora Finance for Development*, op. cit., 9-12.

12 Gelb, S., et al. *Diaspora Finance for Development*, op. cit., 9-12.

13 For an example of the Somali case, see Majid, N. et al. 2017, *Remittances and Vulnerability in Somalia: Assessing sources, uses and delivery mechanisms*, Rift Valley Institute.

are transferred without the expectation of returns, investments are also supposed to deliver benefits to the sender, including (though not only) financially.[14] The sender's expectations can vary significantly: some senders may be primarily interested in gaining a financial return on their investment; others, on the other hand, may be more interested in the social impact of their investment (e.g. the creation of jobs and revenue-generating activities), at times out of a desire to improve the lives of their community members, and at times to create goodwill ahead of their potential return to their country of origin. These different motivations can (and often do) coexist, creating a complex set of drivers for diaspora investors.[15]

Overall, therefore, diaspora investment has the potential to be a tool to support development in the long term. On the one hand, this investment can support the creation of independent revenue streams in the countries of origin. On the other hand, by also providing benefits for the senders, it can be a more attractive option for a larger number of diaspora members – including those with weaker emotional connections to their country of origin. This shift of focus towards productive investments does not mean that money from the diaspora should no longer be used for basic consumption purposes – on the contrary, in many cases remittances have proven to be an important element in ensuring communities' ability to cope with crises and short-term needs.[16] Rather, the growing focus on diaspora investment shows that diaspora finance can be used both to fulfil shorter-term needs, and to support longer-term economic development and livelihoods.

Advantages and risks of diaspora investment in fragile settings

Leveraging diaspora investment as a tool for development offers a number of advantages. Some of these advantages are tied to the diaspora's potential to mobilize private capital in support of the sustainable development goals (SDGs). There is a broad consensus on the benefits that can be obtained by mobilizing the private sector to finance the SDGs.[17] In this context, the diaspora can play a major role, as diaspora members tend to be better placed than other investors to channel finances to their country of origin.[18]

Most notably, diasporas tend to tolerate higher risks, lower rates of return, as well as longer timeframes before recouping their investment. They are also more open to fund smaller-scale opportunities and informal businesses, which in many developing countries tend to be the motor of economic growth and job creation.[19] This tendency, referred to as "patriotic discount", is particularly relevant in fragile contexts, where many non-diaspora investors would not dare to commit their capital due to the relatively high risks involved.[20] In addition, diaspora members are widely thought to enjoy information advantages and lower transaction costs as compared to other investors, owing

14 Gelb, S., et al. *Diaspora Finance for Development*, op. cit., 12.

15 For an example of the Somali case, see: Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, Shuraako and IFAD.

16 Harvey, P. 'Remittances during crises: implication for humanitarian response', Overseas Development Institute.

17 United Nations Deputy Secretary General, 2023, 'Sustainable Development Goals 'Will Fail without Private Sector Support', Deputy Secretary-General Tells High-Level Dialogue on Partnerships', Press Release; OECD, 2022, *Making Private Finance Work for the SDGs*, PF4SD Perspectives Series, July.

18 Gelb, S., et al. *Diaspora Finance for Development*, op. cit., Newland, K. (ed.), 2010, *Diasporas: New Partners in Development Policy*, USAID and Migration Policy Institute, November, 25; Newland, K. and Plaza, S., 2013, *What we know about diasporas and economic development*, Migration Policy Institute Policy Brief no. 5/2013; Asquith, P. and Opoku-Owusu, S., 2020, 'Diaspora Investment to Help Achieve the SDGs in Africa: Prospects and Trends', AFFORD. Note, however, that some authors argue that this willingness may decrease over generations (Newland, K. (ed.), 2010, *Diasporas*, op. cit., 70-71).

19 Asquith, P. and Opoku-Owusu, S., 2020, 'Diaspora Investment to Help Achieve the SDGs in Africa', op. cit.

20 Newland, K. and Plaza, S., 2013, *What we know about diasporas and economic development*, op. cit., 5.

to their familiarity with the context, their local knowledge, and their access to local networks.[21]

In addition, leveraging diaspora investment as a development tool is also in line with a trend among donors to align their development cooperation efforts with the objective of creating economic opportunities for their own businesses. The Dutch government, for instance, has put a considerable focus on the creation of such synergies in its latest policy document on foreign trade and development cooperation.[22] In this context, increased investment by diaspora members is particularly attractive for policy makers in donor countries, because it can not only support livelihoods and economic development in Somalia, but also create opportunities for diaspora-owned businesses in the donor's own economy.

At the same time, however, diaspora investment does not come without challenges and risks. For instance, diaspora members risk overestimating their knowledge of the local context, which has often changed while they have been residing abroad. This may lead them to forego expert advice, and as a result to make unsuccessful investment decisions.[23] Diaspora members may also be viewed with scepticism in their countries of origin, often due to the different social norms and habits that they have acquired while living abroad.[24] In (post-)conflict settings, the local population may also harbour resentment towards the diaspora, blaming them for leaving the country during difficult times. Finally, in certain cases diaspora investment may also have negative economic side effects. A rise in real estate investment by the diaspora, for instance, can lead to rising housing prices, as well as opening up opportunities for speculation by well-connected diaspora members.[25]

Most importantly, diaspora investment also risks undermining social cohesion if most of the finance is channelled along identity lines. Diaspora members often make investment decisions based on family or community ties, rather than pure profit-seeking.[26] As a result, certain communities may enjoy greater benefits from the investment, for instance if they have stronger connections with the diaspora. This risks exacerbating horizontal inequalities, i.e. inequalities between groups that have different cultural identities (e.g. ethnicity, religion, etc.).[27] According to existing research, high levels of horizontal inequality increase the risk of violent conflict.[28] This risk is particularly serious in fragile settings, where tensions between communities already run high.

While the observations outlined above are typical of diaspora investment at large, each specific context has different features that significantly affect how such investment takes shape. This includes the volume of investments, the channels through which they materialize, as well as the advantages and risks associated therewith. As a result, it is the specific context that determines both the potential and the risks associated with diaspora investment as a tool for development, including in relation to alternative tools (e.g. microfinance). Aware of this specificity, the next section delves into the case of Somalia, which is particularly relevant due to the country's large and economically active diaspora.

21 Gelb, S., et al. *Diaspora Finance for Development*, op. cit.; Willemsen, A. et al. 2019, External evaluation of migrant entrepreneurship projects: *Volume 2 – Annexes Final Report*, Ecorys, 56; Newland, K. (ed.), 2010, *Diasporas*, op. cit., 25.

22 Government of the Netherlands, 2022, *Policy Document for Foreign Trade and Development Cooperation: Do what we do best.*

23 Newland, K. (ed.), 2010, *Diasporas*, op. cit., 69-70.

24 Willemsen, A. et al. 2019, External evaluation of migrant entrepreneurship projects, op. cit., 56, 64-65.

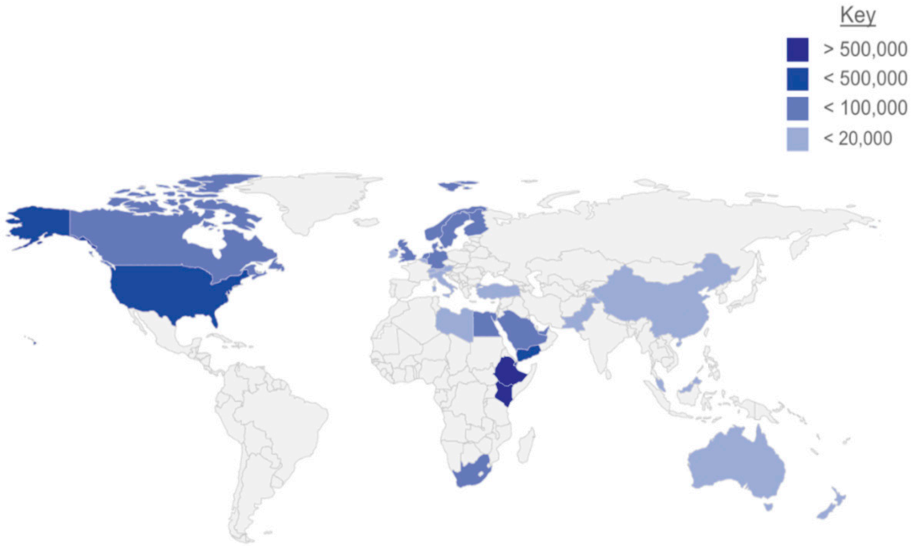
25 McGregor, J., 2014, 'Sentimentality or speculation? Diaspora investment, crisis economies and urban transformation', *Geoforum*, vol. 56, 172-181.

26 Ne Newland, K. (ed.), 2010, *Diasporas*, op. cit., 69.

27 For a definition of horizontal inequalities, see: Stewart, Frances. 2002. "Horizontal Inequalities: A Neglected Dimension of Development." QEH Working Paper Series.

28 Hillesund et al. 2018, 'Horizontal inequality and armed conflict: a comprehensive literature review', *Canadian Journal of Development Studies*, vol. 39.

Figure 1 The Somali diaspora across the world[29]



Diaspora investment in Somalia

The case of Somalia is particularly relevant when discussing the benefits and challenges associated with diaspora investment. The country has a very large diaspora, estimated to number around 2 million people (i.e. 13% of Somalia's total population).[30] Diaspora members maintain strong links with their country of origin, and engage in a wide range of activities in the economic, humanitarian, development, and peacebuilding domains.[31] Transferring money to Somalia is part and parcel of this engagement, with an estimated USD 1.3 to 2 billion in remittances being channelled into Somalia every year.[32] Money from the diaspora is also channelled through investments, as diaspora members seek to have a positive impact in their country of origin, while at the same time making a profit.[33]

Key features of diaspora investment in Somalia

Investment from the Somali diaspora in their country of origin materializes in many different forms. The most comprehensive survey available on the topic, dating to 2017 and involving around a thousand participants, reveals the following features.[34] The size of the investments from the Somali diaspora varies quite widely, from USD 5,000 to USD 100,000, with the majority of investments being within the range of USD 5,000 to 50,000. The frequency tends to depend on available opportunities, which are usually evaluated in consultation with trusted business partners and local family members.
The most prominent sectors targeted by the investments are agriculture, real estate, and education, while other relevant sectors include the hospitality sector, construction, and small-scale industries.

Investments are channelled through a variety of vehicles, including, for instance, equity,

29 Meester, J. et al. 2019. *Transnational capital in Somalia: Blue desert strategy*, Clingendael CRU Report, June, 20.
30 EU Diaspora for Development, 2020, *Diaspora Engagement Mapping: Somalia*.
31 Hammond, L. et al. 2011, *Cash and Compassion: The Role of the Somali Diaspora in Relief, Development and Peacebuilding*, United Nations Development Programme; Laakso, L. and Hautaniemi, P. (eds.), 2014, *Diasporas, development and peacemaking in the Horn of Africa*, The Nordic Africa Institute.
32 Majid, N. et al., 2020, 'How Will Remittances Affect the Somali COVID-19 Response?', LSE Blogs, April.
33 Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, op. cit.
34 Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, op. cit.

joint ventures, public offerings, as well as debt.[35] A significant number of investments are made directly into locally-owned businesses. More active investors generally prefer direct investment into a single business. On the other hand, less active investors and younger people are more likely to opt for co-investment, either with other diaspora members or as part of mutual funds. Across all types of investment, interpersonal trust tends to be more important than any type of formal agreement.

In terms of the motivations underpinning investment decisions, diaspora members tend to be driven by a combination of achieving financial returns and promoting social good. Financial considerations tend to be the dominant factor, with over 60% of the respondents saying that they prioritize either the maximization of returns (29%) or the minimization of risks (32%).[36] For the remaining 39%, maximizing social benefits is the primary concern. The prospect of returning to Somalia is also an important driver for many investors (73%), particularly in the case of housing and real estate investments. Overall, therefore, the line between for-profit investment and social investment is very blurred, with different motives coexisting side by side.

Despite a strong motivation to invest in their country of origin, Somali diaspora members face significant challenges. Most of these challenges are related to Somalia's difficult political and business environment in general (e.g. political instability, a lack of security, the inability to enforce a contract, corruption, an inadequate banking system), and thus lie largely outside of the investor's control. The most prominent challenge falling within the investor's control is that of finding trusted entrepreneurs and partners within Somalia with whom they can cooperate – a major concern for most investors. Diaspora investors are also generally keen to ensure a degree of control over how their investment money is spent – different from what happens with remittances, over which senders tend to exercise little control.

When asked what external support could make it easier for them to invest in Somalia, investors tend to favour engagement by international institutions – a reflection of the lower level of trust in Somali institutions and in the government. In particular, matching grants and loan guarantees provided by international entities are the two preferred specific support mechanisms, followed by pooling funds with other diaspora members. These preferences should be kept in mind by external actors when devising ways to promote diaspora investment in Somalia (see below).

Conversations with Somali diaspora members also reveal the presence of distinct categories of (potential) investors, which tend to have different approaches. For instance, first-generation diasporas (i.e. people who were born in the country of origin and later migrated abroad) tend to have stronger links with the country of origin, and are more likely to invest regardless of any form of external support or guarantees. These investors tend to rely heavily on personal connections within Somalia, paying little attention to any formal arrangement.
On the other hand, second-generation diasporas (i.e. individuals born in a foreign country to parents with a migrant background) have weaker connections within Somalia. Although it is often the case that they still send remittances, their approach to investment is different. In particular, they rely less on personal connections, and

35 Wiring money to Somalia is challenging due to the international isolation faced by the country's financial system. Yet, over the past few decades, Somalis have found various methods to effectively transfer money in and out of the country, ranging from the traditional *hawala* system to the more recent expansion of mobile money services. For an overview of the use of these channels in the transfer of remittances, see: Majid, N. et al. 2017, *Remittances and Vulnerability in Somalia*, op. cit., 38-44.

36 Of the top 5 factors reported to influence investment decisions, the first 4 are financially-related (a well-developed business plan, evidence that the investment is profitable, the presence of a transparent and enforceable contract, projected growth potential), and only the fifth one is related to the social impact (contributing to local community development). For more details, see: Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, op. cit., 30.

place more value in formal mechanisms that can guarantee the success of their investment.

Another important distinction is the one between individual and group-based investors. Individual investment is the most common form of investment, and it largely follows the patterns outlined above. This kind of investment tends to be driven by existing opportunities, and it is less linked to political dynamics. In certain cases, however, larger groups of diaspora members jointly mobilize to coordinate their investment. These groups are often organized due to shared membership of social groups, based for instance on a clan or religion, but at times also on friendship. The sums mobilized by these groups are significantly higher than those mobilized by individual investors, and their engagement is more often linked to the political agenda of some of the group's members.

The value of diaspora investment

The amount of money transferred by the Somali diaspora to their country of origin is extremely large, with estimates ranging from USD 1.3 to 2 billion per year – likely to be an underestimation, given the informal nature of these transfers.[37] Such amounts are reported to account for over 20% of the country's GDP, and they are comparable with the large inflows of official development assistance received by Somalia.[38] Given this scale, the impact of such monetary inflows can be extremely consequential.

Currently, a large share of the funds remitted by the Somali diaspora is used for basic consumption. In particular, according to a 2017 survey, an overwhelming majority of remittance-receiving Somali households associated remittances with an improved capacity to purchase food, followed at some distance by expenditures on water, health, and education.[39]

By contrast, only on a few occasions is this money used for investment purposes. This pattern of use makes remittances a precious safety net for Somali households, particularly in times of crisis (e.g. during droughts).[40] At the same time, however, it leaves room for increasing the share of remittance money that is used to finance productive investment – which, as noted in the previous section, has the potential to support long-term economic development and livelihoods.

In particular, funds from the diaspora are very important sources of capital for Somali businesses. Due to the challenges faced by many Somali companies in accessing capital in the domestic market,[41] monetary inflows from abroad can represent an important source of finance for businesses. At the same time, however, the country struggles to attract foreign investors, due to a difficult business environment characterized by political instability, poor infrastructure, and weak institutions and regulatory frameworks. As a result, diaspora members are often the only investors willing to accept the risks associated with investing in Somalia.

Diaspora investment represents a particularly important source of capital for small and medium-sized enterprises (SMEs), with an estimated 80% of start-up capital for these businesses coming from the diaspora.[42] Somali SMEs have a strong potential to contribute to economic development, but at the same time they face particularly high barriers in terms of access to finance.[43] The greatest number of

37 Majid, N. et al., 2020, 'How Will Remittances Affect the Somali COVID-19 Response?', LSE Blogs, April.

38 Federal Government of Somalia, *Somalia National Development Plan 2020 to 2024*, p. 50-51

39 Majid, N. et al. 2017, *Remittances and Vulnerability in Somalia*, op. cit., 25-34.

40 Majid, N. et al. 2017, *Remittances and Vulnerability in Somalia*, op. cit.

41 Naughton, J. et al., 2021, *Summary Report: Somalia Entrepreneurial Ecosystem Building Landscape Analysis*, DAI Sustainable Business Group, 16-25.

42 UNDP 2009, 10 – with reference to Caitlin Chalmers and Mohamed Aden Hassan, Somali Remittances. May 2008; Hammond, L. et al. 2011, *Cash and Compassion*, op. cit., 83.

43 Meester, J. et al., 2021, *Financial disruption and fragile markets: A political-economic perspective on SMEs in the Somali private sector under COVID-19*, Clingendael CRU Report, 22-26; Naughton, J. et al., 2021, *Somalia*

businesses in Somalia are estimated to have capital needs ranging from USD 10k to USD 500k.[44] However, these businesses are often cut off from most financing opportunities, such as loans from traditional banks (which are not affordable for small businesses, and which most often cover the imports of goods but not working capital or other expenses), microfinance schemes (whose target tends to range from USD 1k to 5k), as well as support from private equity and venture capital firms (which tend to handle sums above USD 2 million).[45] In this context, the diaspora can contribute greatly by channelling its finance to support the growth of these high-potential SMEs.

As noted in the previous section, using diaspora money to finance productive investments can have positive effects for receivers and senders alike. On the one hand, remittance-receiving households can use the funds to develop their own independent sources of income. This mitigates the risk that the receivers of remittances become dependent on money sent from abroad for their livelihoods.[46] In a 2017 survey, senders and receivers of remittances alike have reportedly expressed a shared sentiment that Somali households should be assisted in obtaining their independent livelihoods, rather than depending on the money received.[47]

On the other hand, a growing focus on investment can also benefit the senders. Remittances often represent a significant burden for Somali diaspora members, who are under pressure to send money to their countries of origin, despite often experiencing difficult socio-economic conditions in their countries of residence.[48] This risks reducing the diaspora's willingness to remit money over time (a phenomenon known as "remittance fatigue") – particularly for diaspora members from the second or third generation, who have a weaker attachment to their country of origin.[49] In this context, the potential returns (including financial) promised by investments can encourage diaspora members to keep transferring their money to Somalia.

Past experiences across Somalia have also[50] shown that diaspora investment can have a positive contribution, not only in terms of creating economic opportunities, but also in promoting peace- and state-building. In Somaliland, for instance, diaspora investments financed the construction of the Mansoor and Ambassador Hotels. Besides creating jobs and fostering economic activity locally, the construction of these hotels created a sense of confidence among the population concerning Somaliland's post-war recovery.[51] This confidence, in turn, has contributed to stimulating more diaspora members to invest in their country of origin. Similarly, in the early 2000s diaspora money financed the establishment of the International Horn University in Hargeisa and Nugaal University in Lascanod. These institutions not only provide educational opportunities for young people across Somaliland (including in some of the region's peripheries), but they have also

Entrepreneurial Ecosystem Building Landscape Analysis, op. cit., 16-25. This reflects a pattern, referred to as that of the "Missing Middle", according to which innovative early-stage ventures that have a potential to yield good returns and high social impact but require less than USD 1 million in capital are the most difficult segment of the SME pipeline to reach.

44 The Somali Business Catalytic Fund estimates that the greatest number of opportunities range from USD 50k to 500k; UNIDO notes that ticket sizes of between USD 20k and 30k are in large demand, while UNDP estimates that 52% of businesses need start-up capital of between USD 10k and 100k (Naughton, J. et al., 2021, *Somalia Entrepreneurial Ecosystem Building Landscape Analysis*, op. cit., 24; Hammond, L. et al. 2011, *Cash and Compassion*, op. cit., 85).

45 Naughton, J. et al., 2021, *Somalia Entrepreneurial Ecosystem Building Landscape Analysis*, op. cit., 18, 24.

46 Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, op. cit., 11-13

47 Hammond, L. et al. 2011, *Cash and Compassion*, op. cit., 44.

48 Thompson, D.K. 2017, 'Diaspora Return, Economic Growth and Inequality in Eastern Ethiopia and Somaliland: Redistribution or Reinscription?', Working Paper.

49 Hammond, L. et al. 2011, *Cash and Compassion*, op. cit., 105.

50 Majid, N. et al. 2017, *Remittances and Vulnerability in Somalia*, op. cit.; Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, op. cit.

51 Laakso, L. and Hautaniemi, P. (eds.), 2014, *Diasporas, development and peacemaking in the Horn of Africa*, op. cit., 53-74.

Table 1 Remittances vs. diaspora investment in Somalia[50]

	Remittances	Investment
Usage	Cover basic household expenditures (e.g. food, health, education)	Kick-start longer-term projects (e.g. business, real estate)
Size	Small sums (USD 423 average, USD 300 median)	Substantially larger (majority between USD 5k and 50k)
Frequency	Regular (often monthly)	Occasional (depending on opportunity)
Expectation of return	No financial returns, but a potential for social returns	Mix of social and financial returns, with more emphasis on the latter
Family involvement	Mostly within family / kin	Non-family more often engaged (in various potential roles)

provided them with opportunities to engage in peacebuilding activities as part of their studies.[52]

Similar dynamics can be seen in some donor-sponsored projects aimed at supporting economic engagement by the Somali diaspora in their country of origin. A Dutch-financed project on diaspora entrepreneurship in Somaliland, for instance, succeeded in supporting a few diaspora members to kick-start a business career in their country of origin.[53] Besides the economic impact in terms of new business activities and the jobs created, the project has also had positive spillovers in terms of reconciliation between the authorities in Somaliland, Puntland, and south-central Somalia, which jointly engaged in project-related activities.[54]

Challenges and risks of diaspora investment

Despite the advantages listed above, diaspora investment does not come without its own challenges and risks. In Somalia's political economy, the world of business is deeply intertwined with that of politics. For instance, large transnational business conglomerates that dominate key markets in the Somali economy also have a strong influence over the political agenda.[55] Similarly, logistics firms within Somalia have been deeply embedded in the country's political scene, supporting or undermining politicians according to their own business interests.[56] At the same time, local politicians are often businessmen on the side, and move easily across the two worlds.[57] While these dynamics are most visible at the highest levels of the business and political worlds, they are also relevant on a smaller scale. Viewed in this context, economic investments inherently have political implications, as they can affect the balance of power by allocating resources to certain individuals, groups, or constituencies.

In particular, investments from the diaspora risk fuelling tensions and violent conflict if they are perceived to benefit certain groups at the expense of others. This is a significant risk in Somalia, due to the combination of two factors.

52 Laakso, L. and Hautaniemi, P. (eds.), 2014, *Diasporas, development and peacemaking in the Horn of Africa*, op. cit., 53-74.
53 Willemsen, A. et al. 2019, External evaluation of migrant entrepreneurship projects, op. cit., 22-28.
54 Willemsen, A. et al. 2019, External evaluation of migrant entrepreneurship projects, op. cit., 22-28.
55 Meester, J. et al. 2019. *Transnational capital in Somalia: Blue desert strategy*, Clingendael CRU Report, June.
56 Elder, C., 2022, 'Logistics contracts and the political economy of state failure: Evidence from Somalia', *African Affairs*, Volume 121, Issue 484, 395–417.
57 Multiple conversations with Somali businesspeople and researchers on Somalia, at multiple locations (Hargeisa, Dubai, London), 2019.

Box 1: Diaspora investment vs. microfinance in Somalia

Over the past decades, microfinance (i.e. the provision of small-scale loans to individuals and small businesses that do not enjoy access to finance via conventional banking services) has emerged as a prominent development tool in many regions across the world, including in Africa.[58] Given that microfinance can be used to provide capital for small businesses in fragile settings,[59] it can be interesting to look at how it compares to diaspora investment in the specific context of Somalia.

The microfinance ecosystem in Somalia consists of a handful of Islamic microfinance institutions (MFIs), operating in a largely unregulated environment.[60] Most of these institutions are either affiliated with commercial banks (e.g. MicroDahab, IBS Bank, Premier Bank, Amal Bank, Dara Salam Bank, Salam Somali Bank), or registered as non-governmental organizations (NGOs) (e.g. Kaaba Microfinance, Kaah International Microfinance Services). These institutions provide small loans to individuals and small businesses that struggle to have access to finance through conventional banking channels. While extensive evidence of the impact of microfinance is lacking, a study on its impact in Mogadishu has found that small loans were effective in improving the living standards and monthly incomes of most beneficiaries.[61]

Although both microfinance and diaspora investment promise to provide finance to small businesses that struggle to have access to capital, their target is markedly different. Somali microfinance institutions generally target micro-enterprises, with an average ticket size of USD 1,000 to 2,000.[62] While this targeting does provide important benefits, most notably for women micro-entrepreneurs who struggle to receive finance from any other channel,[63] it falls short of benefiting the larger SMEs that, as noted earlier, have a strong potential to contribute to economic development in Somalia.[64] These larger SMEs can instead be serviced by diaspora investors, whose ticket size tends to be significantly higher (USD 5,000 to 50,000).[65]

58 United Nations Office of Special Adviser on Africa, 2013, *Microfinance in Africa: Overview and Suggestions for Action by Stakeholders*.

59 Armendáriz, B. and Roome, N., 2008, 'Empowering Women via Microfinance in fragile states', Centre Emile Bernheim Working Paper 08/001; Johnson, S.W., 'Post-Conflict Reconstruction, Microfinance and Democratic Engagement', *Peace Economics, Peace Science and Public Policy*, vol. 24, no. 3.

60 Xalane, M.A.E. and Salleh, M.C.M., 2019, 'The Role of Islamic Microfinance for Poverty Alleviation in Mogadishu, Somalia: An Exploratory Study', *International Journal of Management and Applied Research*, 2019, Vol. 6, No. 4.; 359; Shire, S.A. and Azrak, T. 2023, 'The Impact of Covid-19 on Microfinance Institutions in Somali', *Journal of Islamic Economics*, 2023/1, 75-77.

61 Xalane, M.A.E. and Salleh, M.C.M., 2019, 'The Role of Islamic Microfinance for Poverty Alleviation in Mogadishu, Somalia', op. cit.

62 Naughton, J. et al., 2021, *Somalia Entrepreneurial Ecosystem Building Landscape Analysis*, op. cit., 20.

63 Naughton, J. et al., 2021, *Somalia Entrepreneurial Ecosystem Building Landscape Analysis*, op. cit., 19-20.

64 Meester, J. et al., 2021, *Financial disruption and fragile markets*, op. cit.; Naughton, J. et al., 2021, *Somalia Entrepreneurial Ecosystem Building Landscape Analysis*, op. cit., 16-25.

65 Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, op. cit.

First, the allocation of investments from the Somali diaspora often takes place along clan (or sub-clan) lines – much like other processes of resources mobilization in the country (see Box 2). Second, although clan dynamics rarely explain conflict in Somalia, they do provide a critical framework through which politics and conflict play out.[66] In such a context, the economic investments made by diaspora members may well generate economic gains for their communities, but at the same time they may be perceived as a threat by other communities. These perceptions, in turn, can easily feed into existing tensions and conflicts.

Recent developments in Lascanod provide a relevant example of such dynamics.[67] Over the last few years, important infrastructure investments – largely supported by the diaspora – have been instrumental in boosting the city's economic growth. At the same time, however, such developments have also been linked with conflict dynamics. According to narratives that are widespread among the population in the region, the growing economic power of the Dhulbahante-dominated Lascanod was perceived as an economic and political challenge by the Isaaq-dominated administration in Somaliland.[68] Reflecting this view, members of the Dhulbahante community have accused the authorities in Hargeisa of stirring up trouble in Lascanod in order to undermine the city's growth.[69] In late 2022, these tensions sparked renewed violent conflicts in and around the city. Tensions further escalated during the conflict, as Somaliland's armed forces targeted water, health, and electricity infrastructure projects built by the Dhulbahante community and its diaspora, rather than those built by the Somaliland administration.

66 Maxwell, D. and Majid, N. 2016, 'Diversification, Flexibility and Social Connectedness: Understanding the Narratives', in *Famine in Somalia: Competing Imperatives, Collective Failures, 2011–12*, Oxford University Press, 100.
67 Norman, J., 2023, 'Conflict in Las Anod and Crisis in Somaliland', DIIS Article, March.
68 Norman, J., 2023, 'Conflict in Las Anod and Crisis in Somaliland', DIIS Article, March.
69 Norman, J., 2023, 'Conflict in Las Anod and Crisis in Somaliland', DIIS Article, March.

Another example comes from the Port of Garacad, which was largely funded by private investors, including from the diaspora.[70] The opening of the port has been seen by some as creating competition with Somaliland's Berbera, creating a new alternative connection between Ethiopia's Somali region and the Indian Ocean.[71]

This competition has become particularly evident with the eruption of the conflict in Lascanod, which has disrupted road transport between Berbera and Ethiopia. As a result, some traders have indicated a willingness to shift their trade from Berbera to Garacad in order to avoid the insecurity in the regions affected by the conflict.[72] This, in turn, has led to rumours and allegations that businesspeople with a stake in trade through Garacad may be covertly fuelling the conflict in order to profit from increased trade flows.[73] These cases show how perceptions of who benefits from economic investments shape narratives that can fuel tensions among identity groups – often regardless of the evidence that is available to back up such narratives, which in many cases is scarce.[74]

If channelled across identity lines, diaspora investment also risks fuelling tensions by exacerbating existing inequalities between clans. This is due to the fact that the most powerful clans in Somalia (most notably the Dir, Isaaq, Darood, and Hawiye) tend to enjoy a large representation in the diaspora, while less powerful groups (such as the Rahanweyn, and especially the Somali Bantu) have fewer of their members abroad.[75]

70 Garacad Seaport, Investors, https://dekadagaracad.com/investors/ (accessed July 2023).
71 Yassin, A.J. 2022, 'Somalia Plotting Competition to Berbera Port', *Somaliland Intellectuals Institute*, September. Conversation with Somali diaspora returnee, June 2023.
72 Rift Valley Institute, 2023, 'The Crisis in Lasanod: Implications for Trade and Livelihoods in Ethiopia's Somali Region', Blog, March.
73 Conversation with a Somali diaspora returnee, June 2023.
74 Norman, J., 2023, 'Conflict in Las Anod and Crisis in Somaliland', DIIS Article, March.
75 Majid, N. et al. 2017, *Remittances and Vulnerability in Somalia*, op. cit., 19; Maxwell, D. and Majid, N. 2016, 'Diversification, Flexibility and Social Connectedness', op. cit., 101. Note, however, that there can be significant differences within each clan.

Box 2: Resource mobilization along clan lines in Somalia.

In Somalia, processes of resource mobilization often take place along family and clan lines. This trend applies to a wide range of engagements made by the diaspora in their country of origin, including the transfer of remittances,[76] the support provided to humanitarian, development, and peacebuilding efforts,[77] but also the provision of funding for conflict.[78]

The transfer of remittances offers a clear example of this trend. Diaspora members tend to transfer remittance money to their own family or kin.[79] This leads to an uneven distribution of resources across social groups, given that a relatively high proportion of diaspora members are thought to belong to some of Somalia's major clans (e.g. Dir, Isaaq, Darood, Hawiye), while other social groups (e.g. Rahanweyn, Somali Bantu) tend to have fewer diaspora members.[80] As a result, the inflow of remittances – while providing a critical lifeline for large segments of the Somali population, especially in times of crisis – also tend to reinforce inequalities between social groups.[81]

There are some indications that the role of clan dynamics may be more limited in shaping the allocation of funds for business purposes. For instance, diaspora members from Somaliland and south-central Somalia have engaged in fairly extensive cross-clan business partnerships, which have ensured security and access to markets across the country for their businesses.[82] Diaspora investors also tend to dismiss the importance of clan affiliation in influencing their choice of investment opportunities.[83] Moreover, some diaspora members, particularly younger ones from the second generation, report that clan dynamics are playing an increasingly less significant role in shaping decisions around investment, citing examples of diaspora-owned businesses hiring staff based on their qualifications rather than on clan affiliation.[84] These observations fit into a broader pattern, whereby the level of economic fragmentation across clan lines seems to be significantly lower than the level of political fragmentation, including at the diaspora level.[85]

76 Majid, N. et al. 2017, *Remittances and Vulnerability in Somalia*, op. cit.

77 In the humanitarian domain, for instance, support by the diaspora provides much needed support to the population, but it also often follows a logic of exclusion, insofar as blood ties remain a key criterion for the targeting of assistance (Musa, A. 2023, 'Somali Responses to Drought: Social Ties and Practices of Inclusion and Exclusion', DIIS Working Paper 2023:03). The diaspora's contribution to development and peacebuilding activities also depends – at least to a certain extent – on family and clan lines. Quite naturally, diaspora members often direct their support towards their own areas and regions, with the aim of helping their families or clan (Laakso, L. and Hautaniemi, P. (eds.), 2014, *Diasporas, development and peacemaking in the Horn of Africa*, op. cit., 81-84). Supporting projects in regions that are different from one's own may provoke "sharp questions" from family or clan members, and projects established in territories closely affiliated with a clan have reportedly faced difficulties in raising funds from other lineages, which would be concerned that the project would only serve that specific clan (Hammond, L. et al. 2011, *Cash and Compassion*, op. cit., 49).

78 Multiple conversations with Somali businesspeople and researchers on Somalia, at multiple locations (Hargeisa, Dubai, London, The Hague), 2019 and 2023. Several informants reported that diaspora members continue to provide finance to their own clan members engaged in conflicts within Somalia, though they do so less openly than in the past. Forms of support include, for instance, promising to cover blood money payments, which makes it possible for actors on the ground to continue the fighting.

79 Maxwell, D. and Majid, N. 2016, 'Diversification, Flexibility and Social Connectedness', op. cit.

80 Majid, N. et al. 2017, *Remittances and Vulnerability in Somalia*, op. cit., 19.

81 Musa, A. 2023, 'Somali Responses to Drought', op. cit.

82 Hammond, L. et al. 2011, *Cash and Compassion*, op. cit., 88.

83 Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, op. cit., 28, 38. For instance, only 2% of respondents indicated that clan elders are relevant actors in helping the investor to choose a suitable investment opportunity.

84 Conversation with (former) diaspora members, 2023.

85 Hammond, L. et al. 2011, *Cash and Compassion*, op. cit., 90.

At the same time, however, family and clan links do play a significant role in shaping investment flows, according to available survey evidence and to several of the informants consulted for this study.[86] Many diaspora investors are motivated by a desire to cater for their families' needs, as well as by the desire to return to Somalia in the future.[87] In this context, it is natural that their investments will tend to benefit their own family or clan, or the communities in their place of origin. It is not uncommon, for instance, to hear that the jobs created through an investment by a diaspora member are distributed mostly to the member's own family.[88] Even investments highlighted as success stories due to their positive contributions to society at large were in fact geared towards the clan areas of the investors – see, for instance, the case of prominent investments in hotels and universities in Hargeisa and Lascanod.[89]

While family and clan connections tend to play a stronger role for the first-generation diaspora, members of the second generation are not immune either. At times, some of these younger individuals do reportedly try to structure their investments with little consideration for family or clan affiliation. Yet, when faced with difficulties within Somalia's complex business environment, they may be forced to fall back on trusted individuals, who are often family or clan members known by the investor's parents or older relatives.[90] Moreover, although clan elders are seen by few investors as trusted advisers when it comes to choosing investment opportunities, they are still seen by them as key actors in enforcing the (largely informal) contracts that are stipulated around their investments, and also as critical guarantors for business deals in the absence of collateral.[91]

This reliance on kinship structures is to a large extent a consequence of the difficulties faced by investors in Somalia. In the absence of working formal institutions that protect their investment, diaspora members need to rely on trust-based informal institutions, which in Somalia tend to work along family and clan lines.[92] This reliance, however, can often lead to disappointment among investors. Upon travelling to Somalia, diaspora members often realize that the investments made on their behalf have not been implemented correctly – for instance, a house has not been adequately built, or the land that has been purchased did not have the necessary documentation.[93] These disappointments have led to a growing desire – particularly by second-generation diaspora – to rely on professionals and institutions to handle their investments.

86 Conversations with various diaspora members active or living in various regions of Somalia, 2023.

87 Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, op. cit., 32-33. Family needs are cited as being either a very important factor or an important one for investment motivation by 58% of respondents in the SDIS survey. When asked whether they invest in the Somali regions in order to return permanently one day, approximately 73% of respondents answered affirmatively.

88 Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, op. cit., 32

89 Laakso, L. and Hautaniemi, P. (eds.), 2014, *Diasporas, development and peacemaking in the Horn of Africa*, op. cit., 73.

90 Conversation with diaspora members active in Hargeisa, 2023.

91 Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, op. cit., 38. Laakso, L. and Hautaniemi, P. (eds.), 2014, *Diasporas, development and peacemaking in the Horn of Africa*, op. cit., 70-71. For instance, a Somali diaspora investor based in the United States reported the following: "[For example, I] gave USD 50k to open a business. There was no legal Western contract. The contract was with the clan and the elders. The clan is the key – they guarantee the contract as co-signers with collateral. The clan is the collateral, they'll see your sheep, goats; they will ensure you get paid. The clan's name is at stake."

92 Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, op. cit., 25-27; Laakso, L. and Hautaniemi, P. (eds.), 2014, *Diasporas, development and peacemaking in the Horn of Africa*, op. cit., 70-71.

93 Conversation with a Somali businesswoman, 2023.

As a result of this imbalance in connections with the diaspora, the powerful groups are likely to benefit more from inflows of diaspora investment, while more marginalized ones may have fewer such opportunities. This can exacerbate horizontal inequalities (i.e. inequalities between social groups defined by cultural features, in this case the clan) – a phenomenon that has been shown to increase the likelihood of violent conflict.[94]

Diaspora investment can also have other negative side effects. For instance, inflows of money from the diaspora can spur a rise in prices in selected sectors, particularly land and real estate, thus creating economic challenges for the poorer segments of the Somali population.[95] Moreover, small-scale local entrepreneurs may also resent the economic engagement of diaspora members, whom they accuse of leaving the country during difficult times, only to return later in order to make money, leveraging the capital accumulated by living abroad.[96] These dynamics feed into a broader pattern of resentment, whereby part of the local population also dislikes the changed social habits of many diaspora members, as well as their prominence in the country's political life.[97] Overall, however, the economic contribution of the diaspora tends to be widely appreciated by the population of Somalia – including by some of those who complain about the negative side effects.[98]

94 Hillesund et al. 2018, 'Horizontal inequality and armed conflict;, op. cit.

95 Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, op. cit., 12.

96 See Willemsen, A. et al. 2019, External evaluation of migrant entrepreneurship projects, op. cit., 24-25 for the case of Somaliland; Thompson, D.K. 2017, 'Diaspora Return, Economic Growth and Inequality in Eastern Ethiopia and Somaliland', op. cit., 14 for Somaliland and Jigjiga. This tendency was confirmed by interviews with diaspora investors and non-diaspora Somali businesspeople.

97 Ibrahim, M.M. and Ali, H.Y. 2018, *Somali Local-Diaspora Mutual Coexistence: Opportunities and Challenges*, SIPAM; conversations with Somali citizens, both in Somalia and in the diaspora, 2023.

98 Conversations with Somali citizens, both in Somalia and in the diaspora, 2023.

Maximizing opportunities and minimizing risks

The previous section has shown how investment by the Somali diaspora in their country of origin can provide useful contributions to the country's development, particularly if it is leveraged to provide finance to high-potential, capital-hungry SMEs. At the same time, however, such investment can exacerbate tensions and local conflicts if it is perceived to benefit certain groups at the expense of others. In this context, donors seeking to promote diaspora investment in Somalia should seek to exploit this tool's potential, while minimizing the risks associated therewith. To this end, this section proposes a few broad suggestions for policy makers, mindful that any specific decision should depend on the specific aims of the programme, as well as on the outcome of consultations with all relevant stakeholders (i.e. diaspora members, Somali SMEs, Somalia governmental and financial institutions, as well as regulatory authorities in host countries).

Ensure effectiveness through an improved understanding of the beneficiaries' needs and preferences

In order to succeed in promoting economic development and livelihoods, diaspora investment efforts should carefully cater to the needs and preferences of their beneficiaries. Multiple practitioners consulted for this study noted that there is currently a lack of detailed data in this regard, thereby complicating efforts to devise suitable mechanisms to promote investment.[99] While the 2017 Somali Diaspora Investment Survey (SDIS) can serve as a useful tool to examine the attitudes of investors, the major shifts that have taken place over the last few years may have led to significant changes – think of, for instance, the evolution of Somalia's domestic political situation, or the impact of the COVID-19 pandemic on the global economy, including on remittances.

99 Conversation with Somali and international practitioners engaged in diaspora investment promotion efforts in Somalia, multiple locations, 2023.

Building on existing studies, donors should support a thorough mapping exercise of the needs and preferences of potential diaspora investors, as well as of Somali SMEs. On the diaspora's side, it is important to gain a better understanding of the conditions under which diaspora members would be open to investing their money in Somalia. These conditions include, among the many indicators, the amount committed, the frequency of the investment, the expected returns (be they financial, social, or both) and their relative timeframe, as well as preferences in terms of allocating investments towards certain locations or sectors. Detailed information in this regard could help to identify the set of incentives that should be put in place to ensure adequate buy-in from the diaspora – a key precondition for the success of any diaspora investment promotion effort.

The mapping exercise should also gather relevant personal information about the diaspora members, such as age, region of origin, generation, income, risk appetite, etc. This data could then be used to identify different profiles of potential investors, and devise specific instruments that are suitable for them. For instance, anecdotal evidence suggests that first-generation diasporas tend to be more active and risk-prone investors, preferring larger investments into a single business, and usually relying on personal networks within Somalia.[100] Such investors may not need external incentives to commit their money to Somalia, but could instead benefit from business support services (e.g. training in business practices), as they often lack business experience. By contrast, second-generation diasporas tend to be more risk-averse, have a preference for a more formal handling of their investment, and demonstrate a greater appetite for co-investment.[101] To support investment from this group of people, programmes may need to focus on how to create adequate incentives (e.g. a lower minimum threshold for individual investors, the promise of higher financial returns, de-risking mechanisms, etc.), and explore how to implement formal accountability mechanisms to monitor the use of funds.

Within Somalia, mapping exercises should focus on better understanding the type of support that Somali SMEs would benefit the most from. This may include not only their finance requirements (e.g. the amount of finance needed, repayment timelines, etc.), but also potential non-financial support (e.g. access to market information, financial literacy training, etc.). The data should be disaggregated according to relevant indicators (e.g. the size of the company, sector, etc.) so as to identify different company profiles that may benefit from different forms of support. In coordination with relevant government authorities and research institutions, these mapping exercises should also identify priority sectors where increased investment would have a maximum impact on Somalia's economic development and livelihoods. Efforts by Sominvest, with EU funding, to map opportunities in the agribusiness sector are a positive example in this regard.[102]

Ensure conflict sensitivity through inclusive and transparent stakeholder engagement

As noted earlier, perceptions that investments benefit a specific community over others can exacerbate existing tensions, and at times contribute to sparking violent conflict. To prevent this, it is crucial that diaspora investment promotion efforts involve a wide range of stakeholders and beneficiaries. Any programme should be preceded by a thorough political economy analysis that identifies existing power structures and conflict drivers, and analyses how an inflow of money from the diaspora may

100 Multiple conversations with Somali investors, businesspeople, and other relevant stakeholders; June 2023. Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, op. cit.

101 Multiple conversations with Somali investors, businesspeople, and other relevant stakeholders; June 2023. Benson, J.B. et al. 2016, *Somali Diaspora Investment Survey Report*, op. cit.

102 *Priority Sector Investment Study: Agribusiness Opportunities in Somalia's Food Production Sector*, November 2022.

affect political and conflict dynamics. Such analysis should be used to inform a politically sensitive choice of beneficiaries, which should be as inclusive as possible, reflecting the diversity of Somali society. In particular, the focus should be on avoiding that the economic opportunities generated by investments end up being channelled along culturally-defined lines (in Somalia's case, mostly clan lines) – which, as noted earlier, increase the risk of tensions and violent conflict.

Considerations of inclusivity should extend beyond explicit, formal requirements – rather, they should factor in the informal, less visible channels through which the benefits of investments are distributed. For instance, from a formal standpoint, setting up an online platform that matches investors in the diaspora with businesses looking for finance within Somalia may stimulate opportunities for financing any business. In reality, however, as noted earlier, diaspora investors have a tendency to channel finance towards their own communities, and more powerful groups tend to have a stronger representation in the diaspora. As a result, Somali entrepreneurs from the most powerful groups would likely stand to reap more benefits than their counterparts from more marginalized groups, thus further increasing existing inequalities.

Although it is arguably impossible to achieve a completely equitable distribution of benefits, it is still possible to be aware of the risks of fuelling inequalities, and to explore creative strategies to mitigate them. At times, for instance, diaspora contributions to universities in Somalia have been allocated on the basis of a lottery with several potential beneficiaries to ensure that donations would be made regardless of the beneficiary.[103] Efforts should be made to explore how these kinds of mitigation measures could be adapted to the allocation of funds for investment purpose – for instance, by restricting the lottery to a limited pool of potential investees who have been selected due to their attractive business model.

Specific programme design choices also matter when it comes to shaping how benefits are distributed. In the case of Somalia, for instance, targeting first-generation diasporas or the second one may lead to different outcomes. As noted earlier, anecdotal evidence suggests that first-generation diasporas are more likely to base their investment decisions on the basis of personal ties. By contrast, members of the second generation tend to have a stronger focus on supporting potentially successful businesses, with less consideration being given to personal ties, and they are more eager to rely on professionals and on formal mechanisms (rather than on traditional clan structures) to ensure that their funds are being well managed.[104] If these preferences are confirmed, a stronger engagement of diaspora members from later generations may mean a lower risk of channelling funds along identity lines.

The choice of the investment vehicle may also affect the distribution of benefits. As seen earlier, for instance, crowdlending schemes via online platforms are particularly prone to the risk of diaspora members channelling their support to entrepreneurs with whom they have connections.[105] This risk is even higher in a context like that of Somalia, where social lending is very widespread, and it is hard to mitigate given the inherently decentralized functioning of crowdlending. By contrast, channelling diaspora investment through pooled funds may severe the direct connection between investor and investee, thus reducing the likelihood that the decision of individual investors is based on personal ties.[106] On the other hand, however, this mechanism centralizes decision making under the fund manager's duties, requiring strong accountability

103 Hammond, L. et al. 2011, *Cash and Compassion*, op. cit., 49-50.

104 Multiple conversations with Somali businesspeople and diaspora members, June 2023.

105 Fonrouge, C. and Bolzani, D., 2019, 'Motivations and barriers to crowdlending as a tool for diasporic entrepreneurial finance', International Journal of Entrepreneurship and Innovation Management, 15.

106 Pooled funds gather financial contributions from two or more depositors in order to invest the accumulated sum, then redistributing the financial returns according to the share of funds provided by each contributor (Office for the Superintendent of Financial Institutions Canada, 2014, *Definition of "mutual fund" and "pooled fund"*).

mechanisms to ensure that the manager's decisions lead to an inclusive distribution of the investment's benefits.

While all these choices and their impact matter, it is crucial to keep in mind that, in conflict settings, perceptions of how benefits are distributed may matter more than the actual distribution. As noted in the earlier examples of the conflict in Lascanod, these perceptions can fuel narratives that become extremely widespread and end up fuelling tensions – often regardless of the amount of evidence that is available to back them up.[107] To mitigate this risk, it is crucial to ensure the highest degree of transparency concerning the mechanisms used to select beneficiaries. As part of this, complete and timely information about any relevant decisions should be provided by means of a broad, inclusive communication strategy.

Conclusions and recommendations

This policy brief has explored the extent to which diaspora investment can support economic development and livelihoods in the diaspora's country of origin, with a particular focus on fragile settings. The analysis has shown that increasing the share of diaspora finance channelled into productive investments can help to mobilize private capital in support of the SDGs, while also making it more attractive for diaspora members to commit money to their countries of origin by promising them a return on their investment. At the same time, however, the inflow of capital from the diaspora can have negative side effects. Most notably, if the investment is channelled along identity lines, it can exacerbate existing inequalities and tensions, undermining social cohesion and potentially leading to violent conflict – a very serious risk in fragile settings.

To explore the advantages and risks of diaspora investment more in detail, the brief has focused on the case of Somalia, whose diaspora is particularly large and economically active. In the Somali case, diaspora investment has a great development potential, most notably as a source of capital for high-potential SMEs that struggle to have access to finance through existing mechanisms. At the same time, however, the tight links between the world of business and that of politics in Somalia mean that these investments can have significant political repercussions. This is particularly the case because investment is often channelled along the very same identity lines (i.e. clan and sub-clan) through which politics and conflict tend to play out.

Donor governments have an interest in promoting diaspora investment as a tool for development, as it aligns with their efforts to leverage private capital in support of the SDGs, while also delivering benefits to diaspora-owned businesses based in their own country. At the same time, however, they should ensure that any effort to promote diaspora investment is designed in a way that maximises its benefits, while minimizing its risks – particularly in fragile settings, where such risks include an increase in violent conflicts. To this end, the brief offers some recommendations to policy makers in donor governments who are interested in supporting diaspora investment in Somalia and beyond.

1. Ensuring effectiveness: Improving the understanding of the beneficiaries' needs and preferences

To be effective, diaspora investment promotion efforts should adequately cater for the needs and preferences of its beneficiaries, i.e. potential investors in the diaspora and businesses within the country of origin. However, data in this regard is often lacking – not only in Somalia, but also in most other developing countries.[108] Therefore, before proceeding to the design and implementation of diaspora investment support programmes, donors should support a comprehensive data-gathering exercise, aimed at better understanding: (i) under which

107 Norman, J., 2023, 'Conflict in Las Anod and Crisis in Somaliland', DIIS Article, March.

108 Naujoks, D., 2022, 'A transnational research agenda on the determinants, policies, and impacts of diaspora direct investments', *Research in Globalization* 4 (2022), 3.

conditions (potential) investors in the diaspora would commit their money to their country of origin; (ii) how money from the diaspora can be used to benefit high-potential, finance-hungry businesses in the country of origin. Detailed, disaggregated data should be gathered, allowing for the identification of different profiles of investors and investees. This analysis, together with consultations with relevant stakeholders, could allow policy makers to target specific sub-groups of investors and investees, thereby maximizing the potential of their efforts.

2. Ensuring conflict sensitivity: Inclusive and transparent stakeholder engagement

If investments are perceived to benefit certain groups at the expense of others, they have the potential to stir up tensions and increase the likelihood of conflict. This risk is particularly high in Somalia, where both diaspora investments and conflict often play out along clan lines. However, it is not unique to the Somali context: investments always create winners and losers, and in fragile settings this can lead to contestation.[109] To mitigate the risk of fuelling tensions, donor governments willing to promote diaspora investment should be as inclusive and transparent as possible in their engagement with stakeholders, including in the selection of beneficiaries. To be politically sensitive, donors should be aware of the political economy context in which they operate, including the informal mechanisms that determine who benefits from investment inflows. Although achieving a completely equitable distribution of benefits is arguably impossible, it is still possible to be aware of how investments can fuel inequalities and tensions, and to explore creative strategies to mitigate such risks (for concrete examples, see the main text above).

3. Ensuring context-specificity: The need for conflict analysis

As noted above, the main advantages and risks associated with diaspora investment are not exclusive to Somalia, but can also be seen in other fragile settings. At the same time, however, the contribution of diaspora investment, as well as the nature and severity of its associated risks, will depend on the specific context of the country in question. Therefore, any programme aimed at promoting diaspora investment in a fragile setting should be based on an in-depth, context-specific analysis of conflict dynamics in the country of origin. Such analysis should explore the drivers of conflict, as well as the multiple ways in which inflows of money from the diaspora interact with these drivers. An understanding of these dynamics can allow policy makers and implementers to devise risk mitigation strategies that are suitable for the specific context at hand.

109 International Dialogue on Peacebuilding and Statebuilding, 2016, *How to Scale up Responsible Investment and Promote Sustainable Peace in Fragile Environments*.

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