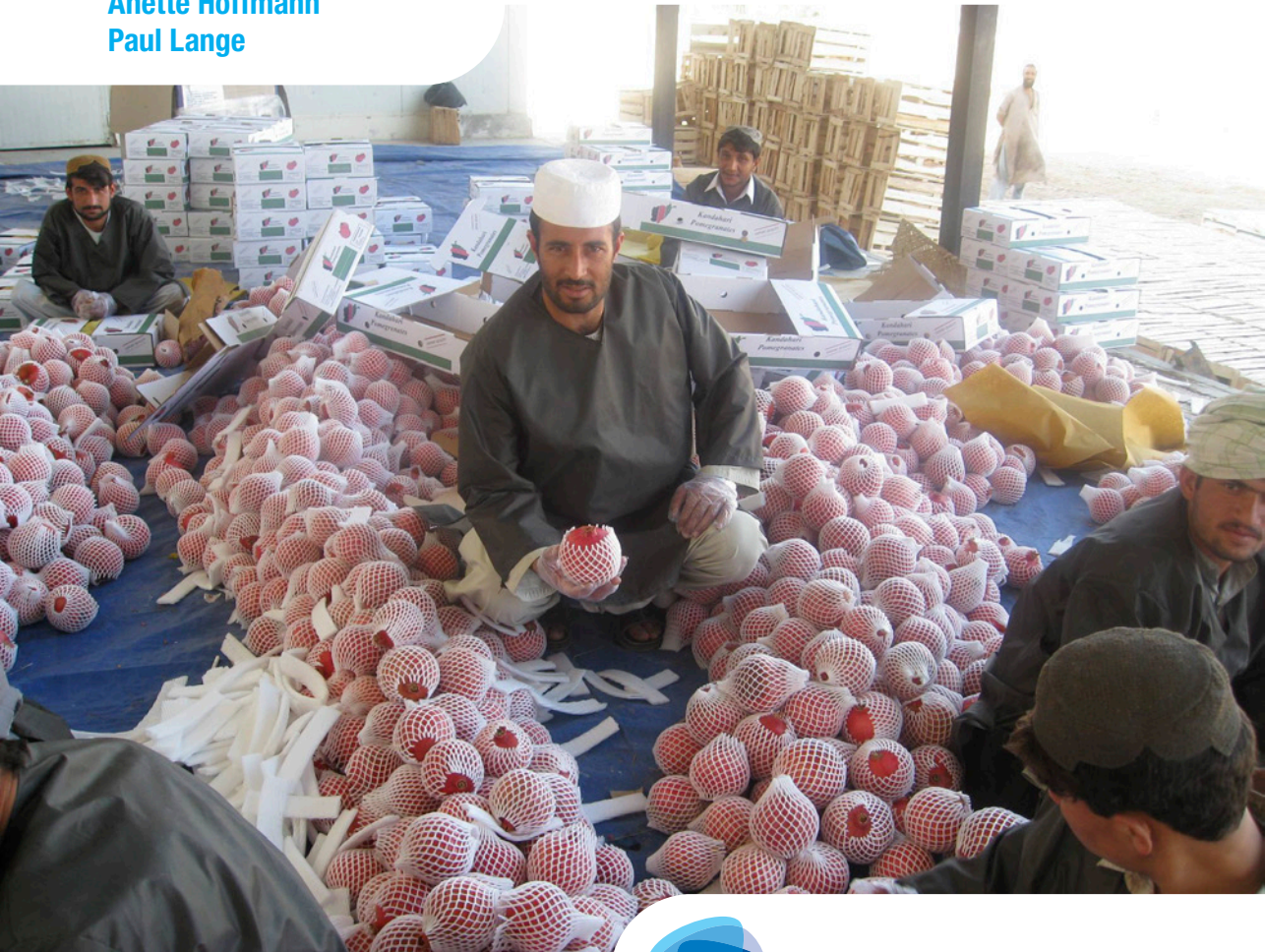


# Growing or Coping?

Evidence from small and medium sized enterprises in fragile settings

CRU Report

Anette Hoffmann  
Paul Lange



**Clingendael**

Netherlands Institute of International Relations



# Clingendael

Netherlands Institute of International Relations

## Growing or Coping?

Evidence from small and medium sized enterprises  
in fragile settings

Anette Hoffmann  
Paul Lange

CRU Report  
August 2016

## August 2016

© Netherlands Institute of International Relations 'Clingendael'.

Cover photo: AfghanEnterprise.com

Unauthorized use of any materials violates copyright, trademark and / or other laws. Should a user reproduce, distribute or display material from Clingendael publications or any other source for personal or non-commercial use, the user must retain all copyright, trademark or other similar notices contained in the original material on or any copies of the material.

Material may be reproduced or publicly displayed, distributed or used for any public and non-commercial purposes, but only by mentioning the Clingendael Institute as its source. Permission is required to use the logo of the Clingendael Institute. This can be obtained by contacting the Communication desk of the Clingendael Institute (press@clingendael.nl).

The following web link activities are prohibited by the Clingendael Institute and may present trademark and copyright infringement issues: links that involve unauthorized use of our logo, framing, inline links, or metatags, as well as hyperlinks or a form of link disguising the URL.


### About the authors


**Anette Hoffmann** is a Senior Research Fellow at the Conflict Research Unit of Clingendael. Her work at the CRU focuses on the interaction between economic and political drivers of conflict and fragility. She is particularly interested in ways private sector development can best contribute to peace building and conflict prevention.

**Paul Lange** used to work as a research assistant at the Conflict Research Unit of Clingendael. His work focused on job creation and socio-economic development in fragile and conflict-affected environments.

The Clingendael Institute  
P.O. Box 93080  
2509 AB The Hague  
The Netherlands

Follow us on social media

 @clingendael83

 The Clingendael Institute

Email: [cru-info@clingendael.nl](mailto:cru-info@clingendael.nl)

Website: <http://www.clingendael.nl/cru>

# Contents

Abstract	1
Acknowledgement	2
Executive summary	3
Introduction	6
Objective	6
Methodology	7
Structure of the report	8
1 International perspective on SMEs in fragile settings: the embeddedness of SMEs in social and governance fragility	9
1.1 Why SMEs matter for prosperity and peace	10
1.2 Limited understanding of fragile contexts in which SMEs operate	14
1.3 Looking beyond formal regulations and technical constraints	18
2 Evidence from SMEs coping and growing in fragile settings	24
2.1 SMEs' perceptions of conflict and fragility	26
2.2 SME constraints and their links to conflict and fragility	28
2.3 Business strategies: between coping and growing	41
3 Major findings and practical considerations for SME support in fragile settings	47
3.1 Major findings	49
3.2 Implications for policy, practice and research	53
References	61
Annex A: Characteristics of survey samples	65
Abbreviations	67

# Abstract

Interest in small businesses in fragile states has grown and is now large: Small and medium-sized enterprises (SMEs) are not only recognised for their ability to provide jobs, incomes and much-needed products and services in places where large or foreign businesses are scarce. The present focus on SMEs as a means to bring about development goes beyond their positive economic contribution and stresses their role in building social cohesion, fostering state legitimacy and restoring community security. However, the assumptions underpinning this policy discourse lack solid empirical evidence. The aim of this study therefore is to help fill that gap. Drawing on the experience from the Netherlands Private Sector Investment Programme for fragile states and based on interviews with 50 entrepreneurs of small firms in Afghanistan, Pakistan, the Democratic Republic of Congo, Sierra Leone and South Sudan this report presents firsthand evidence on how local entrepreneurs perceive, experience and deal with fragility.

A core finding of the study points to the fact that the success of many SMEs in fragile settings hinges on their ability to rely on personal and social networks as well as on arrangements with non-state governance actors (e.g. traditional leaders or insurgent groups) rather than on formal institutions. This inevitably affects the way these businesses foster or undermine social cohesion and state legitimacy. A second finding of this study is that, although equipped and eager to grow, many SMEs operating in places of insecurity and high risk deliberately deploy coping strategies rather than realising their growth potential. A third finding combines elements of the two earlier conclusions: If the structural drivers of business constraints in fragile contexts are ignored and eventually reinforced by conventional donor interventions, the latter risk reproducing and solidifying the very same structures that cause long-term instability and preclude firms from shifting from a focus on short-term resilience to longer-term growth strategies.

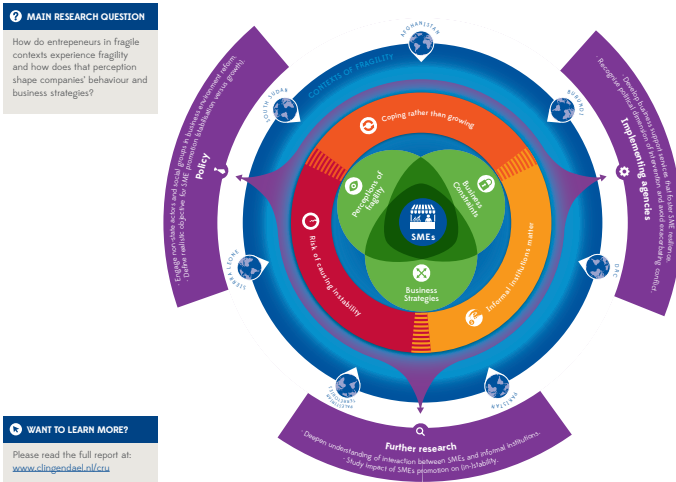
Discussing these findings the study proposes critical elements for SME support strategies that strive to assist SMEs with running their businesses despite insecurity and risks while strengthening their broader stabilising effects.

# Acknowledgement

This research project draws on two sets of data, collected by the Rijksdienst voor Ondernemend Nederland (RVO) and OnFrontiers. We are grateful for both partners' flexibility and readiness to accommodate and handle qualitative research questions that fall outside the more commonly used SME surveys. RVO staff not only shared their own data and valuable information to broaden the research's evidence base, they also dedicated time to reflect upon their experience with the implementation of the Netherlands funded Private Sector Investment programme in ten fragile states and discussed the findings of the present analysis with the aim to distil considerations for future SME support practices. Martijn Moonen, RVO's fragile states coordinator, has been an invaluable guarantor of that cooperation. His firm conviction of the relevance of the research questions and his sedulous commitment to improve RVO's work in the most challenging environments made him act as a tough sounding board throughout the process that led to this report.

The research further draws on primary data gathered by the consultancy firm OnFrontiers. With a well-established network of entrepreneurs and experts on the ground, their team proved very apt at translating the mostly qualitative research questions into the reality of local SMEs. We are indebted to both organisations and to all these entrepreneurs who made time available in support of the research that underpins this report. Clingendael colleagues Steven Schoofs, Grégory Chauzal and Rosan Smits provided helpful comments and quality assurance. Finally, thanks for copy-editing go to Frances Ellery and for typesetting to Textcetera. The contents of this study remain the responsibility of the authors.

# Executive summary



As an engine of growth, jobs and social cohesion, small and medium-sized enterprises (SMEs) receive increasing attention in international policy circles on conflict and development. However, while high on the political agenda, surprisingly little is known about how entrepreneurs themselves experience fragility and how that perception shapes companies' behaviour and business strategies. This lack of understanding is likely to explain to a significant extent both the persisting shortage of SMEs support and the limited success of SME promotion strategies to date.

The aim of this study is to shed some light onto the ways in which SMEs experience fragility and how they choose to deal with the challenges at hand. It draws on the Netherlands Enterprise Agency's experience in working with more than 100 SMEs in 10 fragile states, combined with the insights of 48 entrepreneurs and 10 local advisers in Afghanistan, Pakistan, the Democratic Republic of Congo, Sierra Leone and South Sudan. The research findings challenge conventional approaches to SME promotion and stress some core elements that deserve further attention in future research, policy making and programming in the field of SME promotion in the context of fragility.

The core finding of this study confirms an emerging argument in recent literature emphasising the influential role of informal institutions on both business constraints and behaviour. In the absence of functioning or legitimate state institutions and the prevalence of high levels of mistrust – settings that are typically referred to as “fragile

environments” – business success hinges to a significant degree on personal and social networks (e.g. family ties or membership of identity groups) as well as on arrangements with non-state governance actors (e.g. traditional leaders or insurgent groups). Such informal arrangements are found to be closely entangled with formal structures. As a result, the readiness to hire employees based on their social background rather than (solely) on experience and merit and the willingness to pay informal protection fees to rebels and government officials largely determine whether an entrepreneur is able to obtain and retain his or her licence to operate, source inputs, secure assets and access markets.

These informal institutional factors are not, however, captured by the widely used Doing Business reports and enterprise surveys. The latter essentially focus on technical constraints, such as access to electricity or finance, which this study unmask as mere symptoms of deeply entrenched informal arrangements. Access is rarely guaranteed on the basis of formal rules, but rather negotiated on the basis of personal connections or traded in exchange for loyalty or informal fees offered to non-state power holders or government officials.

A second finding of this study is that, although equipped and eager to grow, many SMEs operating in places of insecurity and high risk deliberately deploy coping strategies rather than realising their growth ambitions. This allows them to operate below the radar, minimise exposure to risks and circumvent relations of mistrust. As such, these commonly found coping strategies are likely to differ from the promising investment plan that typically makes an SME qualify as a beneficiary of commercially driven SME support programmes.

A third finding combines elements of the two earlier conclusions: If the structural drivers of business constraints in fragile contexts tend to be ignored and eventually reinforced by conventional donor interventions, these latter bear the risk of reproducing and solidifying the very same structures that cause long-term instability and prevent firms from shifting from a focus on short-term resilience to longer-term growth strategies. At the same time, these findings also suggest that changing existing arrangements in favour of more transparent and inclusive strategies (be it in employment strategies or payment of informal fees) will imply a rupture with the current networks of patronage and inevitably provoke some instability.

Drawing on these findings, the report offers some considerations with a view to translating the insights of local entrepreneurs into more conflict-sensitive SME support strategies for fragile settings. In terms of research, there is a need to: i) explore the multiple ways in which social networks and non-state governance structures have taken on tasks of missing or malfunctioning state structures that now help or hinder SME development; ii) analyse past experience, in which efforts to enhance productivity and expansion of small businesses have yielded limited results and sometimes even



exacerbated tensions; iii) and identify promising entry points for *de facto* business environment reform by studying patterns of SMEs' reliance and dependency on powerful elite coalitions.

Policy makers in turn will be better equipped to design suitable SME development policies for fragile states if they: i) complement the Doing Business reports and enterprise surveys with political economy analysis as a basis for agenda setting; ii) differentiate between growth and stabilisation objectives and define their target group and strategies accordingly; and iii) embed SME promotion into broader business environment reform that includes non-state actors.

Lastly, the findings of this study suggest that implementing agencies would be well advised to: i) pay particular attention to the role of social networks and non-state actors in their selection, appraisal and implementation procedures; ii) develop tools for SMEs that might not be able to grow in the short term, but that would benefit from support in order to survive and build resilience in the communities in which they operate; and iii) offer technical assistance to encourage conflict-sensitive business operations.

# Introduction

Doing business in a place of insecurity and socio-political complexity takes more than a capable entrepreneur with a sound business plan. Managing competing political interests, prevailing mistrust and persistent unpredictability requires a great deal of sensitivity, adaptability and compromise. For many local entrepreneurs the decision to start or continue operating in such circumstances is a matter of necessity rather than choice. Both foreign and domestic business owners have to cope with high risks without the risk insurance services that entrepreneurs routinely enjoy in non-fragile places. A thorough understanding of the nature and underlying causes of fragility and risk will therefore help entrepreneurs and respective support programmes to anticipate, mitigate or manage multiple uncertainties more effectively.

Successful business strategies that allow a small Afghan logistics company in the Eastern province of the country, a restaurant owner in Juba or a domestic livestock farmer in the Democratic Republic of Congo (DRC) to sustain operations despite daunting insecurity may seem inefficient from a purely economic stance. Only when placing the firm in its broader institutional and societal context does it become clear why certain ostensibly less efficient or even growth-adverse measures are in fact the prerequisites of survival and growth.

Looking beyond the economic factors and taking account of the political and social embeddedness of small and medium-sized enterprises (SMEs) is therefore critical for the success of interventions aimed at supporting foreign and domestic firms, particularly in fragile environments, where formal rules are weak and markets distorted. Yet, thus far, surprisingly little is known about the ways in which SMEs do business and have to interact with their broader socio-political context if they are to pursue operations.

## Objective

This research project seeks to raise awareness of the embeddedness of SMEs in socially and politically complex environments. It reveals how smaller businesses struggle with the multiple effects of insecurity, social and governance fragility, and which strategies they deploy to cope with those challenges. The ambition of the research project was to go beyond the commonly adopted focus on technical constraints and to better understand these more readily measurable obstacles by placing them in a broader socio-political and economic context in order to unravel the underpinning, though less readily measurable, drivers and incentives.

## Methodology

The study draws on desk research and on two sets of primary data. It further applies both quantitative and qualitative research methods, with a strong emphasis on qualitative data and analysis. One set of evidence draws on a close collaboration with the Netherlands enterprise agency, Rijksdienst voor Ondernemend Nederland, referred to in the report as 'RVO'. This agency is part of the Netherlands Ministry of Economic Affairs and provides financial and technical support to incentivise (Dutch and non-Dutch) entrepreneurs to undertake sustainable and innovative business worldwide.<sup>1</sup> RVO was in charge of implementing a Private Sector Investment programme (PSI plus) that was specifically designed for investments in fragile states and aimed at achieving transfers of technology and knowledge, and positive spin-off effects for local economies.<sup>2</sup> As such the programme has generated solid experience with regard to the challenges and opportunities small firms face in those environments.<sup>3</sup> For the purpose of this study it offered relevant insights from approximately 125 SMEs in 10 fragile states, including Mali, Burundi, DRC, Sierra Leone, South Sudan, Afghanistan, Pakistan, Palestine and Yemen.<sup>4</sup>

In order to tap into the experience of the PSI+ programme, country fund managers who have been selecting and accompanying eligible entrepreneurs and their partners over the past five years were consulted. Besides sharing their own perceptions and anecdotes on the links between conflict, fragility and SMEs in a workshop organised at the Clingendael Institute on 10 April 2014, RVO's 'fragile states' managers also conducted interviews with some of their clients and respective local partner businesses, whose views are reflected in the analysis. In addition, RVO provided the research team with a random selection of written security risk assessments extracted from the regular application forms submitted by PSI+ applicants.

To complement and triangulate this source of information, the consultancy firm OnFrontiers, which specialises in collecting investment-relevant data in conflict-affected

---

1 For more information see RVO's website: <https://english.rvo.nl/>

2 The contribution to a project in one of the currently 7 PSI Plus countries is 60 percent of the project budget, with a maximum contribution of EUR 1,5 million in 2013 and EUR 900,000 in 2014.

3 Under the PSI+ programme local and foreign companies investing together in a fragile state were offered a grant covering 60% of total investment costs plus extra facilities for risk management and the possibility of subsidised insurance for. Technical details can be found in the brochure by NL Agency (2013), PSI in practice: From Idea to Result.

4 By now this list of fragile states has been expanded to all 18 low-income countries featuring on the World Bank's fragile states and situations list. The resulting list RVO uses for the implementation the DGGF can be found at: <http://www.rvo.nl/sites/default/files/2014/12/landenlijst%20Dutch%20Good%20Growth&20Fund.pdf>

countries, was hired to conduct a survey of SMEs in five countries, covering a total of 50 SMEs and 10 locally-based experts.<sup>5</sup> The findings of this survey constitute the second set of primary data.

It is important to stress that the findings of this research project lean primarily on the responses and opinions of entrepreneurs, and that the views and opinions of interviewed advisers and RVO officers were used to better understand the contexts in which entrepreneurs were found to operate. We therefore refrained from applying an ex ante chosen definition of fragility and conflict, and combined multiple-choice questions with open questions.

The focus on entrepreneurs' own perspectives and the combination of quantitative and qualitative data through semi-structured interviews distinguishes the supporting evidence of this report from most conventional surveys, notably the World Bank's Doing Business reports, which essentially rely on the assessment of local experts well acquainted with the formal rules and regulations, but less familiar with the daily struggles of SMEs that either circumvent or suffer from the inefficient enforcement of those regulations.<sup>6</sup>

## Structure of the report

Chapter 1 of this report summarises the current discussion on the role SMEs are commonly perceived to play in post-conflict and fragile societies and sheds some light on the institutional complexity that entrepreneurs typically face in fragile contexts. Chapter 2 presents the major findings of the two SME surveys conducted by RVO country managers and OnFrontiers from June to September 2014. It also includes a qualitative analysis of business constraints as well as business strategies. Chapter 3 considers the empirical findings in the light of earlier reflections on the role of SMEs in complex institutional settings. Chapter 4 analyses the implications for policy, practice and research, and offers practical considerations for future SME support in fragile contexts.

---

5 More details on the type of countries, sectors and enterprises covered in both sets of evidence and the background of advisers are presented in Annex A.

6 A limitation recently brought forward by Kaplan (2013) and the Dutch NGO Spark (2014).

# 1 International perspective on SMEs in fragile settings: the embeddedness of SMEs in social and governance fragility

## Summary

- As an engine of growth, jobs and social cohesion, SMEs are receiving increasing attention in the international policy discourse on conflict and development for their potential to foster prosperity and peace.
- Yet SMEs continue to be underserved in terms of financial and technical support, and to date, SME support has yielded mixed results.
- This is likely to be due, at least in part, to a limited understanding of SMEs' embeddedness in the informal and formal institutional context. Indeed, the reality for SMEs in developing countries is primarily understood in terms of business constraints and weak statehood or governance failure.
- However, particularly in fragile societies, small businesses greatly depend on i) their personal connections and social relations and ii) their allegiance to challenger authorities or alternative governance mechanisms offered by non-state actors.
- These dimensions are not captured by conventional business surveys such as the World Bank's Doing Business reports and SME surveys.
- In turn, modern thinking on institutional economics has significantly contributed to a better understanding of markets and economic activity in contexts where formal institutions are weak and where, instead, social relations, power and trust determine the rules of the game.
- These insights can deepen our understanding of the reality small businesses face when operating in fragile settings. In particular, the role of social relations, personal connections and competing systems of power appear to be critical concepts to elucidate the underlying, often structural, causes of technical constraints.

Where state capacity is weak, international attention is increasingly turning to the private sector as an entry point for stabilisation and peace building. Among the diverse range of businesses in fragile settings, encompassing multinational corporations as well as informal street vendors, local SMEs have attracted particular interest from the donor

community and their development partners for the prominent role they can play in post-conflict recovery and in helping fragile economies to transition towards more resilient societies.

And yet, SMEs' perception of and experience within the broader ecosystem, and the actions they undertake to survive and expand in spite of all the risks, remain under-researched. Only very recent literature hints at the need to understand the interdependence of complex formal and informal institutional arrangements in order to design more effective support strategies for SMEs in fragile settings. Both the perceived relevance of SME development for prosperity and peace, and our limited understanding of the multiple ways in which firms interact with the broader conflict-affected environment, are the topics of the following sections. As such, they prepare the ground for the introduction of two analytical lenses that will be applied to the survey data.

## 1.1 Why SMEs matter for prosperity and peace

Most fragile states are SME economies.<sup>7</sup> They rely heavily on these types of firms for both high growth rates and the employment they provide for a significant part of the population. Indeed, it is estimated that the vast majority of all formerly registered companies in these markets are SMEs.<sup>8</sup> Contrary to previous beliefs, local firms continue to operate in the midst of war and insecurity, when larger – notably foreign and more riskaverse companies, other than resource-extracting companies (Kolk and Lenfant, 2012) – typically decide to relocate or leave the country.

### a) Early economic recovery and mitigating economic causes of conflict

Based on this reality, domestic firms are increasingly credited with the potential to play a critical role in economic recovery (Naude, 2007; MacSweeney/Naoise, 2008; De Vries/Specker, 2009; UNDP, 2013). First, through the provision of jobs, income, much-needed products and services and infrastructure, they not only provide people in need with a livelihood, they also instigate a sense of security and confidence that can attract larger and foreign direct investment (WB, 2014: v). SMEs are further said to prove more flexible in adapting to volatile circumstances, utilising “opportunities that larger firms, including state-owned enterprises and multinational firms, cannot take” (Naude, 2007: 25). Consequently, humanitarian and development organisations increasingly display efforts to not distort local markets (by importing goods and services that are available locally or

---

7 Hellman, J. in his presentation at the Donor Forum 2012, session 3 'Working together in fragile and conflict-affected situations', 15/16 May, 2012 in Paris. (Slide 6).

8 World Bank (2014), *The Big Business of Small Enterprises: Evaluation of the World Bank Group Experience with Targeted Support to Small and Medium-Size Enterprises, 2006-12*. Washington, DC: World Bank.

by subsidising new businesses), but to engage and strengthen them in their relief and recovery efforts as much as possible (UN 2009; UNDP 2013).

Second, by creating employment and income for a significant share of the local population, estimated by McKinsey to amount to over 50% in emerging markets,<sup>9</sup> SMEs are appreciated for their potential to mitigate causes of conflict. This is believed to happen through two channels. The first channel has been widely propagated through the World Development Report 2011: According to surveys conducted in preparation of the report in areas affected by violence, unemployment and under-employment were highlighted as the most important factors motivating youths to join rebel movements, thereby increasing the risk of violence (WB, 2011: 79, WB, 2010). This correlation, albeit not based on empirical evidence but posteriori perceptions (Collier, 2010: 25), has become a standard argument across various policy domains. Whether in the domain of economic development or state- and peacebuilding, strategies to promote youth employment as a means of conflict prevention are flourishing in the policies of bilateral donors and multilateral development organisations (OECD/DAC, 2011: 72).<sup>10</sup> As a particular facet of youth unemployment, the challenge of reintegrating ex-combatants into productive (self-) employment and preventing them from returning to fighting has received particular interest (UN, 2009; Peschke, 2011: 9).

Whereas a causal relationship between (youth) employment creation and a decrease of conflict remains a contentious issue (Holmes, 2013; Walton, 2011), the potential of SMEs to provide more jobs than larger firms is increasingly recognised, including by actors such as the International Finance Corporation (IFC), which mainly target larger enterprises and banks: “SMEs can have a higher impact on job creation than larger firms when they get access to financing, since they tend to be more labor intensive.” (IFC, 2013: 88) In fact, compared with larger businesses, SMEs have been appreciated for their ability to accommodate workers in places where larger-scale investment is unlikely to become a more common reality.

A more solid correlation links SME development to economic growth and poverty reduction, which in turn positively correlates with a lower risk for conflict. Considering that inequality between identity groups increases the likelihood of violent confrontation,<sup>11</sup> it is further argued that micro, small and medium-sized firms have the greatest potential to generate broad-based and inclusive growth, from which the

---

9 IFC and McKinsey & Company, *Two trillion and counting*, Oct 2010.

10 In the Dutch policy context, corresponding policy arguments can be found in the policy letter Entrepreneurship for Development (2013: 18), as well as in the Security and the Rule of Law spearhead letter of 2012 (p. 8).

11 Identity groups may be defined by ethnic or political affiliation, gender, geography or age. For a detailed analysis of the link between horizontal inequality and the propensity of conflict see Stewart et al. (2006).

majority of the population benefit (UNDP, 2013: 68; Keele/Lofbom 2013: 4). Conversely, as the backbone of most emerging economies, a neglect or further weakening of local SMEs (for instance by unfair competition through the large-scale import and free-of-charge distribution of development supplies) can, in turn, reinforce state fragility (OECD/DAC, 2011: 73; UN, 2019: 15; UNDP, 2013: 35, 38, 56, 72).

In light of this strong potential for economic recovery, development agents call for greater engagement with and support for domestic SMEs in contexts plagued by conflict and fragility, be it in the form of development agencies sourcing more systematically from local SMEs, or international companies investing into local supply and distribution chains, or in supporting SMEs in their own right, for the sake of reviving the local economy.

#### **b) SME's broader state- and peacebuilding potential**

The recent appreciation of SMEs in fragile settings goes beyond their positive economic contribution. A growing body of literature and policy documents advocates the multiple non-economic ways through which these firms can contribute to broader state and peacebuilding goals. In fact, SMEs are believed to have great potential as a critical ingredient for social cohesion, state legitimacy and community security.

The World Development Report (WDR) 2011 on *Conflict, Security and Development* and its more recent successor on *Jobs* (WDR 2013) emphasise the positive effects that employment can have on the self-esteem of an individual and his/her position in society. For example, jobs for men are often found to relate to a decrease in sexual violence against women, whereas jobs for women are in some instances correlated with an increase in physical aggression towards women if not promoted in a way that is sensitive to existing norms around women and manhood (UNDP and UNDDR, 2012: 51 ff., 61 ff.). Similarly, employment opportunities for youth, including ex-combatants, can provide young adolescents with a better perspective, provided the older generation is involved in and benefits from the process in order to overcome inter-generational conflict that often lies at the root of youth marginalisation. Hence, gender sensitivity and generational responsiveness are key for successfully linking employment to stability (Kessler, 2013: 8).

The collaboration of SMEs, be it along a value chain or within a cluster, can be instrumental in rebuilding trust and initiate a process of reconciliation between adverse groups at community and regional levels. A quantitative study of local entrepreneurs in the Rwandan coffee sector proved a significant correlation between economic advancement and increased intergroup interaction, which in turn reportedly resulted in



a more positive attitude towards intergroup reconciliation (Tobias/Boudreaux, 2009: 2).<sup>12</sup> Overall, these social effects of SME development are understood as critical foundations for rebuilding the social fabric of conflict-affected and fragile societies (WDR 2011: 30 ff.).

It is further argued that local SMEs are usually more interested in making a difference in peacebuilding than large companies as they suffer much more from conflict (International Alert, 2007). In that sense, local SMEs are also seen as a critical partner in “establishing a shared understanding of statebuilding reforms and priorities as they evolve” (OECD/DAC, 2011: 62). In contrast to micro businesses that are more likely than SMEs to operate outside formal regulation and largely rely on unpaid family labour, local SMEs can help restore state legitimacy by (eventually) paying taxes, thereby expanding the revenue base that in theory enables a government to provide better services to its citizens (Peschke, 2011: 10). Finally, local businesses can help address key security concerns by functioning as early-warning systems on potential security breakdowns at community level. (International Alert, 2006: 7).

While these various arguments linking SME development to improved stability are still to be thoroughly tested and substantiated with evidence (Brueck et al., 2015), the purpose of summarising them here is to demonstrate that the current donor discourse on conflict and development emphasises the non-economic, socio-political dimensions of businesses. However, as will be shown later in this report, the socio-political nature and role of small firms as displayed in donors’ ambitious peace and development narratives stands in stark contrast with the essentially economically defined financial and technical assistance strategies deployed to support those businesses in what tend to be socially complex and often highly politicised societies.

### c) Nevertheless SMEs remain under-served: the missing middle

Despite the well-established recognition of the economic and socio-political roles that SMEs can play in rebuilding conflict-affected societies, this particular segment continues to be under-served.<sup>13</sup> While local banks are reluctant to offer SMEs access to long-term capital and prefer to serve larger enterprises that have collateral, NGOs cater almost exclusively for micro businesses.<sup>14</sup> As a consequence, the SME segment

---

12 For a comprehensive list of literature exploring the links between private sector development and peacebuilding, see, for example, the informative website of the Donor Committee for Enterprise Development: <https://www.enterprise-development.org>

13 According to a recent IFC publication, 55-68% of formal SMEs in developing economies are unserved or underserved, with 35-43% of formal SMEs being unserved and 20-25% underserved. Women-owned firms are particularly affected. (<http://www.ifc.org/wps/wcm/connect/1f2c968041689903950bb79e78015671/AccessCreditMSME-Brochure-Final.pdf?MOD=AJPERES>).

14 Ibid.

has come to be referred to as the ‘missing middle’.<sup>15</sup> Evidence suggests that the kind of support that does exist for SME development has yielded limited success, both in terms of firm productivity and job creation (Grimm and Pfaffhausen, 2014).

Notwithstanding its potential positive contribution to state and peacebuilding, research on SMEs in fragile settings is still in its infancy (Tobias/Boudreauw, 2009: 1). Guglielmetti (2010) rightly observes that the growing body of research on the positive effects of entrepreneurship on development and peace has to a large extent neglected the multiple (and two-directional) interactions between enterprises/entrepreneurship and the institutional environment, including the ambiguous role that firms can play in those contexts (Guglielmetti 2010: 1). However, solid corroboration of the peacebuilding potential, particularly of the political and social impact channels, will require a more thorough understanding of SMEs’ embeddedness in the broader political, social and economic context. Before exploring this apparent gap further, we first turn to what we know about SMEs in fragile settings.

## **1.2 Limited understanding of fragile contexts in which SMEs operate**

To date, our knowledge of the reality that SMEs face in fragile settings has been largely shaped in terms of obstacles and weak state capacity. To explain the poor performance of SMEs in developing contexts in general and in fragile contexts in particular, current research either refers to the type of markets most SMEs operate in and that are characterised by low access and saturation (Altenburg and Eckhardt, 2006) or to the lack of education and skills upgrading that prevents economies from transforming into more capital-intensive manufacturing industries (Golub and Hayat, 2014; Basnett and Sen, 2013). Others point to the particularly unfavourable investment climate in, for example, sub-Saharan African countries (Golub and Hayat, 2014), which would explain 40% of the difference between firm sizes in Africa and the rest of the world (Iavone et al., 2013).

Most of these economically focused studies draw on the conventional business environment standards and tools used to measure the conduciveness of the business climate. Indeed, conventional enterprise surveys and business environment reports aim to detect, quantify and rank the main bottlenecks enterprises face in order to promote

---

15 As Skyler Fernandez and Sene rightly observe, the phrase has been used relatively loosely in economic development discussions: “For some, the term has meant ‘a lack of SMEs in the developing world’. For others, the term has meant ‘the lack of investable capital targeted at funding SMEs’.”

reform towards a more conducive business environment and to develop effective enterprise support strategies.

**Box: The benefits and limitations of the World Bank's Doing Business Reports and enterprise surveys**

Among the most prominent and influential data sources used by academics and policy makers alike are the World Bank Group's annual Doing Business (DB) report and the World Bank enterprise surveys. Both are different but complementary approaches to benchmarking the quality of the business environment across countries.<sup>16</sup> The DB report is aimed at measuring the costs to firms of business regulations. The 2014 DB report covers 189 countries with Libya, Myanmar, San Marino and South Sudan included for the first time, among a total of 33 fragile countries or territories. As to the enterprise surveys, 22 of the 181 countries included are fragile and conflict-affected states (WB, 2013b: 17). By benchmarking the regulations that affect private sector firms, SMEs in particular, the DB report presents a detailed analysis of the costs, requirements and procedures that a specific type of private firm is subject to in all countries, and then, creates rankings for every country.

Whereas DB draws on a review of laws and regulations as well as interviews (an average of 39 surveys per economy) with local experts (e.g. accountants, lawyers), the enterprise surveys are answered by business owners and top managers of small, medium and large firms (between 200 and 1,500 interviews per country depending on the size of the economy). The enterprise surveys cover a broader range of business environment aspects, compared with only 11 business regulation topics measured by the DB. For example, the former include access to finance, corruption, infrastructure, crime, competition, and performance measures. Moreover, while the DB is based on standardised case studies (i.e. hypothetical scenarios illustrating how regulations affect firms), the enterprise surveys seek to capture the actual experience of firms in their attempt to comply with regulations.<sup>17</sup>

---

16 A comparative description of both tools can be found at: <http://www.enterprisesurveys.org/Methodology/Enterprise-Surveys-versus-Doing-Business>

17 *ibid.*

In 2014, the DB report for the first time also published a regional study for the g7+.<sup>18</sup> Of the 10 business regulation areas covered by the report, two relate to access to power and access to finance – the top two obstacles for firms operating in fragile and conflict-affected states according to enterprise surveys conducted by the World Bank (WB, 2014: v). Not surprisingly, among the 185 economies covered by DB, the g7+ economies feature at the lower end, with an average ranking of 160 on the ease of doing business. Entrepreneurs in these countries face both more complex regulatory processes and weaker legal institutions (p. 7). What may in turn surprise the reader is that sporadically individual fragile states score rather high on some of the indicators. If one takes the best score for each of the indicators measured among the g7+ members, as a group these fragile states would stand at 10 in the global ranking on the ease of doing business (p. 1), 82 places higher than their best-performing individual member, the Solomon Islands (ranked 92).<sup>19</sup>

The World Bank optimistically interprets this observation as an illustration of the fact that many g7+ economies have already implemented globally observed good practices in some areas of business regulation, further suggesting that the positive examples could inspire governments to take on bold regulatory reforms. However, the question is whether, rather than proof of progress, the fact that some fragile states score conspicuously high on certain indicators may also suggest that *de jure* legislation (and the assessment by local experts) in fragile states says little about the *de facto* realities that entrepreneurs face in those environments. While, officially, an entrepreneur in Burundi can start a business by completing four procedures in eight days and paying a price equivalent to 18% of income per capita with no minimum capital requirement, this does not tell us whether all Burundian would-be entrepreneurs actually enjoy these formal entitlements. In fact, as Stell (2012) reveals in the case of Lebanon, discrepancy between formal rules and actual practice tends to be significant in fragile states.<sup>20</sup>

---

18 The g7+ group is a country-owned and country-led global mechanism established in April 2010 to monitor, report and draw attention to the unique challenges faced by fragile states. The member countries included in the report are Afghanistan, Burundi, the Central African Republic, Chad, the Comoros, the DRC, Côte d'Ivoire, Guinea, Guinea-Bissau, Haiti, Liberia, Papua New Guinea, Sierra Leone, the Solomon Islands, South Sudan, Timor-Leste and Togo.

19 In this hypothetical g7+ economy, starting a business would take just six days (the same as in Liberia), registering a property for commercial use would cost 3.3% of the property value (as in Burundi), and exporting would require six documents (as in Timor-Leste).

20 Nora Stel offers a good illustration of this point by confronting the relatively high score of Lebanon in getting a electricity connection with the reality of Lebanese who face electricity shortages on a daily basis, despite the connection (Stel, 2012: 11).

Development programmes that conduct their own SME needs assessments have the clear advantage of a narrower geographical focus and the direct involvement of entrepreneurs in the assessment of business constraints (instead of solely focusing on the regulatory framework and relying on the assessment of experts). However, they usually come to similar conclusions, which may be explained by the use of predefined lists of obstacles that surveyed entrepreneurs are then asked to choose from.<sup>21</sup>

Based on those assessments, governments and their development partners have developed support strategies that essentially focus on two levels: removing institutional barriers to entry (macro level) and providing financial and technical assistance to firms aimed at removing (some of) these barriers (micro level). In fact, business environment reform, as well as subsidies, loans and technical assistance to business development service networks can be instrumental in helping local businesses gain access to services necessary for them to expand and unleash their development potential (UN, 2009: 37, UNDP, 2013: 66).

However big the influence of the DB reports in promoting and guiding developing countries' reforms and attracting (or repelling) potential investment, criticism persists that goes beyond the methodology used and this has been substantiated in recent years. One criticism is that the reports struggle to capture obstacles such as social divisions, and the incompetence and various forms of corruption that infest government bodies (Kaplan, 2013). Spark, in turn (2014) highlights the limited focus on specific obstacles that often prevent young and female entrepreneurs in fragile states from starting or growing a business (SPARK, 2014: 2). According to Spark's own survey, conflict-related concerns include: i) dealing with the tax administration; ii) paying additional fees (bribery); and iii) obtaining permits (Spark 2014: 13). More generally, Spark expresses surprise that "these more conflict sensitive matters" are currently not being measured by the WB's business barriers studies. In fact, although the WB's enterprise surveys, the complementary matching part of the DB report, refer to corruption and bribery, their restrained definition of crime and corruption leaves out a wide range of corruption practices that often determine the survival of local firms.

Another criticism emerges from the growing awareness of the influence that the institutional context has on private enterprise development. Guglielmetti (2010), for example, argues that as long as the specific characteristics of emerging economies in fragile situations with their atypical informal and formal institutions are not understood, policies will fail to provide effective support to SME development in fragile situations: "The

---

21 The recurrence of similar responses in these types of surveys may partly be the result of entrepreneurs' knowledge of the kind of support they can and cannot expect from the agency commissioning the survey. Realistic expectations regarding future support interventions may guide the answers more than their most urgent needs and challenges. See for example recent studies such as Spark (2014) or Goodwell (2013).

context in which economic agents act varies in terms of opportunities, constraints and incentives, and exerts a strong influence on individual behaviour” (Guglielmetti, 2010: 2).

In addition to the two types of criticism summarised above, two major blind spots emerge. By assessing the business environment through the lens of predefined categories of government regulation and with a focus on commonly found bottlenecks to business creation and growth, the way in which SMEs interact with their ecosystems cannot be understood in its complexity. First, the tools fall short of understanding the multiple ways in which SMEs not only experience but also actively tackle the challenges and opportunities they face. Through their agency, businesses, small though they may be, do influence the institutional settings – both formal and informal – in which they operate and hope to thrive. Predefining certain practices as obstacles (e.g. corruption: WB 2014: 2) may prevent us from understanding them as part of a deeply embedded coping mechanism, second-best in nature, but better suited to the fragile realities than the textbook recipes designed for functioning markets. Addressing corruption solely as an ill is likely to carry its own risks of destabilising informal arrangements, which, at least in the short term, allow businesses to survive or even prosper.

This brings us to the second blind spot: state-centrism. The World Bank and most donors recognise that the state has to play a critical role in creating an enabling business environment, i.e. by defining and enforcing the rules and regulations that will ease strong private sector-led economic growth (WB 2014: 2). However, in situations where state authority is weak or contested, formal institutions and enforcement mechanisms, if they exist, are typically either by-passed or co-opted by competing authorities, including non-state armed groups. As a result, the ecosystem in which SMEs operate in fragile contexts is often shaped by highly personalised or informal institutions rather than by formal rules and regulations, which might exist alongside. In those environments, personal connections and alignment with the interests of powerful elites are likely to determine the success or failure of small businesses.

This report sheds some light on both blind spots, based on the findings that will be presented in the next chapter and that stem directly from SMEs’ perceptions of the risks they face and the strategies they believe to be best suited to confronting and ideally mitigating these risks. But before turning to that, we will further define what is missing in our present knowledge of SMEs in fragile settings and what it is we would need to know in order to come up with more effective policies. With these questions in mind, the following section will develop a framework for the analysis of our survey findings.

### **1.3 Looking beyond formal regulations and technical constraints**

There is a fast-growing body of political economy literature that explores the interaction between political and economic processes and grapples with the distribution of power

and wealth between different groups and individuals and the incentives and processes that create, sustain and transform these relationships over time. Political economy has proved a valuable tool in assessing why institutional settings serve personal interests rather than the public cause (Corduneanu-Huci, 2013: 2). For example, recent research in the fields of *Institutionalist Political Economy* (Chang, 2011) and *Economic Sociology* (drawing on theories of embeddedness) go beyond the narrow notions of efficiency and rationality, and give more weight to the influence of history, culture and power on institutions and economic activity, stressing the non-economic forces in institutional processes and markets. In this sense, modern thinking on institutional economics, particularly institutionalist political economy, has highlighted the limitations of neoclassical theory, on which much of the old institutional economics relies.<sup>22</sup>

Furthermore, the recent institutional debate has contributed greatly to a better understanding of markets and economic activity in contexts where formal institutions are weak. In these environments, markets are found to be highly fragmented and exclusive, with strong power distortions and informal institutions prevailing (Ritchie, 2014: 4, 69).

Indeed, social relations, power and trust – rather than formal institutions – determine “the rules of the game”. Membership of a certain identity group, power over a given resource, or loyalty to a dominant elite faction<sup>23</sup> decide whether an entrepreneur can obtain a business licence in a reasonable number of days. As shown above, there is increasing recognition that conventional business environment indicators fall short of capturing those informal determinants. They merely measure the symptoms of more structural and political dynamics (Gugliemetti, 2010; Stel, 2012; Kaplan, 2013; Spark 2014).

When state institutions fail to provide basic services such as security and livelihoods, entrepreneurs (just like all ordinary people) have to rely on (or turn to) alternative service providers. These tend to be highly personalised, exclusive and may claim payment for their services through violent means (Wood, 2003). Understanding these informal arrangements, social relations, systems of trust and power is critical in order to effectively target and design strategies that will strengthen SMEs’ ability to grow in a conflict-sensitive and sustainable manner.

---

22 Key concepts of neoclassical thinking include individual rationality, choice theory, maximisation of utility, and economic efficiency.

23 Recent World Bank studies offer quantitative data to underpin this phenomenon. They demonstrate how politically well-connected firms in the Middle East and North Africa shape the enabling environment resulting in jobs for some and not for others. See for example: Rijkers et al.: *All in the family – State Capture in Tunisia* (2014) and Schiffbauer, M. et al.: *Jobs and Privileges – Unleashing the Employment Potential of the Middle East and North Africa* (2015).

The present paper seeks to draw attention to this gap between current understanding of SMEs in fragile settings and recent thinking on the interdependence of complex institutional arrangements and markets by presenting empirical evidence. Placing ourselves in the shoes of entrepreneurs, we aim to shed some light on how they perceive and react to environments that donors have come to consider fragile. Mindful, on the one hand, of the earlier identified blind spots (focus on technical bottlenecks and state centrism) and, on the other hand, the impact channels through which policy increasingly expects SMEs to contribute to inclusive development and peace (e.g. through social cohesion, security perceptions and state legitimacy) the findings of two enterprise surveys will be analysed through two lenses. They are of course interrelated, but highlight two different perspectives that have received little attention in analyses of enterprise development in fragile states to date, notably in economists' circles: a) personal connections, social networks and trust and b) competing systems of power and governance. These will be used to analyse the perceptions obtained from SMEs.

#### a) Personal connections, social networks and trust

Trust is considered critical for economic transaction. It is both “an outcome and an antecedent of economic activity” (Ritchie, 2014: 71). On the one hand the hiring of labour, sourcing from suppliers and selling to customers requires a minimum level of trust between actors. On the other hand, this interaction, particularly if it grows from a one-off cooperation to a more regular relationship, creates and fosters confidence.

While literature emerging around the concept of social cohesion points to business development and job creation as compelling means of trust building within and between communities,<sup>24</sup> conspicuously fewer efforts have been made to understand the kind and scope of social relations or social capital that underpin economic exchange in markets plagued by high risk and mistrust.<sup>25</sup> In fact, in those environments markets tend to be dominated by family business and economic transactions confined to trusted members of the same identify group (Hellman, 2012; Ritchie, 2014: 70). Missing or dysfunctional institutions are substituted by personal relations between economic actors.

Even scarcer is the literature on the ways in which reliance on traditional social networks for doing business in fragile contexts tend to hamper growth and prevent competitive behaviour. Where formal institutions are weak and social, cultural and political affiliation determines access to and scope of participation in market, the performance of insiders is likely to increase (Gugliemetti, 2010: 11). However, the exclusive character of these

---

24 For the benefits of job creation in terms of social cohesion see WDR 2011 and WDR 2013. For the potential of building inter-community trust, see literature on value chains in conflict-affected environments: Parker (2008), Dudwick and Srinivasan (2013).

25 With the earlier mentioned exception of Brueck/Naude/Verwimp and their special issue *Small Business, Entrepreneurship, and Violent Conflict in Developing Countries* of the *Journal of Small Business and Entrepreneurship*, Vol 24 No. 2 (2011) and Ritchie (2013).



networks, often grounded in ethnicity, family relations, history and religion, prevents broader participation in markets, thereby risking the reinforcement of existing patterns of marginalisation and horizontal inequality in access to assets, employment and income, all likely causes of conflict (Stewart, 2006; Biggs/Shah, 2006: 4-5).

More generally, confining economic activities to trusted business partners is likely to inhibit growth and innovation. Productivity and growth are hindered as long as hiring, sourcing and marketing strategies are based on allegiance to family and identify groups rather than on merit, quality and market demand. Innovation is unlikely to thrive based on exclusive reliance on well-known business partners and “static patterns of business exchange” (Biggs/Shah 2006: 36; Munshi, 2007: 2; Naude, 2011).

Despite their significant influence on economic growth in contexts of fragility, the inclusiveness (or degree of exclusion) and (im)permeability of the social networks that underpin market activity are not covered in current business surveys. Yet, if not factored into the design of business support strategies, they are likely to undermine the latter’s success.

#### **b) Hybrid governance or competing systems of power**

The second determinant, so far neglected in accounts of business constraints, is the presence of competing (non-state) authorities that in general not only challenge weak state institutions in delivering security and basic services, but also compete in the business of buying and exchanging loyalties and dependencies to broaden their respective constituencies (Reno, 1998; Wood, 2003; Boege et al., 2008). In fact, their legitimacy does not derive from representing a public interest, but from a complex exchange network of personal favours. The resulting competition for power, resources and loyalties prompts an entanglement of politicians and businessmen on the one hand, and of state institutions and traditional authorities on the other. In many instances, these overlap and are commonly referred to as situations of “hybrid governance”.<sup>26</sup>

As Stel convincingly argues, “with regard to entrepreneurship, the most significant aspect of hybrid governance is public-private overlap or entanglement”, an arrangement in which politicians and businessmen alike are less concerned with the general conditions for doing business (for instance, through reforms leading to a more conducive enabling business climate), but primarily interested in their personal business success (Stel, 2012: 5).

The other facet of the entanglement involves state institutions and traditional or other non-state authorities. Such non-state authorities can consist of a group of elders, an insurgency movement or a religious authority. In the absence of legitimate and

---

26 See for example: Meagher et al. (2014).

functioning state institutions, these are found to be critical in providing security and basic services, including to businesses. But they may also look for opportunities to get access to resources in order to maintain the distribution of material benefits to their kin. State institutions, in turn, may have an incentive to tolerate informal taxation by those traditional, competing authorities, if this is part of a broader power balance that guarantees their own hold on power.<sup>27</sup>

Caught in such a highly political marketplace, SMEs often address basic security threats by investing their own political authority (the wealth they accumulate and the employment they generate) into new allegiances with private or traditional authorities, albeit “at the cost of dependent and sometimes bonded loyalty (adverse incorporation)” (Wood, 2003: 457/8). Rarely are they merely victims of corrupt and hybrid governance systems. Their business strategies have to actively engage with those practices if they want to continue operations or grow. Therefore, most viable businesses are more likely to reproduce and reinforce the conditions that ultimately prevent a transition from uncompetitive growth and poverty to sustainable, inclusive growth and stability.

As with the literature on business development, social cohesion and peacebuilding, most research into the link between corruption and business is unidirectional and focuses on the negative consequences of clientelism and corruption<sup>28</sup> for entrepreneurship. Only recent contributions explore the trade-offs between a certain level of patronage and conflict (Khan, 2006; North, Wallis, and Weingast, 2009; de Waal, 2009; WDR 2011). One argument points to the risk that suddenly dismantling these relationships can have unintended destabilising effects. Another argument is that the benefits of short-term stability and some degree of legitimacy that patronage networks entail can offer a starting point for more auspicious reform strategies: readiness to engage with prevailing “second-best” governance arrangements (the WDR 2011 recommends engaging elite pacts in inclusive-enough coalitions) and gradually improving those in terms of accountability and inclusiveness is believed to yield better results than continuing to work with perfect blue prints and zero-corruption tolerance (WDR 2011; Waal, 2009).

Much of the current SME literature and support strategies focuses on regulations and firm performance, rarely paying attention to the political compromises entrepreneurs accept in order to survive, let alone thrive. But taking those dynamics of hybrid governance

---

27 Gutierrez (2011) refers to examples in eastern DRC and southern Philippines where warlords were “allowed” to extract rents from mineral resource extraction or smuggling, thereby creating common interests in keeping these regions stable (Gutierrez, 2010: 11). Similarly, in Mexico in the late 19th century, General Diaz supported rival warlords of unstable regions to become equity owners in foreign cotton investments, thereby creating an interest to keep the contested regions stable (Levy, 2014: 185).

28 A good overview of this literature is offered by Cordineanu-Huci et al. (2012: 67 ff.).

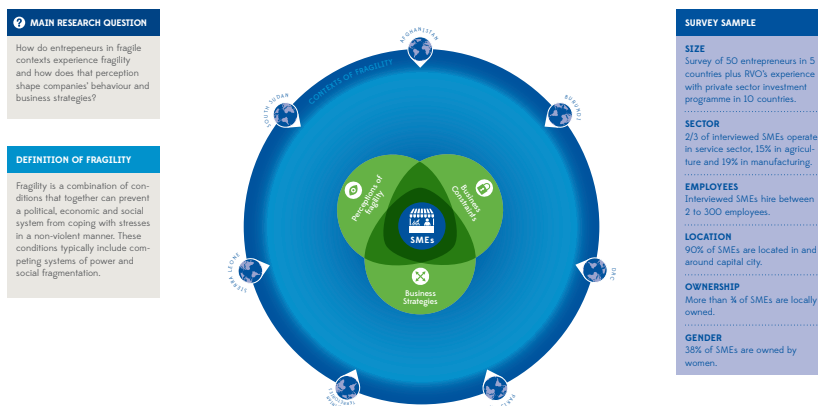
into account is essential in order to understand the constrained choices and options SMEs face in fragile settings.

By adding these two lenses to our understanding of SMEs in fragile settings, this report seeks to do more than merely complement the list of missing business barriers that require more attention in future SME surveys. More importantly, we argue that even the commonly cited and largely technical constraints can only be addressed effectively and sustainably if understood as symptoms of the broader structural context, particularly the reality of social relations and competing systems of power.

## 2 Evidence from SMEs coping and growing in fragile settings

### Summary

- The vast majority of SMEs interviewed think of conflict primarily in terms of direct physical threats to personnel and assets. The underlying causes of fragility and the legacies of (in many cases recurrent) conflict appear to be institutionalised and to shape an environment of general uncertainty. As such, they are generally perceived as regular circumstances, rather than a state of emergency clearly distinguishable from non-fragile settings.
- However, when asked about their daily challenges, entrepreneurs offer a wealth of anecdotes that contain elements generally associated with fragility, including the role of mistrust and social relations and the interaction with competing systems of power.
- The type and relative significance of business constraints identified in the OnFrontiers and RVO surveys largely coincide with the SME barriers acknowledged in conventional business environment reports such as the World Bank's Doing Business reports. The main bottlenecks are insecurity, deficient transport infrastructure and lack of energy supply.
- Qualitative (anecdotal) evidence confirms the argument in recent literature that business behaviour is largely shaped by non-formal institutions, including social networks and non-state governance structures. Public authorities tend to collude with these informal structures.
- A significant share of surveyed businesses (notably in Afghanistan, Pakistan and South Sudan) has developed strategies of resilience rather than growth in order to keep operating despite insecurity and unpredictability. Only in less insecure and more predictable settings (Sierra Leone and Kinshasa in the DRC) did some interviewed businesses describe clear growth strategies.
- Many entrepreneurs rely on (clan- or ethnicity-based) social networks to cope with and overcome issues of insecurity and access. Having a friend in the right place determines whether, and at what price and pace, an entrepreneur obtains permits, receives capital, or accesses raw material. Conversely, a businessman's loyalty to these networks is expressed through the provision of employment opportunities, access to basic services such as health care, and charity.
- Most interviewees engage with non-state actors and governance structures to be able to continue operations. This often involves more or less voluntary informal payments to both state and non-state actors in exchange for protection, safe passage, or access to resources or services such as electricity. Other forms of loyalty towards public authorities include offering company shares to local authorities.



How do SMEs perceive the conflict-affected environment in which they operate and to what extent do they feel affected by and (un)able to influence this environment? By answering these questions on the basis of two sets of data, the objective is to fill a twofold gap. First, the subsequent analysis primarily draws directly on the perceptions of small firms, interviewed for this purpose in the context of their business operations and with a particular focus on qualitative information. Perceptions of local entrepreneurs matter because, whether accurate or not, they are critical in understanding the interaction between the entrepreneurs and the broader context.

Second, what further distinguishes the following information from other business surveys is the focus on the social and political structures that are likely to drive the more technical and commonly identified constraints. The analysis is driven by the hypothesis that understanding these structural underlying causes is critical for the development of realistic support strategies that start from where the entrepreneur actually stands.

The chapter will offer some qualitative insights into how SMEs and local experts perceive conflict and fragility dynamics (3.1), what they see as the major constraints on doing business in such conflict-affected or fragile contexts (3.2) and, finally, which strategies they adopt or see as most suitable in order to handle those constraints (3.3). The two fragility determinants introduced in the previous chapter – social fragmentation and hybrid governance – will be used as analytical tools to explore the underlying causes and connections.

## 2.1 SMEs' perceptions of conflict and fragility

Although the regions covered in this study differ greatly in type, intensity and legacy of conflict, the evidence reveals some patterns in SMEs' perceptions of conflict and fragility and in the business interaction with acute or latent conflict dynamics.

Generally, when asked about conflict and fragility, SMEs think of overt violent confrontation and armed fighting. In fact, the concept of fragility currently so much in vogue with policy makers does not resonate with most entrepreneurs. What policy makers commonly agree to be fragile or conflict-affected for most entrepreneurs is just the given reality, in which they happen to operate and, in some cases, have been operating for many years. In that sense, their replies suggest that underlying factors of conflict have been institutionalised, both in formal and informal arrangements that constitute normal circumstances, rather than a state of emergency clearly distinguishable from non-fragile settings.

This becomes clear in the attempt of various respondents to localise and thus limit the conflict to a particular (remote) locality (e.g. eastern DRC) or to the distant past (e.g. the invasion of Iraq in 2003). For example, an entrepreneur in animal husbandry with plans to establish a joint venture in Kinshasa argues: "The distance between Goma, the main city in eastern DRC, and the capital Kinshasa is the same as between The Netherlands and Romania. Would you be afraid to do business in The Netherlands when there is trouble in Romania? Certainly not."<sup>29</sup> This response illustrates that, aside from the physical distance between the centre and the periphery, the perceived – and to a certain extent *de facto* – absence of Kinshasa in eastern DRC attests to a lack of statehood or state legitimacy, which is one of the inherent challenges faced by entrepreneurs in that region.

Further illustrating the institutionalised character of fragility and conflict is the finding that corruption and insecurity are described by a majority of respondents as part of their interaction with the officials and formal state institutions that are meant to make society less fragile. More generally, an interviewee in Afghanistan explains conflict dynamics in his country as a result of an ongoing struggle for political power.<sup>30</sup>

Eighty per cent of interviewees feel their business is (somehow or heavily) affected by operating in a conflict-affected country.<sup>31</sup> First and foremost, almost every entrepreneur

---

29 RVO (2014), RVO Security Risk Assessment – DRC.

30 OnFrontiers (2014), Adviser Interview Notes, in: Consolidated Results (p. 4).

31 While in the DRC and Sierra Leone only half of the entrepreneurs interviewed report being affected, all interviewees in the remaining countries perceive their business as somehow or heavily affected by conflict dynamics.

across the sample has experienced conflict as a direct physical threat. Illustrations range from–kidnappings, loss of assets and reprisals against communities hosting militias<sup>32</sup> to terrorist attacks.<sup>33</sup> Some business owners relate incidents of relocation and abandoned expansion plans due to immanent security threats to personnel and assets.<sup>34</sup> Entrepreneurs in South Sudan, for instance, report that the withdrawal of international organisations and the evacuation of foreigners have robbed many businesses of their customer base and/or employees. Interestingly, in a way these businesses had at first been affected positively by conflict, as it generated an influx of foreigners with their own demand and purchasing power. Security threats to assets and staff are further reported to put a strain on transport of goods and staff movement. For instance, in the Palestinian Territories, entrepreneurs report having to struggle significantly because of movement restrictions, emphasising how the closedown of border crossings seriously obstructs the import and export of their goods.<sup>35</sup>

Second, many entrepreneurs stress that the way they run their business is heavily influenced by political instability and the unpredictability of the future. Several SMEs in Pakistan and Afghanistan blame the absence of a stable political climate for the challenges their businesses have to cope with.<sup>36</sup> Conversely, an entrepreneur from Sierra Leone confirms that the improved political climate in recent years is the main reason for a more positive business outlook for his firm.<sup>37</sup> Some entrepreneurs and local advisers refer to the legacies of conflict they feel affect their business operations. A local expert in Sierra Leone stresses the large-scale displacement of people, the destruction of livelihoods and therefore limited purchasing power, and the lack of qualified and skilled people due to a disrupted education system.<sup>38</sup> Along the same line, a local expert from the DRC links SMEs' lack of access to finance to a general culture of mistrust, disrupted information networks and the absence of legal enforcement as a long-term consequence of conflict.<sup>39</sup> The presence of the international aid community is also repeatedly mentioned by entrepreneurs and local advisers as a long-term characteristic of post-conflict markets, shaping both demand and prices in certain market segments served by local SMEs.

---

32 RVO, Security Risk Assessments.

33 OnFrontiers, Consolidated Results – Afghanistan/Pakistan (p. 7 and 12). OnFrontiers comments that terrorist attacks that occurred during the week of interviews in Karachi are likely to have influenced responses from Pakistani entrepreneurs (OnFrontiers, Consolidated Results, p. 12).

34 For instance, in South Sudan advisers estimated that: “Approximately 70% of businesses in and around Juba had to relocate or shut down when the civil war broke out.” OnFrontiers, Consolidated Results, South Sudan (p. 27).

35 RVO, Conflict Report, Palestinian Territories.

36 OnFrontiers, SME Data Survey Results – Afghanistan/Pakistan (p. 7 and 12).

37 OnFrontiers, Consolidated Results, Sierra Leone (p. 22).

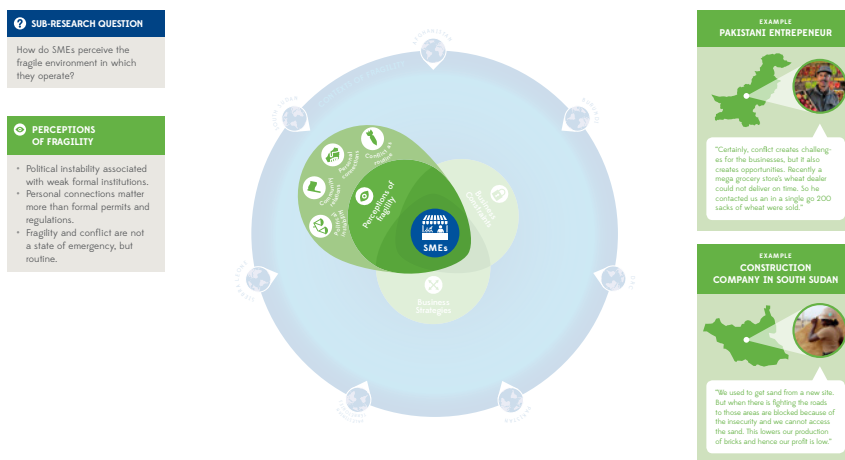
38 OnFrontiers, *Adviser Interview Notes*, in: Consolidated Results (p. 24–25).

39 OnFrontiers, *Adviser Interview Notes*, in: Consolidated Results (p. 16).

PSI+ managers confirm and complement the perceptions of SMEs. Comparing the conflict-affected business reality with the circumstances businesses face in non-fragile settings, these experts identify three features that differentiate fragile contexts from non-fragile ones:

- The fact that personal connections matter more than formal permits;
- A high level of political instability and uncertainty, associated with weak formal institutions;
- Lack of security and/or quickly changing levels of security.<sup>40</sup>

While the two latter features coincide with the ways entrepreneurs see their economic activities being affected by conflict, the first issue was not identified as a constraining factor caused or reinforced by conflict and fragility. Instead, as we will see in the final section of this chapter, the significance of personal connections features prominently in SMEs' coping strategies, a finding that again underlines the extent to which fragility has become part of entrepreneurs' day-to-day reality.



## 2.2 SME constraints and their links to conflict and fragility

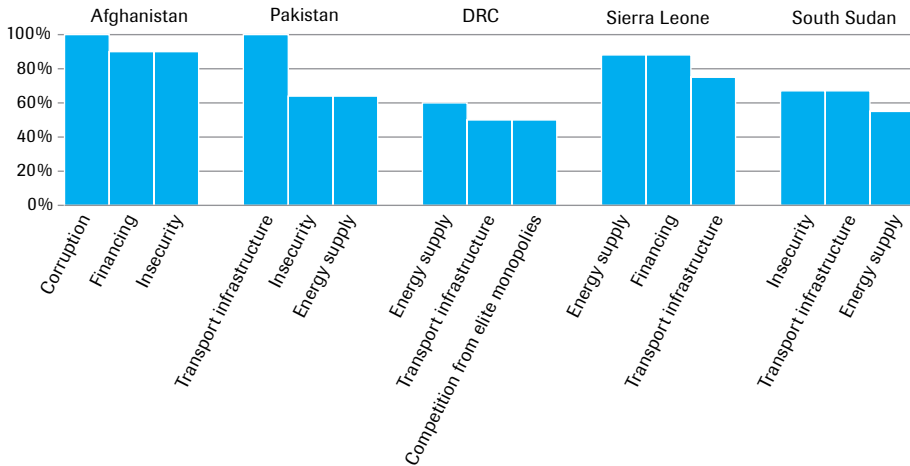
Entrepreneurs from both the PSI+ programme and the OnFrontiers survey identify similar key business bottlenecks as those put forward in conventional surveys. Entrepreneurs interviewed by OnFrontiers highlight the lack of energy (electricity) supply,

40 Workshop with RVO 'fragile states' managers on 10 April 2014.



deficient transport infrastructure and insecurity as major constraints<sup>41</sup>, while RVO clients stress political instability and transport infrastructure as the most significant obstacles to their business.<sup>42</sup>

**Figure 1 Main business constraints by country**



*(Source: Aggregated data, OnFrontiers SME survey data results)*

For the 22 fragile and conflict-affected states of the 181 countries included in the World Bank (WB)’s enterprise surveys, electricity emerged as the most important business barrier, closely followed by political instability. Additional top constraints that feature high in the WB’s enterprise surveys but less prominently in OnFrontier’s aggregated data are access to finance, informal sector practices, and corruption (WB, 2013b: 17 and WDR 2011: 176, f.n.69). Transport infrastructure (inadequate roads, rail, ports, frequent blockages) is not part of the relatively small set of Doing Business indicators (WB, 2013b: 25), but emerges as a key explanatory factor for high costs and the limited competitiveness of SMEs in fragile settings in the OnFrontiers survey.

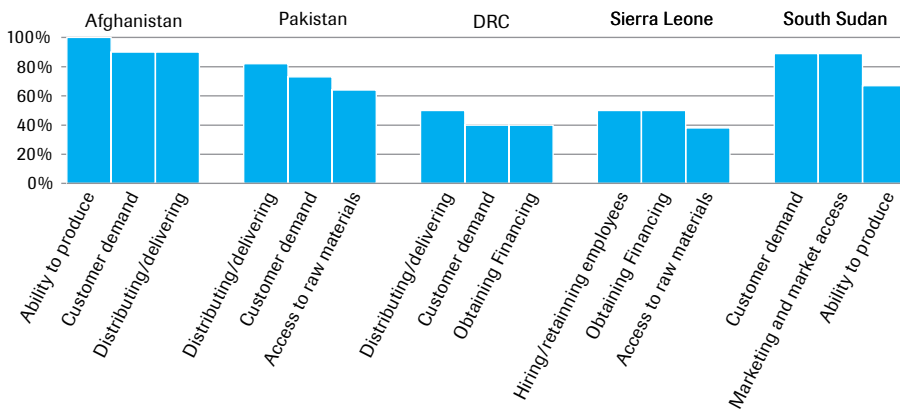
As well as bringing this transport bottleneck to the surface, OnFrontiers also provides some qualitative data that reveal both underlying connections between seemingly different constraints such as political instability and infrastructure and the structural causes behind the more technical obstacles to specific business functions.

41 The questionnaires used in both surveys can be obtained from the authors..

42 Lack of energy supply does not feature prominently in the PSI+ applicants’ risk assessment, as it is likely to be conceived as a given factor that can be factored in from the start, for example, the extra fixed costs occurring for the purchase of a back-up generator or electricity from a private source.

For example, the two most frequently cited business areas that interviewees feel were negatively affected are distribution/delivery of products and customer demand for goods and services. Qualitative data suggest a strong correlation between politically motivated (and therefore unexpected) roadblocks and general uncertainties about the future as being the primary causes behind those constraints. According to entrepreneurs, distribution problems stem from damaged transport infrastructure and roadblocks, which increase the cost of transporting goods,<sup>43</sup> while shrinking demand is believed to be caused by the uncertainty that conflict generates: people tend to be less ready to invest in products that can be stolen or destroyed if fighting recurs.<sup>44</sup>

**Figure 2 Main business areas affected by country**



*(Source: Aggregated data, OnFrontiers SME survey data results)*

Multiple links to social and institutional complexity emerge from respondents' qualitative descriptions of the various technical obstacles they encounter. The following paragraphs offer some anecdotal evidence for each of those constraints.

In the following sections, quantitative findings regarding SME constraints are complemented with qualitative findings. In particular, insights provided by interviewed entrepreneurs and advisers are used to shed light on the connections between technical constraints and their social and political underpinnings. For this purpose, we focus on the five key constraints as identified by OnFrontiers (transport, energy, corruption, insecurity and financing) and complement these by also elaborating on two additional factors identified by interviews (crime and competition from elite monopolies) which

43 OnFrontiers: Consolidated Results, Afghanistan (p. 5).

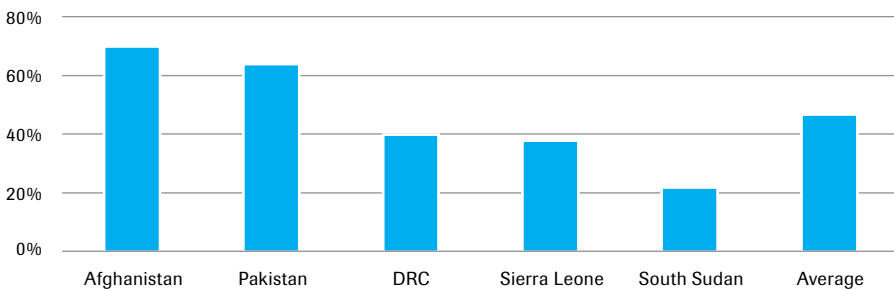
44 Ibid.

can be closely linked to the two themes, social fragility and hybrid governance, identified as key characteristics of fragile settings.

### Insecurity – an opaque combination of government incapacity, government complicity, competing security providers and crime

While insecurity of personnel and assets is highlighted as a major obstacle by most interviewees, it is of much more concern in Afghanistan and Pakistan and surprisingly less of an issue in South Sudan, despite the resurgence and persistence of violent conflict since December 2013.

**Figure 3** Businesses “often or severely affected by insecurity”



(Source: Aggregated data, OnFrontiers SME survey data results)

The reported impact of actual and expected insecurity is huge and ranges from relocation or interruption of operations to loss of assets and/or staff. Thefts from warehouses or from customers immediately after they have purchased goods are also reported as direct consequences of acute insecurity. Less directly, deteriorating security can prompt the disappearance or significant weakening of a customer base. This is mentioned, for instance, by businesses in Juba that primarily target the international community.<sup>45</sup>

Insecurity, as experienced by SMEs, appears to be not solely caused by the incapacity of state authorities to prevent crime and disorder and the presence of insurgents or criminals keen to exploit that weakness. What seems to reinforce and worsen the nature of insecurity in contexts where statebuilding proves to be an arduous and often contested process is the complicity and impunity of state security forces and the collusion of state officials with criminal gangs and insurgents.

---

45 A restaurant owner in South Sudan testified how he saw his entire clientele leaving the country in reaction to the outbreak of fighting in December 2013: OnFrontiers, Consolidated Results, South Sudan, p. 28.

RVO gives an account of an Afghan logistics company and its ways of dealing with insecurity:

“He (the entrepreneur) used to participate in convoys, paying private security firms to protect the lorries. He suspected that private firms had good relations with the insurgents and passed them money in exchange for safe passage.

Nowadays, the use of private security is prohibited and he has to pay the Ministry of Internal Affairs for protection by the army and police. This is more expensive and less effective.”

In addition, the competition between political parties and between formal and informal authorities, including religious leaders and warlords, is perceived to be a systematic threat. One Pakistani entrepreneur referred to this as “normal law and order”.<sup>46</sup> In Afghanistan, a logistics company explains that given the nature of its business, it is very difficult to secure operations in less familiar regions where personnel cannot rely on the two best security guarantees: tribal ties and local knowledge.<sup>47</sup>

Overall, the state is mostly described as an institution that not only fails to provide security but actively contributes to persistent insecurity, while entrepreneurs find more reliable and efficient security guarantees in social networks and non-state groups. Indeed, anecdotes from PSI+ recipients in Afghanistan testify to the fact that, in order to invest in or expand operations into contested (i.e. Taliban-controlled) regions, a business can only survive if it has solid kinship support or tribal ties in that region or if it manages to quickly establish material benefits for local authorities and their constituency.<sup>48</sup>

### Transport infrastructure – either in poor condition or a source of informal taxation

Deficient transport infrastructure was ranked among the most severe business constraints across all countries covered by the two surveys. Coupled with security concerns, difficult transport conditions account for ‘distribution and delivery of products’ being one of the business areas believed to be most affected by conflict. As well as hindering physical access to markets, bad infrastructure affects SMEs’ competitiveness by prompting

---

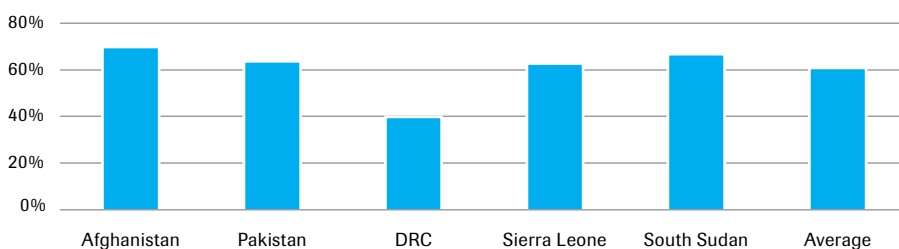
46 Another illustration of the institutionalisation of fragility: OnFrontiers, Consolidated Results, Pakistan (p. 13).

47 RVO, interview with Afghan logistic company, August 2014.

48 *Ibid.*

higher costs (e.g. due to the need for spare parts and repair),<sup>49</sup> delays, and quality or product losses (in the case of perishables).<sup>50</sup>

**Figure 4 Businesses “often or severely affected by transport infrastructure”**



*(Source: Aggregated data, OnFrontiers SME survey data results)*

Whereas violent conflict can leave its physical traces in damaged road infrastructure, as was reported from Burundi, for example,<sup>51</sup> access to roads is also found to be deliberately hindered by road blockages and the closing of border crossings, as reported by an entrepreneur from the Palestinian Territories.<sup>52</sup> The apparent arbitrariness and unpredictability of these politically motivated hindrances tend to affect business even more, as they are difficult to be planned for.<sup>53</sup> As latest literature on bribes confirms, the unpredictability of corruption matters more than its size. Predictable bribes can be planned for regardless, to some extent, of their amount, while unexpected bribes are more difficult to be factored in and therefore foil business planning. Roadblocks may be politically motivated, as in the Palestinian Territories,<sup>54</sup> linked to crime, as reported from Pakistan,<sup>55</sup> or a combination of both when state authorities and criminal gangs collude. Obviously, infrastructure rehabilitation will not address these issues.

### Energy supply – not a matter of getting a connection, but of accessing power

More than half of OnFrontiers’ respondents identify the lack of access to energy or unreliable power supply as a major bottleneck, with direct impacts on the production

49 OnFrontiers, SME Consolidated Results, DRC (p.19); and Sierra Leone (p. 23).

50 This issue was highlighted as critical by a frozen food business in the DRC, OnFrontiers, Consolidated Results, DRC (p. 19).

51 RVO, Security Assessments, Burundi (p. 3).

52 RVO, Security Assessments, Palestinian Territories (p. 1, 7).

53 Another SME from the Palestinian Territories highlights the difficulty in dealing with movement restrictions imposed by Israeli authorities without prior warning, which would allow his business to look for alternatives.

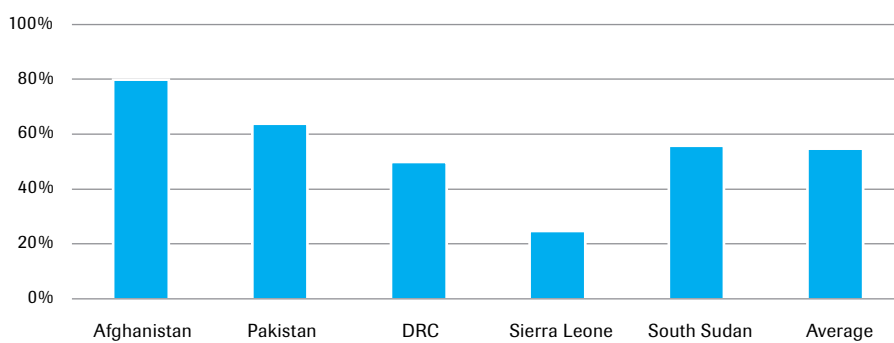
54 Ibid.

55 OnFrontiers, Consolidated Results, Pakistan (p. 13).

and storage of (perishable) goods, the business areas that 53% and 45% of interviewees report to be most affected. Yet, only just over one-third of respondents consider poor energy supply to be directly related to conflict.

While some businesses have resorted to buying their own generator as a back-up,<sup>56</sup> increasing fuel prices impede their regular use, which results in exorbitant production costs.<sup>57</sup> Given this reality, most entrepreneurs see the delivery of electricity as a core responsibility of government.

**Figure 5 Businesses “often or severely affected by energy supply”**



(Source: Aggregated data, OnFrontiers SME survey data results)

As a matter of comparison, it is worth noting that in her political economy analysis of the electricity sector in Lebanon, Stel reveals various incentives of political elites to grant or deny access to power. She decries the WB’s Doing Business report for not capturing *de facto* access to power, but merely registering *de jure* access through an electricity connection. In a careful analysis of political and economic patronage networks, she then demonstrates how the distribution of electricity is used as a means to give priority treatment in exchange for political support or material gain. Competition within government authorities and a general lack of transparency and accountability within government structures, as routinely encountered in fragile states, offers a fertile ground for such practices.

A local expert in Pakistan explains the lack of reliable energy as a by-product of the political/ethnic conflict between the five major provinces. He links prevailing inter-regional tensions to competing interests within the government, which translate into

56 OnFrontiers, Consolidated Results, DRC (p. 20). Interviewees in Kinshasa estimate that 40% of SMEs have their own generator.

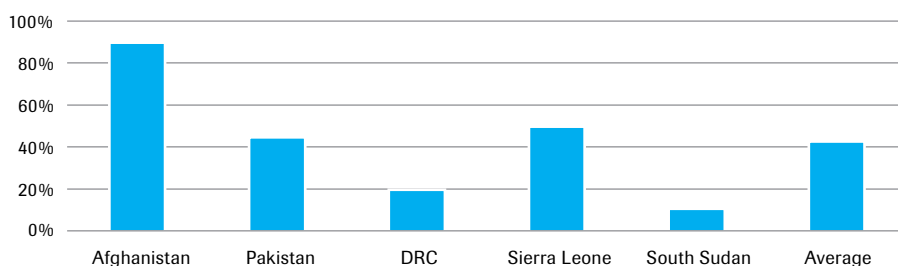
57 OnFrontiers, Consolidated Results, Pakistan (p. 15), and DRC (p. 18)

favouring one ethnic/political group over another – for instance, through access to more reliable energy provision.<sup>58</sup>

### Limited access to finance and issues of trust, corruption and collusion

Lack of or limited access to finance is seen as a ‘frequent’ or ‘severe’ bottleneck by at least half of the entrepreneurs in Afghanistan and Sierra Leone. In both countries there is some agreement among most interviewees that this constraint was (partly or primarily) to be blamed on conflict. In fact, respondents link the lack of unaffordable finance to the “lack of investor confidence” and to the “political uncertainty”.

**Figure 6 Businesses “often or severely affected by financing”**



(Source: Aggregated data, OnFrontiers SME survey data results)

Although mistrust within and between communities and vis-à-vis the government was not identified as a significant impediment to businesses,<sup>59</sup> issues of distrust feature in many anecdotes used to illustrate the technical constraints, such as access to finance, encountered by SMEs. For instance, an entrepreneur in South Sudan explains that access to capital is a matter of either having a wealthy relative or an uncle in the right place.<sup>60</sup>

Another compelling example of deficient financial services is the report of an entrepreneur who relates how SMEs’ suffer from the entanglement of financial institutions with organised crime:

58 OnFrontier, *Adviser Interview Notes*, in: Consolidated Results, (p. 7).

59 Less than a third of interviewees felt their business was affected: OnFrontiers, SME Survey Summary Results.

60 OnFrontiers, Consolidated Results, South Sudan (p. 30).

61 OnFrontiers, Consolidated Results, Afghanistan, p. 9.

“One time a member of our staff went to withdraw money from the bank and someone from within the bank informed some thieves that he was withdrawing a lot of money. He was kidnapped right in front of the bank. Now we deposit funds with money dealers, which is safer.”<sup>63</sup>

Such anecdotes underline that finance is not only a technical bottleneck due to “unbanked areas”, “unaffordable services” or “a lack of collateral”,<sup>62</sup> but also the result of “lack of trust, networks and legal enforcement”.<sup>63</sup> Hence, social fragmentation and unaccountable governance structures are likely to stymie access to finance even where it is technically available to SMEs.

More generally, entrepreneurs confirm that, as obvious beneficiaries of financial assistance, they would typically become more vulnerable to extortion.

### Corruption - an integral part of state-business relation

More than half of SMEs interviewed consider corruption (e.g. patronage, exchange of goods and services for political support) to negatively affect their operation. Even in countries where interviewees are optimistic about the general business outlook for the next three years, respondents are the least positive about corruption trends, with one-third of interviewees believing that the issue will remain the same or get worse in the near future. While most business constraints are perceived to be driven by conflict and expected to improve in the years ahead, in many cases corruption constitutes the outlier, with many respondents seeing corruption as independent of conflict and likely to remain the same or become more of a concern in the next three years.<sup>64</sup>

---

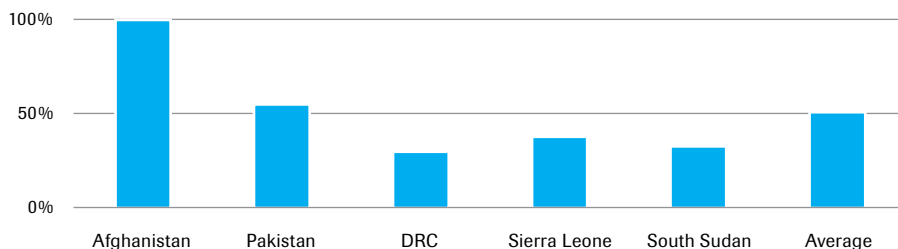
62 Interviews with two advisers in Sierra Leone. OnFrontiers, *Adviser Interview Notes*, in Consolidated Results, (p. 25, 20 and 23)

63 OnFrontiers, *Adviser Interview Notes*, in: Consolidated Results (p. 16).

64 For example in the case of Sierra Leone, despite a general optimistic business outlook, 38% expect the issue of corruption to worsen, 82% in Pakistan.



**Figure 7 Businesses “often or severely affected by corruption”**



*(Source: Aggregated data, OnFrontiers SME survey data results)*

A possible explanation for this is the fact that corruption dynamics in fragile societies may indeed be similar to those in non-fragile polities. However, as recent literature suggests, where state legitimacy needs to be rebuilt and high levels of mistrust and poverty prevail, corruption tends to intensify and entrench itself in social structures (Lindberg&Orjuela, 2014: 724). As a result, the (short-term) cost for individual businesses in not responding or engaging in corruptive practices is much higher than the cost for complying with the system (Rothstein, 2014). Indeed, illustrations of corruptive practices range from incidental corruption for the personal gain of individual state officials, to structural corruption and entrenched patronage systems involving public authorities and businesses, along with other non-state actors such as warlords and criminal gangs.

With South Sudan ranking 173 out of 177 in Transparency International’s 2013 corruption perceptions index and the DRC also scoring very high (154/177), it is striking that entrepreneurs in both countries do not perceive corruption as a major obstacle to their business, and that one-third of South Sudanese respondents and almost two-thirds of businessmen in the DRC state that corruption would not affect their operations at all.<sup>65</sup>

The picture looks quite different in Afghanistan, which is also at the top of Transparency International’s corruption perceptions index (175/177). None of the interviewees denies the negative impact of corruption on business. Interestingly, in Afghanistan and Pakistan, where more than half of interviewees perceive corruption as a major bottleneck to their business, a large majority of respondents believes the conflict to be a driver of this impediment.<sup>66</sup> One of the advisers interviewed in Kabul estimates corruption to outpace government revenue by 100–200%.<sup>67</sup> In fact, an Afghan business owner concludes that corruption is so endemic within the government that the latter cannot be expected

65 OnFrontiers, Consolidated Results, South Sudan (p. 29) and DRC (p. 19).

66 This perception coincides with Goodhands analysis of the role corruption plays in undermining the peacebuilding process in Afghanistan (Goodhand, 2013).

67 OnFrontiers, Consolidated Results, Afghanistan (p. 8).

to address the problem.<sup>68</sup> This statement challenges the prevailing policy stance on corruption, which political analyst Mungiu-Pippidi describes as the ‘principal-agent approach’ in which higher authorities such as ministries and enforcement agencies are assumed to have the moral and technical supremacy to contain corruption.<sup>69</sup> In reality, as the responses indicate, those higher instances are typically found to maintain and reinforce corruption as a means to retain and expand power.

Furthermore in some instances, entrepreneurs lament the fact that local law enforces act in collusion with local gangsters who break into warehouses for theft and use the incident for racketeering.<sup>70</sup> Bigger companies with more resources are perceived by SMEs to have a competitive edge when bidding for government contracts, as government officials have an interest in gaining political support from those companies and their constituencies (including customers, suppliers, employees, etc.).<sup>71</sup>

“Mafia businessmen (...) are getting the opportunities from the government, while the large majority of firms doesn’t get a chance to receive contracts from the Afghan government or the international community.”<sup>72</sup>

The same kind of collusion between political and economic leaders occurs on the side of competing authorities such as the Taliban in Pakistan who were expected to selectively promote business growth among their own business clientele: “The Taliban are more likely to favour business growth to empower their own people.”<sup>73</sup>

To conclude, corruption and clientelism are commonplace in the fragile societies that are the subject of this study.<sup>74</sup> Entrepreneurs conceive it as both a constraint and an integral part of doing business. On the one hand, not only does corruption in government offices “waste SMEs’ time and money through long bureaucracy”,<sup>75</sup> it also, and more importantly, impedes SME growth by systematically favouring political protégés over less well-connected small firms, punishing growth through further extortion, and increasing

---

68 OnFrontiers, Consolidated Results, Afghanistan (p. 7).

69 Mungiu-Pippidi, A. (2011) ‘Contextual Choices in Fighting Corruption: Lessons Learned’, NORAD, Report 4/2011, July 2011.

70 OnFrontiers, Consolidated Results, Pakistan, (p.13). Similar accounts were reported by RVO from a marble business in Afghanistan: interview with entrepreneur conducted by RVO in Afghanistan, August 2014.

71 OnFrontiers, Consolidated Results, Sierra Leone (p. 23).

72 Comment by local data collector explaining the frustrations voiced by several interviewees: OnFrontiers, Consolidated Results, Afghanistan (p. 8).

73 OnFrontiers, *Adviser Interview Notes*, in: Consolidated Results (p. 13).

74 While corruption might be a feature of many non-fragile countries, Lindberg and Orjuela (2014) and others have argued that conflict-affected societies often generate “an intensification and entrenchment of corruption-related problems”. (p. 723).

75 OnFrontiers, Consolidated Results, Sierra Leone (p. 24).

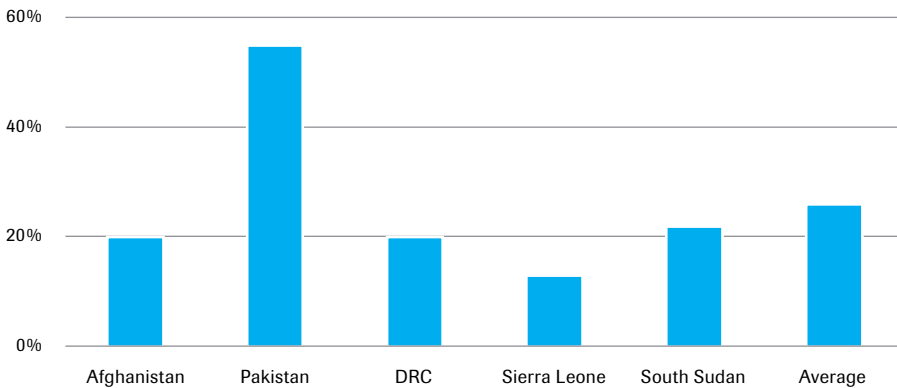
the burden of crime on those firms that have the least resources to protect themselves. On the other hand, many entrepreneurs readily admit that corruption has become a necessary evil in their daily business operations, be it to secure safe passage, obtain a licence to operate, or to build legitimacy and trust with the host community.

**Community mistrust – Social connections defining business constraints**

Close to one-third of SMEs interviewed by OnFrontiers felt that mistrust between individuals, businesses or groups did negatively impact their business with more than half of the entrepreneurs in Pakistan stressing this as a burdensome hindrance to doing business, while in Sierra Leone only 13% of business owners felt their business was affected (and never severely). Similarly, when asked in more detail about the specific business areas most affected by conflict, “community relations” were highlighted by one-fifth of interviewees.

Businesses in Pakistan said they face suspicion from surrounding communities and stressed the importance of adhering to cultural and religious norms and values as a basis for doing business.

**Figure 9 Businesses “often or severely affected by community mistrust”**



*(Source: Aggregated data, OnFrontiers SME survey data results)*

For example, while smoking and the use of the prophet’s name for marketing purposes had reportedly caused distrust,<sup>76</sup> hiring a disabled employee and keeping a modest appearance in public prompted greater acceptance within the community.<sup>77</sup> This applies as much to entrepreneurs as to financial service providers. One respondent points out that any financial services will have to appeal to an Islamic mind-set in order to meet a demand.<sup>78</sup>

76 OnFrontiers, Consolidated Results, Pakistan (p. 16).

77 RVO, interview with businessmen in Afghanistan, August 2014.

78 OnFrontiers, Consolidated Results, Pakistan (p. 16).

A concrete example of social fragmentation comes from Afghanistan, where an SME brought its labour from the North province to start operations in Khost province:

But residents in Khost “did not allow us [the company] to use staff from the North” and the company had to recruit new staff from the locality.<sup>80</sup>

In terms of social acceptance, women entrepreneurs and young people are said to face social barriers. For instance, in Pakistan women entrepreneurs are perceived to face additional obstacles, as the more lucrative business locations are usually reserved for older and established businessmen. Young entrepreneurs or women need the elders’ consent and support to access those markets. More generally, it is reported to be harder for women to start businesses in rural areas, where entrepreneurial women are less accepted within local traditions and culture.<sup>80</sup>

Lastly, as mentioned in the paragraph on insecurity, tribal ties can greatly ease operations in unsafe areas, just as hiring employees from the local community or securing local people’s loyalty to the business (through employment or charity) is said to be critical for a business to survive in a fragile society.

**1 SUB-RESEARCH QUESTION**

To what extent do SMEs feel affected by the fragile environment in which they operate?

---

**2 BUSINESS CONSTRAINTS**

- Main bottlenecks are insecurity, deficient transport infrastructure, and lack of energy supply.
- Social fragmentation and competing non-state authorities shape and reinforce these constraints.



**EXAMPLE**  
AFGHAN POULTRY BUSINESS

Afghan poultry business linking transport problems to insurgents:

“The roads were good in the past, but some of the insurgents attack transport convoys. Most of the roads are damaged now.”

**EXAMPLE**  
LEBANESE FOOD TRADER IN DRC

“We have to pay too many taxes both legal and illegal which forces companies to bribery.”

79 OnFrontiers, Consolidated Results, Afghanistan (p. 10).

80 OnFrontiers, Consolidated Results, Pakistan (p. 16).

## 2.3 Business strategies: between coping and growing

The link between business and the environment is not unilateral. Whether entrepreneurs act in reaction to the constraints and opportunities they perceive or whether they operate in anticipation (or ignorance) of the risks and possibilities that are likely to occur, their operations also have an impact on the broader economic, social and political environment. Any business strategy will therefore affect existing power balances and struggles.

To shed some light on the multiple ways in which SMEs affect their surroundings, the OnFrontiers and RVO surveys explore firms' coping strategies and their priorities for potential external assistance.<sup>81</sup>

### SMEs' response strategies to conflict or fragility-related obstacles

In general, direct security threats and long-term uncertainty are two key factors shaping small firms' behaviour in fragile settings. In response to direct security threats, SMEs across all countries confirmed significant investments in security measures, e.g. by equipping production sites and warehouses with surveillance cameras, alarms and security guards (Pakistan, South Sudan) or even using armoured vehicles (DRC). How long-term uncertainty shapes SMEs' strategies depends on the degree of optimism about the general business outlook. Where the level of conflict is expected to deteriorate over the next three years (e.g. Afghanistan, Pakistan and, to a lesser extent, South Sudan<sup>82</sup>), economic (long-term) efficiency takes a backseat and entrepreneurs' coping mechanisms are aimed primarily at resilience. In places where there is more confidence in the future, entrepreneurs take a less risk-adverse, more adventurous stance.

Overall, the following traits of business can be distilled from all the interviews.

- a) *Avoiding and mitigating risk: business strategies aimed at resilience rather than growth*

“We need to plan for distribution routes which are less prone to conflict; open stores where the situation is likely to remain stable. However, all this increases costs.” (Interview with business owner in Pakistan)

---

81 Questions 20, 21 and 22 in OnFrontier's questionnaire respectively: complete questionnaire can be obtained from the authors.

82 As noted earlier, this overly optimistic view is more likely to illustrate entrepreneurs' eagerness to attract donor support than their realistic assessment of the future political, economic and security situation.

Many respondents in Pakistan, Afghanistan and South Sudan report their operations to be on hold due to an uncertain future. Whether waiting for the outcome of contested elections or the impact of the withdrawal of international troops (Afghanistan), whether in expectation of some progress in the ongoing peace talks and, hence, a return of evacuated employees (South Sudan), or in anxiety about follow-up actions in response to recent insurgency (Pakistan), most entrepreneurs in these countries have adopted a “wait and see” attitude and kept a low-profile, reluctant to plan for the future before the political situation improves. Avoidance of further losses and unnecessary risk appears to be the guiding principle in order to keep operations running.

Resulting coping strategies include the reduction of inventory and in-bulk purchases in anticipation of theft, sudden drops in customer demand<sup>83</sup> or arbitrary confiscations.<sup>84</sup> Another element of resilient business behaviour is the choice to serve only local markets in the immediate vicinity rather than exploring potentially more lucrative markets further away, as the latter would bring additional risks arising from unsafe distribution routes and an uncertain customer base.<sup>85</sup> A further common risk-averse strategy consists of favouring safe locations over strategically better-situated areas. Such preferences are reflected in the selection of warehouses, raw material providers, or points of sale.<sup>86</sup> All of these measures were explicitly described as economically less efficient, and coming at the expense of economies of scale, increased transaction costs and missed opportunities in terms of un-served additional markets.

Given that most of the firms interviewed in these countries have directly or indirectly experienced interruptions to their business operations,<sup>87</sup> their appetite for risk is generally low. The entrepreneurs interviewed seem to consciously choose a strategy of resilience rather than aspiring to growth.

By contrast, entrepreneurs in Sierra Leone and the DRC, where the general business outlook among interviewees was more optimistic, describe a coping strategy that aims at the highest possible degree of flexibility to be able to adjust to shifting markets. Examples include the purchase of raw materials in large quantities at minimum costs and the diversification of suppliers to avoid dependency on regions that might be hit by conflict.<sup>88</sup>

---

83 OnFrontiers, Consolidated Results, Afghanistan (p. 8 f.) and South Sudan (p. 30).

84 RVO, security assessment, (p. 2).

85 OnFrontiers, Consolidated Results, Pakistan (p. 14).

86 OnFrontiers, Consolidated Results, Pakistan (p. 14), South Sudan (p. 30).

87 In Karachi, unrest results in businesses shutting down several days a year and in Juba 70% of businesses shut down after fighting broke out in December 2013. (OnFrontier, Consolidated Results, Pakistan (p. 13) and South Sudan (p. 27).

88 OnFrontiers, Consolidated Results, Sierra Leone (p. 23).

b) *Community relations and clan-ship critical for SME survival*

“There is a general sense of belonging and people are more likely to go to businesses that are from the same locality as them.” (Interview with local adviser in Pakistan)

The significance of business–community relations and businesses’ reliance on family, clan-ship and ethnicity was testified throughout the interviews and seems to be of particular importance in contexts marked by social fragmentation and mistrust. Both features influence SMEs’ strategic choices with regard to employment, investment location, sourcing of inputs, business linkages and transport routes.

Illustrating the importance of family relations, an Afghan paint maker reports that he is only able to operate in a highly contested region because he can rely on the provision of chalk from a mine owned by his brother’s family-in-law. In the same vein, an interviewee in South Sudan concludes that the “most important thing locally is whether you have a relative who can give you capital (...) It’s all about connections, about having the right uncle in the right place.”<sup>89</sup> Along the same lines, a logistics company says their main challenge is their lack of tribal ties to assure safe passage in many of the areas they need to cross.<sup>90</sup> In Pakistan, SMEs often operate in clusters that are based along ethnic lines. Whereas in the past such clusters used to cut across ethnic lines, current ethnic conflict and local extortion were reported to have caused the breakdown of some clusters along ethnic lines, destroying its competitiveness.<sup>91</sup>

Beyond ethnic networks, a positive relationship with the host community is also critical for SMEs to operate in highly fragmented markets. For example, in Pakistan an interviewee explains that there is a strong sense of belonging which prompts customers to prefer engaging with businesses owned by people from the same locality. This rule of thumb appears to affect SMEs particularly, and applies to a lesser extent to larger businesses.<sup>92</sup> A businessman in Afghanistan confirms that business expansion into a new locality entails an extra investment in trust building with the community; adhering to local norms of behaviour may not suffice. Direct benefits in terms of employment for the local population (often requiring additional investment in training) and additional favours such as access to health facilities<sup>93</sup> will be expected from a new business before community members consider becoming customers.

---

89 OnFrontiers, Consolidated Results, South Sudan (p. 30).

90 RVO, Interview with several local partners of PSI+ clients, August 2014.

91 A Pakistani adviser cites the example of a once-competitive shoe cluster that broke down as a consequence of ethnic conflict and local extortion: RVO, Adviser Interview Notes, Pakistan (p. 10).

92 OnFrontiers, *Adviser Interview Notes*, in: Consolidated Results (p. 8).

93 RVO, interview with marble company in Afghanistan, August 2014.

In response, entrepreneurs in the Palestinian Territories and Afghanistan stress that hiring locals has proved a successful risk mitigation strategy,<sup>94</sup> even though it generally requires additional investment in training. As well as creating employment opportunities for the local population, SMEs report undertaking special efforts to gain a social licence to operate in a given locality. Examples include giving discounts to customers “to make them loyal” (DRC)<sup>95</sup> and distributing material benefits and charity (Afghanistan).<sup>96</sup> In a broader sense, business strategies (notably in marketing) that fail to comply with religious and cultural values and norms in ethnically or religiously biased societies will trigger suspicion and ultimately rejection, a fact that can become a constraint or a source of innovation.<sup>97</sup>

Finally, anecdotes from the Gaza Strip reveal how good personal connections with suppliers or customers in Israel can significantly mitigate burdensome restrictions on movement across the border with Israel.<sup>98</sup> This example illustrates that personal connections and informal arrangements rather than institutional reforms are seen by entrepreneurs as a means to overcome a discouraging business environment.

*c) Not a matter of choice: SMEs readiness to pay bribes to public officials, non-state authorities and local gangs*

“To operate, businesses have grown immune to organised crime and corruption and treat it as a cost associated with operation. The cost of loss of assets or cost of extortion money is included in the cost of business.” (Comment by data collector in Pakistan)

Whereas a significant proportion of respondents in South Sudan and the DRC does not list corruption as an obstacle to doing business, entrepreneurs and advisers in both countries readily admit to “paying bribes” and stress the need to “establish good connections with public officials” as a prerequisite for doing business.<sup>99</sup> Rather than being seen as a problem, corruptive practices are primarily perceived and presented by entrepreneurs as a solution, a means to overcome security threats and obtain services

---

94 RVO, Security Risk Assessment, Palestinian Territories and RVO interview with local SME in Afghanistan.

95 OnFrontier, *Adviser Interview Notes*, in: Consolidated Results (p. 19).

96 RVO, interview with entrepreneur in Afghanistan, August 2014.

97 Islamic banking shows how successful adherence to religious belief can be, whereas the felt urgency to remain low-profile and go with the flow was also noted as well as a culture in which the concept of innovation is simply missing (OnFrontiers, Consolidated Results, Pakistan (p. 19)).

98 RVO, risks assessments, Palestinian Territories, (p. 2).

99 OnFrontiers, Consolidated Results, DRC (p. 17 f.) and Adviser Interview Notes, South Sudan (p. 30) as well as RVO's interviews with local SMEs in Afghanistan, August 2014.



that dysfunctional formal institutions are unable or unwilling to provide. Only businesses that cater mainly for the international community (e.g. a logistics company working primarily for the International Security Assistance Force in Afghanistan) are thought to be in a position to refrain from working with a corrupt government given their financial interest “to keep a clean image vis-à-vis international donors”.<sup>100</sup> The reality of most SMEs demands greater readiness to compromise, as they simply lack the political clout to oppose such common practice. Many entrepreneurs across all countries report that they commonly experience extortion by both state officials and criminals, to the point that average extortion fees are factored into production costs.<sup>101</sup> In the case of business expansion, an entrepreneur argues that only by inviting the governor of the ‘new’ province to become a minor shareholder had the business secured his support.<sup>102</sup> At odds with this common reality, and mindful of the formal request for adherence to certain performance standards, most applicants for the PSI+ grant assert that they have a zero-tolerance approach to corruptive practices.<sup>103</sup>

SMEs’ readiness to bribe public officials also applies to competing non-state authorities such as the Taliban in Afghanistan and Pakistan and traditional chiefs in South Sudan.<sup>104</sup> For instance, in order to start operations, a chalk ore company in Afghanistan explains that it has to follow three separate procedures involving a permit from Kabul, a social licence to operate from the local community (e.g. in the form of employment guarantees, free access to medical care) and a deal with the local Taliban commander. Although they are a heavy bureaucratic and financial burden for the business, such multi-layered arrangements enable the entrepreneur to operate in the here and now. However, they leave the business in a vulnerable position in the medium to long term. A shift in power can close the area down and nullify the agreements, leaving the entrepreneur with obsolete hardware.

In many cases it is the immediate need for security of assets or personnel that prompts SMEs to seek protection arrangements. This often means that they end up supporting patronage networks – either by directly paying informal security taxes to state officials<sup>105</sup> or competing non-state authorities, or by paying extortion fees to local gangs/insurgents who are likely to be linked either to government or to a contesting entity. In doing so, SMEs obtain security provision in the short term, while reinforcing structures of long-term uncertainty.

---

100 OnFrontiers, Consolidated Results, Afghanistan (p. 7).

101 OnFrontiers, Consolidated Results, Pakistan (p. 15).

102 RVO, interview with PSI+ client and local partner in Afghanistan, July 2014.

103 RVO, Security Risk Assessments.

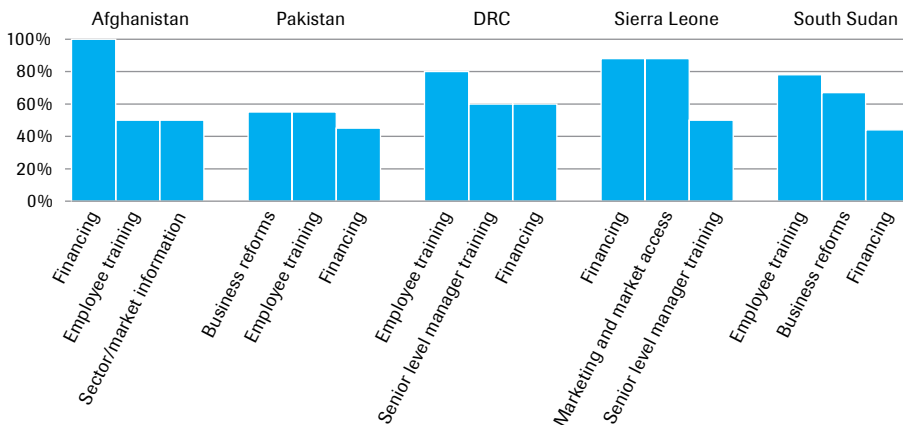
104 RVO, Consolidated Results, South Sudan (p. 33).

105 OnFrontiers, Consolidated Results, Pakistan (p. 13).

### Expected support

When asked about the kind of support SMEs would welcome as most useful, access to finance and training of employees are mentioned most often. Strikingly, these two areas of support do not rank highest among the business bottlenecks identified by interviewees. But they do match quite closely with what donors and their development implementers usually have on offer. Another explanation for the mismatch between constraints and expected support lies in the common assumption that governance and infrastructure concerns would need to be addressed by the respective government, not by a donor or NGO.

**Figure 10 Main areas for external support by country**



*(Source: Aggregated data, OnFrontiers SME survey data results)*

Perhaps more importantly, it is striking that the investment plans that interviewees draw in the hypothetical anticipation of funding clearly do not quite align with their present coping strategies. While the large majority, certainly in Afghanistan, Pakistan and South Sudan, primarily pursue risk-averse consolidation strategies aimed at resilience and survival, the hypothetical prospect of funding prompts them to design strategies of growth and expansion. This triggers two questions: first, to what extent is this discrepancy between SMEs’ resilience strategies and suggested growth ambitions the result of commonly pre-designed donor support packages? Second, are there any risks (with regard to stability and peace) when encouraging SMEs in fragile contexts to switch from resilience to growth in order to receive support? The next section will discuss these questions in greater detail.

# 3 Major findings and practical considerations for SME support in fragile settings

## Summary

**Finding # 1: Many business constraints in fragile settings are driven by deeply entrenched informal institutions, such as social networks and non-state authorities.** These structural drivers of business performance are not captured by conventional business surveys. They however shape and often reinforce the widely measured business constraints such as a 'lack of access to finance'.

Implication: The nature and persistence of SME constraints in fragile settings can only be understood in light of the often informal interaction between companies and their socio-political and economic context.

Considerations for:

- research: A better understanding of the socio-political constraints of SMEs will require a more qualitative assessment of the interaction between the 'rules of the game' and entrepreneurs.
- policy makers: Combine the existing business (environment) surveys with political economy analysis as a basis for agenda setting and strategy design.
- implementers: Adjust intervention tools to the reality of SMEs by accommodating the role of social networks and non-state authorities, instead of treating them as taboos.

**Finding # 2: In instances of insecurity and unpredictability, SMEs' coping strategies are often aimed at resilience rather than at growth.**

Implication: Whether an SME aims at growth or consolidation has implications for support strategies. In some instances growth strategies may have destabilising effects.

Considerations for:

- research: Analyse past experience, in which efforts to enhance productivity and expansion of small businesses have yielded limited results and sometimes even exacerbated tensions.
- policy makers: Define realistic objectives for SME promotion in fragile settings (e.g. stabilisation versus economic growth?) and anticipate the trade-offs. Make sure that policy objectives align with the objectives of the target group, i.e. the genuine aspirations of entrepreneurs, and take account of the acceptance level within broader society.

- implementers: Reflect the policy goal in intervention tools. Develop tools that differentiate between (but value equally) businesses that have the potential to grow and firms that, with the right support, will be able to survive and build resilience.

**Finding # 3: By neglecting the underlying institutional drivers of SME constraints, support strategies can easily reproduce and foster the social, economic and political conditions for insecurity and exclusive growth.**

Implication: Embed SME promotion strategies in more comprehensive support strategies that take account of the institutional environment and power configurations.

Considerations for:

- research: Research into SMEs' reliance and dependency on powerful elite coalitions can reveal promising entry points for de facto business environment reform.
- policy makers: Embed SME promotion in broader business environment reform that involves/takes into account the role of non-state actors, social identity groups.
- implementers: Recognise the political nature of interventions, combine business development with mediation skills and anticipate the potential harm that can be created.

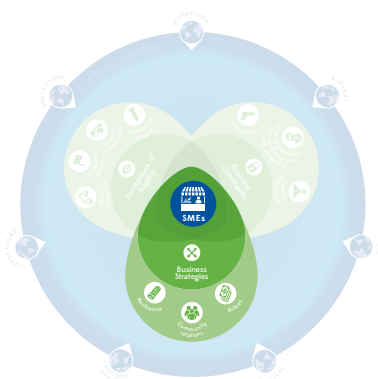
**SUB-RESEARCH QUESTION**

Which strategies do SMEs deploy to manage fragility?

---

**BUSINESS STRATEGIES**

- Many SMEs aim for resilience rather than growth.
- Community relations and clan/tribe are critical for SME survival.
- Most SMEs pay bribes to often colluding public officials, non-state authorities and criminals.



**EXAMPLE**  
CAR BUSINESS IN SOUTH SUDAN

"The strategy I apply in my business is that in the time of the conflict I have reduced the number of cars I import so that I am not left with surplus stock."

---

**EXAMPLE**  
LOGISTICS COMPANY FROM AFGHANISTAN

"Hiring or recruiting staff from other provinces gave us more problems e.g. we had a project in Khost province and we hired some staff from North provinces but the resistance of that area did not let us hire them so we had to hire the Northern staff and we hire from the Khost province."

This report has presented and analysed the evidence of SMEs in fragile settings by combining current insights from new institutional economics, with evidence from small and medium-sized firms. This last chapter will summarise major findings with regard to business constraints, firms' strategies and donor support. From these, a number of practical considerations will be derived for policy makers, development practitioners and researchers committed to supporting SMEs in their endeavours to cope and grow.

### 3.1 Major findings

#### Finding # 1: Structural drivers of business constraints

Many business constraints in fragile settings are driven by deeply entrenched informal institutions, such as social networks and non-state authorities. These informal institutional factors, although increasingly recognised, are not captured by conventional business surveys. As defining characteristics of the business reality in many fragile settings, however, they form an inherent part of firms' day-to-day business strategies.

Qualitative evidence gathered in this research project confirms recent insights that technical business constraints are to a certain extent the mere symptoms of a more structural phenomenon. The role of mistrust, the recourse to personal networks, and the influence of competing (state and non-state) governance systems shape to a significant degree the reality of SMEs in fragile markets. On the one hand, belonging to a certain identity group can decide whether a business will have access to electricity, finance or raw materials. This correlation was testified to by interviewees in very different contexts, ranging from Pakistan where the distribution of electricity mirrors a region's ethnic affiliation, to South Sudan or Burundi, where obtaining capital depends on having a relative in the right position, or Afghanistan and the DRC where, due to high levels of insecurity and mistrust, family connections are critical to source inputs in a reliable manner. Yet, the very same social networks that allow entrepreneurs to operate in the absence of trust and services are based on adherence to a given (ethnic, religious, regional, political or gender) identity and hence exclusionary in nature. They can exclude qualified new actors from business and trade, prevent innovation and nurture exclusion.

On the other hand, readiness to cooperate with non-state governance systems, such as the Taliban in Afghanistan and Pakistan, frequently becomes a sheer necessity for running a business in a certain region or addressing some immediate security concerns for personnel and goods. Also, women or younger entrepreneurs in patriarchic or traditional societies depend on the authority and consent of elders to gain access to the more lucrative, hence more exposed, selling spots in the local market (Afghanistan). While these alternative service providers serve the business case in the short run, their vested interests in the status quo are likely to prevent reforms towards more accountable, transparent and equitable arrangements of service provision and market access in the long term.

Much of the literature describes firms' reliance and dependence on personal networks and/or competing governance systems as a consequence, rather than a cause, of non-functioning formal institutions and the lack of public goods (such as security, electricity, transport infrastructure). However, based on the findings of this study, we argue that the causal relationship works both ways. Where formal institutions have been substituted or complemented (and challenged) by personal networks and non-state governance structures, they are likely to remain in place and survive the most ambitious institutional reform programme. In many cases, the deeply entrenched informal arrangements will

either bypass or co-opt reformed institutions, making the latter indicators of *de jure* change, while remaining irrelevant to the *de facto* reality of SMEs.

Conventional SME surveys struggle to capture these structural informal constraints by focusing on readily quantifiable and measurable symptoms, such as access to finance. For example, corruption paid to non-state actors is not recorded by the World Bank's enterprise surveys. Nor is non-state actors' ability to provide security to their supporters and their obstructive effect on efforts to create more sustainable and inclusive security arrangements. A recent publication on private firms and crime (Goldberg et al., 2014) puts it in a nutshell: By forging a narrow understanding of corruption as "forced donation", the authors argue, the WB's enterprise surveys fail to differentiate between the various shades of corruption, thereby undermining the huge grey area ranging from voluntary contribution to outright extortion. Moreover, corruption is essentially understood as a bribe payment to public officials, leaving out informal payments to alternative governance arrangements that may co-exist alongside the state.

An inevitable first step to understanding the complex reality in which many SMEs operate will require an approach that straddles the formal and informal spheres, dismantles the patron-client thinking of corruption, and views the entrepreneurs neither solely as victims or perpetrators of corruption but as a junction, where security of assets and access to services are being traded for employment opportunities. Or access to electricity, for example, is granted on the basis of voting for the right political party.

#### **Finding # 2: Consolidation rather than growth.**

In instances of insecurity and unpredictability, SMEs' coping strategies are often aimed at resilience rather than growth.

The majority of interviewed businesses – notably in South Sudan, Afghanistan and Pakistan, where insecurity and unpredictability were perceived most burdensome – have adopted resilience strategies focused on survival rather than growth. Contrary to growth-oriented tactics, those coping mechanisms involve short-term (rather than medium- to long-term) planning, minimum investment (rather than economies of scale), restriction to local markets (rather than looking for expansion), a low profile (going with the flow rather than being innovative), and sticking to long-established relationships and networks (rather than opening up to new business linkages).

To fully appreciate the value of SMEs' consolidation strategies in fragile settings, it is important to realise that business success can have multiple meanings. As increasingly recognised, the impact of firms goes beyond their economic effects. Even if a business stagnates commercially, and fails to grow or to meet its commercial targets, it can still be productive and have positive effects on the broader political and societal environment (Naude, 2007: 9). A company that fails to create paid jobs (to non-family members) and expand operations may still deliver a key service or product to the community and sustain hope for a more peaceful and prosperous future.

However, risk management in the present involves loyalty to institutions, organisations and personal networks that work and deliver livelihoods today, whatever the longer-term cost. Whether they are insurgents, corrupt government officials, terrorist groups or relatives in high places, as long as they provide critical ingredients for business survival, SMEs are likely to postpone more strategic business preparations for the future in the pursuit of survival and security in the present. This often comes at the price of dependency and sometimes bonded loyalty. By paying bribes and buying permits from non-state actors, those informal short-term security arrangements reproduce and perpetuate the conditions for long-term insecurity.

Clearly, in order to grow out of resilience mode, a business needs to overcome these networks of dependency. As Naude (2007) points out, those elements of a business strategy that prove to work well for survival, might actually hamper companies from growing in times when prospects are better. In fact, many companies interviewed in Sierra Leone and the DRC were in the process of switching to more flexible business strategies, adopting more long-term planning, searching for new markets and means to decrease their dependency on a small group of suppliers and customers, and buying in stock. But this switch is likely to encounter some resistance from those more powerful players whose power and resources have relied on the loyalty of their protégé SMEs, a phenomenon that was attested to by respondents in Sierra Leone.

As the discrepancy between identified business bottlenecks and priorities for external intervention reveals, the ambitious growth aspirations that dominate most interviewees' wish lists – with financial assistance and employees' training ranked highest – may match donors' combined investment and development agenda better than what SMEs consider their most pressing needs. Only a careful analysis of small firms' embeddedness in a complex social and governance context will prevent financial and technical assistance pushing entrepreneurs into growth strategies that could easily undermine their resilience, and potentially pose a risk to the broader stabilising effects of these firms.

### **Finding # 3: the risk of exacerbating fragility**

If the structural drivers of business constraints in fragile contexts tend to be ignored and eventually reinforced by conventional donor interventions, there is a risk of reproducing and fostering the social, economic and political conditions for insecurity and exclusive growth. Attempts to reform the rules of the game will, in turn, meet resistance from those with vested interests in the status quo.

While the Doing Business report and ensuing business reform processes have, in many cases, led to better regulations and country rankings, enforcement of the rules and actual improvements in SME conditions often fail to occur. In particular, macro-oriented reform programmes have been described by some authors as an “expensive failure” (Schramm, 2010: 90-91; Patterson, 2010: 226). This is likely to be at least partly

due to the fact that fixing formal institutions and their ability to deliver services will not automatically dismantle and replace the role of the incentives networks and power structures that have grown in their absence. On the contrary, additional resources into good governance programmes and state capacity building have proven to fuel and foster the complicity of those institutions, further undermining the accountability, impersonality and inclusiveness they were meant to build or restore (Corduneanu-Huci, 2013).

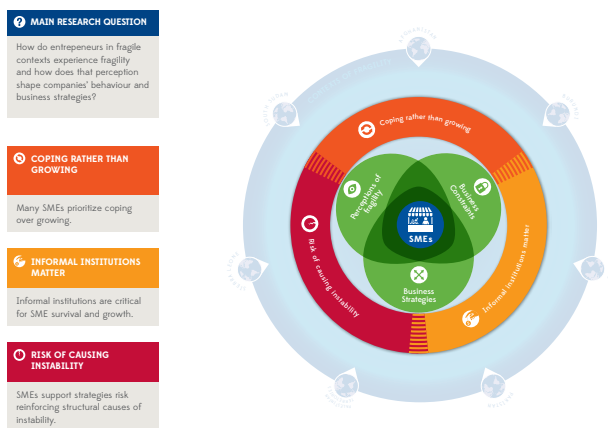
The mixed results of SME development programmes in fragile settings have so far at least partly been explained by a focus on readily measurable business constraints and formal institutions. By seeking to fix the symptoms rather than the underlying causes, *de facto* obstacles will remain, as generalised patterns of clientelism and corruption are likely to persist. At the level of the individual entrepreneur, resources directly channelled to SMEs are likely to create extra incentives for state officials and non-state actors alike to extort the beneficiary businesses or misuse control over access to security provision, transport infrastructure, electricity or finance as lucrative channels to exchange favours for additional rents or loyalties. Evidence from OnFrontiers and RVO offers various examples in which entrepreneurs describe their increased exposure to government officials or warlords who extract rents from those businesses that have visibly or reportedly benefited from financial donor support.<sup>106</sup>

At the level of the overall business environment, reforms that are not accompanied by broader social, political and economic transformations that include considerable benefits for the main beneficiaries of the status quo, will inevitably feed into and therefore strengthen the existing personalised arrangements. Where patronage is commonplace, this assistance can easily evaporate in an opaque system without achieving its target. But more importantly, assistance in such an environment also carries the risk of reinforcing the same structures that prevent small businesses from growing and fragile situations from stabilising. However, the necessity to instigate and sustain a *de facto* reform process towards a level playing field for SMEs comes with its own challenge, as persistent attempts to transform the power configuration into a more equitable, transparent and fair business environment are likely to trigger strong opposition and potentially violent resistance.

---

106 For example, this point was emphasised by a local adviser in Afghanistan: OnFrontiers, Adviser Notes, Afghanistan, (p. 5) and by an RVO staff member working on the investment programme in the Palestinian Territories.





### 3.2 Implications for policy, practice and research

In an attempt to bring the analysis back to the policy and programming domain, the above findings suggest a number of practical considerations for policy makers, practitioners and researchers. In short, the above findings call for i) a better understanding of the socio-political constraints on SMEs in fragile settings, ii) clarity on the objectives of SME promotion policies and programmes in those contexts and lastly, iii) a systematic embeddedness of SME promotion strategies in more comprehensive approaches in order for them to be effective in complex and contested institutional settings.

**Implications of finding # 1: The structural causes of SME constraints in fragile settings can only be understood by exploring the often informal interaction between companies and the broader socio-political and economic context.**

Conventional understanding of small firms in fragile settings has largely been framed in terms of typical business constraints and dysfunctional regulations that can be addressed by readily available financial and technical assistance packages. A lack of access to finance will be countered by the provision of loans. A disproportionate number of days needed to register a business will be reduced by the establishment of a one-stop shop. Low production capacity among businesses will be tackled by enhancing the capacity of business development service providers. However, in environments that are largely determined by personal connections and competition between state and non-state authorities, technical remedies will not remove the structural barriers and political incentives at play.

*...for research*

A more qualitative and political assessment is needed to gain a better understanding of the institutional complexity that shapes SMEs' day-to-day operations. In particular, the extent to which social networks help or hinder SME development deserves further investigation. Also the role of non-state actors in providing services that are critical for SME survival in the short to medium term – but that often maintain competing power structures, which undermine statebuilding and more sustainable stability – needs to be better understood. Research into the structural causes of SME constraints and potential needs to:

- take into account the perspective of the entrepreneur;
- consider both constraints and coping mechanisms; and
- not be limited to state institutions, but extend the analysis to firms' interaction with social networks and non-state authorities (including traditional leaders, rebel groups, etc.).

One theme in particular would benefit from further research. It concerns the many shades of corruption, and the much larger phenomenon of patronage, of which SMEs often form part. Understanding the exchange of goods, money and favours through a narrow and normative patron-client concept fails to comprehend the workings of a wide range of bribes, from voluntary payments to forced extortion, which link entrepreneurs to multiple, often competing (state and non-state) patrons, while securing loyalty and dependency from customers, employers, and suppliers. A more nuanced understanding of such an opaque web of favours and payments in the absence of transparent institutions will attest to the limited relevance of anti-corruption clauses in loan contracts. It will further demonstrate the powerful vested interests that any anti-corruption reform process will need to prepare for.

*...for policy makers*

The World Bank's Doing Business report and enterprise surveys should be complemented by political economy analysis to form a basis for agenda setting and policy instruments. In fragile contexts where informal power arrangements rather than the rule of law and formal institutions determine the business environment, understanding who the power holders and their support bases are, and how they interact, will provide critical information on both the growth and stabilisation potential of a given industry.

Grounded in a deeper understanding of the stabilising and destabilising effects of corruption and patronage networks, future policy making will have to rethink its anti-corruption strategies in fragile contexts. Although not a direct consequence of conflict or fragility, corruptive practices appear to intensify and become entrenched where state capacity is dysfunctional at best. If the exchange of informal payments and favours is the rule rather than an exception for most entrepreneurs, and if these informal, potentially illegal, transactions are not only a means to access services that dysfunctional state institutions struggle to provide, but also a critical means to maintain some kind of power

balance between competing systems of authority, strict adherence to a zero-tolerance of corruption stance will inevitably have destabilising effects.

*...for implementers:*

Adjust intervention tools to the reality of SMEs accommodating the role of social networks and non-state authorities, instead of treating them as taboos.

- In addition to a qualitative assessment of the business context as described above, loan applicants (firms or financial intermediaries) and any potential SME beneficiaries of a support programme could be asked to include elements of such information in their regular feasibility study or/and risk assessment.
- Donors and development implementers should bundle resources, gather and share information on SMEs' social networks, patronage webs and links to non-state actors.
- Consider the (facilitation of) cooperation with unusual partners, such as the military or human rights activists and research institutes, which are well placed to gather such sensitive information in a particular region or sector. Recognise that this is the kind of information that is not readily available to foreign investors or development actors.

**Implications of finding # 2: Whether an SME aims at growth or consolidation has implications for support strategies. In some instances, growth strategies may have destabilising effects.**

In the context of converging trade and development agendas and a growing donor interest in fragile contexts, this research encourages policy makers to reflect upon the trade-offs that will inevitably arise if SME promotion is to serve multiple goals. In fact, from the perspective of small firms, looking at the emerging enthusiasm among donors to entrust SMEs with the task of bringing prosperity and peace to their conflict-ridden societies raises important questions with regard to the distinct policy goals at play. What exactly are SME promotion policies and programmes designed to achieve? To what extent do these (complementary but sometimes conflicting) goals align with the targets that small entrepreneurs have set themselves?

While the prevailing trend of combined policy agendas emphasises the synergies of different goals (e.g. trade and development, but also stabilisation or peace- and statebuilding), essential differences persist but receive much less attention. Evidence suggests that in fragile settings these trade-offs are particularly severe.

First and foremost, the research illustrates some obvious trade-offs between a focus on development and a focus on growth. For instance, productive enterprises operating in fragile settings are generally believed to be of particular relevance for inclusive development, and even more so if headed by women or youth. However, rather than aspiring to grow and create employment, many of these enterprises are found to be focusing on consolidating their operations, keeping a low profile and minimising risks.

It was also argued that women-owned or managed enterprises would be even less likely to expand due to security risks and cultural bias.<sup>107</sup>

Furthermore, and maybe more importantly, the anecdotes gathered in this research illustrate some serious trade-offs in combining stabilisation and economic development agendas. In other words, the underlying assumption that links SME promotion to peace sees itself confronted with a business reality whose fragility can worsen in multiple ways as a result of SME promotion. The influx of resources, through (non-)financial assistance, and the stiffening of competition not only provoke a shift in power balances but also expose beneficiaries to a heightened risk of rent seeking and extortion.<sup>108</sup>

At a more general level, where entrepreneurs' ability to grow and invest (and eventually pay back their loans) hinges on their readiness to rely on unlawful security and service providers, their (immediate) economic progress is likely to come at the high price of reinforcing exclusionary structures that will impede more inclusive systems of security and service delivery in the long run.

Having said that, donors' and programme managers' insistence on zero-tolerance of corruption as a conditionality of eligibility for support is arguably a safe way for donors and development implementers to keep their distance from unlawful practices. However, urging entrepreneurs to refrain from paying off their loyalties to powerful actors can destabilise the social order these actors, unlike the state, are able to maintain in the short to medium term.

Ultimately, the needs and ambitions of the SMEs themselves will decide which among development, growth or stabilisation objectives has primacy over the others. Taking the multiple ways of defining SME success as a starting point, there is a strong argument in favour of supporting SMEs in fragile states even if they are not able to grow in the short term from a stabilisation and development perspective. However, this support will require a different strategy and tools aimed at business consolidation and risk

---

107 Sequencing may solve some of the conflicts between objectives (consolidation first, growth and jobs later), but not all. The improvement of production capacity may be a necessary first step for a company to grow. It may entail the reduction of labour in the short run, to optimise productivity and competitiveness that will prompt additional hiring in the medium to long term. However, that is not a guaranteed course. And conditionalities that are meant to safeguard greater development relevance, such as for instance the business being owned by a woman, may impose natural impediments to business growth due to prevailing security and cultural constraints. Changing the latter demands more comprehensive forms of support than setting a numeric target for SME support to be channelled to women entrepreneurs. More generally, the challenge of achieving both development and economic growth is not sufficiently addressed by imposing compulsory target groups on otherwise demanding criteria for eligibility.

108 A situation described by RVO staff during the April workshop.

mitigation, i.e. direct support to business organisations and public-private dialogue rather than market-based business development services, loans and equity.

If support strategies seek to invest in SMEs with a broader (stabilisation or development) ambition, a thorough understanding of the multiple interaction between the firm and its social and political context is even more crucial.

*...for researchers:*

Confronted with the pressing demand for evidence that links SME promotion to improved stability, it remains critical to analyse past experience. The mechanism through which business strategies have either fuelled tensions or contributed to great societal cohesion need to be carefully studied to test existing policy assumptions and inform more effective programming.

*...for policy makers:*

It is critical to define realistic objectives for SME promotion in fragile settings (e.g. stabilisation versus economic growth?) and problematise the trade-offs. Policy objectives should align with the objectives of the target group, i.e. the genuine aspirations of entrepreneurs, which not only depend on the health and growth potential of the company, but also on the entrepreneur's own assessment of how safe it is for the company to grow (and whether that means an increased visibility and risk exposure). If stabilisation is the main objective, the positive contribution of small firms to more resilient societies needs to be defined beyond increased productivity and job creation.

Prioritising job creation, in turn, will require recognition of the fact that in societies with high levels of mistrust, employment is likely to be offered on the basis of group membership, not merit. Instead of creating trust between adverse groups, such employment patterns might then reinforce exclusion and marginalisation. Similarly, putting the promotion of young and female entrepreneurs high on the policy agenda might expose these target groups to greater gender and intergenerational tensions if the cultural and socio-political context is not addressed as a whole.

*...for implementers:*

Develop SME development tools that differentiate between businesses that have the potential to grow and firms that, with the right support, will be able to survive and build resilience.

- Analyse the needs for finance and non-financial support in the context of businesses' existing coping mechanisms.
- Think of possible trade-offs at programme level. For instance, weigh the development relevance through job creation against the development relevance through female ownership, etc.
- Consider offering technical assistance to strengthen firms' resilience, e.g. by combining business skills with conflict mediation skills, early warning mechanisms,

anti-corruption campaigning.

- If the objective of SME promotion is (among others) to stabilise the environment, a monitoring and evaluation system should be developed with the businesses to capture potentially stabilising and destabilising effects of SME development through their community relations, employment practices, influence on state legitimacy, etc. The monitoring can also serve the business as an early warning system.

### Implications of finding # 3: Embed SME promotion strategies in more comprehensive support strategies that take account of the institutional environment and power configurations.

While the literature suggests that SMEs are best placed to generate broad-based, inclusive growth, our research suggests that SME support strategies that ignore the embeddedness of enterprises in the wider socio-political and economic context can reinforce rather than counter-balance exclusionary structures. Given that personal connections and the competition and sometimes collusion of state and non-state authorities shape the 'rules of the game', an injection of financial or non-financial resources (assistance) into structures that suffer not only from a lack of capacity but also and, more importantly, from infiltration of personalised interests, are likely to entrench exclusive structures even further and, hence, do harm.

*...for researchers:*

If evidence suggests that those entrepreneurs who have the right connections and enjoy the protection by relevant authorities are most likely to grow successfully, a critical question in view of improved stability and development needs to be answered: What strategies need to be in place in order to not only promote the well-connected high potential businesses but also create the incentive structures that will gradually open the benefits of SME growth to a broader and more diverse group of beneficiaries? In other words, a better understanding is needed of the role small firms could play in what the World Development Report 2011 called 'inclusive enough coalitions'. These are essentially groups of actors with power, whose beneficiaries and support bases are restricted to a certain identity-based group and whose interests align to a minimum extent with the ambition of broad-based development. Research into the SMEs' reliance and dependency on such powerful coalitions can identify entry points for *de facto* business environment reform.

*...for policy makers:*

It is important to recognise that challenges to SMEs in fragile contexts cannot be effectively addressed with financial assistance and standard technical assistance packages and that such interventions run a real risk of reinforcing unbalanced wealth distribution structures, thereby hampering rather than facilitating a transition to more inclusive and stable societies.

Policy strategies and instruments for SME promotion have greater chances of success if they are embedded in broader business environment reform that involves non-state actors and civil society leaders from different (ethnic, political, religious, gender, age) groups in a public-private dialogue. For such a comprehensive approach, close coordination and collaboration with the host government and other western and non-western donors is essential. It is equally critical for donor governments to engage with their home-based multinational companies on issues of local sourcing. Not only do these larger companies have a significant share in the local market, they also have - through the employment, income and business opportunities they generate for different parts of the populations - political leverage that can be harnessed for broader political reform.

*...for implementers:*

Financial and technical assistance in fragile states has a greater chance of success as part of a more comprehensive business environment reform that is neither restricted to state institutions nor exclusively targeted at the economic sphere. For example, connecting SME promotion to public-private dialogue that involves both formal and informal institutions and organisations is likely to contribute to a more level playing field and to do so in a sustainable manner.

Technical assistance could be designed to improve the conflict-sensitivity of businesses when it comes to their operations vis-à-vis: their employees (training on balanced and transparent recruitment and employment practices); the community (training on communication and mediation strategies and on local conflict history and current conflict lines); and the government (training in communication, local legislation, advocacy and lobbying).

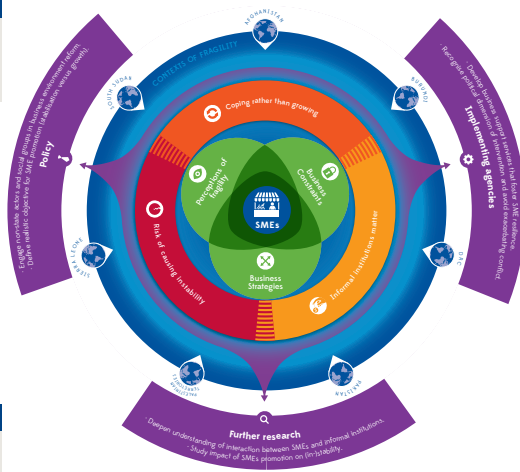
It is important to realise that any external support to businesses in fragile contexts comes with two types of conflict-related risks. On the one hand, there is a risk of doing harm by exposing the beneficiaries of external support to a heightened propensity for extortion and greed. On the other hand, an unequal distribution of financial or technical assistance can easily reinforce the predominance of a certain group, thereby underpinning existing horizontal inequality and fuelling potential grievances. Similarly, prioritising the promotion of female or young entrepreneurs should anticipate possible effects on traditions and value systems in order to navigate possible conflicts. Both risks should be carefully monitored and mitigated.

**MAIN RESEARCH QUESTION**

How do entrepreneurs in fragile contexts experience fragility and how does that perception shape companies' behaviour and business strategies?

**WANT TO LEARN MORE?**

Please read the full report at: [www.diegensack.nl/cru](http://www.diegensack.nl/cru)





# References

- Altenburg, T. and U. Eckhardt (2006), *Productivity enhancement and equitable development: challenges for SME development*, UNIDO, Vienna.
- Banfield, J. et al. (eds.) (2006), *Local Business Local Peace – The peacebuilding potential of the domestic private sector*, International Alert, London. <http://www.international-alert.org/resources/publications/local-business-local-peace> (accessed August 2015)
- Basnett, Y. and R. Sen (2013), *What do empirical studies say about economic growth and job creation in developing countries?*, ODI, London.
- Biggs, T. and M.K. Shah (2006), *African SMEs, networks and manufacturing performance*, Policy Research Working Paper 3855, World Bank, Washington D.C.
- Binzel, C. T. Brück (2007), 'Analyzing conflict and fragility at the micro-level', paper presented at the UNU-WIDER Conference on Fragile States–Fragile Groups, Helsinki, 15–16 June 2007.
- Boege, V. et al. (2008), *On Hybrid Political Orders and Emerging States. State Formation in the Context of 'Fragility'*, Berghof Research Center for Constructive Conflict Management, Berlin.
- Brueck, T. et al. (ed.) (2011) *Small Business, Entrepreneurship, and Violent Conflict in Developing Countries*, Special Issue of the *Journal of Small Business and Entrepreneurship*, Vol 24 No. 2 (2011)
- Brueck, T. et al. (2015), *Theories of Change Linking Employment and Stability in Fragile and Conflict-affected Situations*. A scoping study for the Working Group on Employment for Stability of the Dutch Government 'Knowledge Platform' of Security and Rule of Law.
- Cheng C.S. and D. Zaum (eds.) (2013), *Corruption and Post-Conflict Peacebuilding: Selling the Peace?*, IPPC, London.
- Chang, H. (2011), 'Institutions and economic development: theory, policy and history', *Journal of International Economics* 7 (4), December 2011, 473-498.
- Collier, P. (2010), 'State-building: Job creation, investment promotion, and the provision of basic services', *Prism* 2(4), pp. 17-30.
- Corduneanu-Huci, C. et al. (2012), *Understanding policy change: How to apply political economy concepts in practice*, World Bank, Washington D.C.
- De Vries H. and L. Specker (2009), *Early Economic Recovery in Fragile States. Priority Areas and Operational Challenges*, Conflict Research Unit, the Clingendael Institute, The Hague.
- Dudwick, N. and R. Srinivasan (2013), *Creating Jobs in Africa's Fragile States: Are Value Chains an Answer?*, Direction in Development, World Bank, Washington D.C.
- Goodhand, J. (2013), 'Corrupting or Consolidating the Peace? The drugs economy and post-conflict peacebuilding in Afghanistan', in: Cheng C.S. and D. Zaum (2013), *Corruption and Post-Conflict Peacebuilding: Selling the Peace?*, IPPC, London.
- Goldberg, M. et al. (2014), *How Firms Cope with Crime and Violence: Experiences from around the World*, Directions in Development. World Bank Independent Evaluation Group, Washington DC.
- Golub S. and H. Faraz (2014), *Employment, unemployment, and underemployment*, Working Paper, UNU-WIDER, Helsinki.

- Goodwell Investments (2013), *Dutch Good Growth Fund – enhance access to finance for SME segment in developing countries – ('spoor 2')*, Strategic advice by Goodwell Investments, commissioned by Dutch Ministry of Foreign Affairs.
- Gugliemetti, C. (2010), *Measuring the business environment for entrepreneurship in fragile states*, Working Paper, UNU-WIDER, Helsinki.
- Gutierrez, E. (2011), *Introducing Political Settlements*, Christian Aid Occasional Paper Number 4.
- Hellman, J. (2012), 'Working together in fragile and conflict-affected situations', presentation delivered at the Donor Forum 2012, session 3, 15/16 May 2012 in Paris.
- Iacovone, L. et al. (2013), *Stunted growth? Why don't African firms create more jobs?*, Policy Research Working Paper, World Bank, Washington D.C.
- IFC (2013), *IFC Jobs Study: Assessing private sector contributions to job creation and poverty reduction*, Washington D.C.
- IFC and McKinsey & Company (2010), *Two trillion and counting. Assessing the credit gap for micro, small, and medium-size enterprises in the developing world*, Washington D.C.
- Kaplan, S. (2013), *What the World Bank does not understand about 'doing business'*, blog posted April 2013, <http://www.fragilestates.org/2013/04/22/what-the-world-bank-does-not-understand-about-doing-business/> (accessed August 2015)
- Khan, M. (2006), '[Determinants of Corruption in Developing Countries: the Limits of Conventional Economic Analysis](#)', in: Rose-Ackerman, S., (ed.), *International Handbook on the Economics of Corruption*. Cheltenham: Edward Elgar, pp. 216-244.
- Keeler R. and J. Lofbom (2013), *Risky Business: Promoting Private Sector Development in Post-Conflict States – Lessons from the Africa Enterprise Challenge Fund*, Impact Paper 12, KPMG International Development Advisory Services (IDAS), Nairobi.
- Kessler, A. (2013), *Measuring Results of Private Sector Development in Conflict-Affected Environment: A Case Study of the Sustainable Employment and Economic Development (SEED) Programme in Somalia*, prepared by MarketShare Associates for the Donor Committee for Enterprise Development, Cambridge.
- Kolk, A. and F. Lenfant (2012), '[Business-NGO collaboration in a conflict setting: partnership activities in the Democratic Republic of Congo](#)', *Business & Society*, 51 (3).
- Levy, B. (2014), *Working with the Grain. Integrating governance and growth in development strategies*, Oxford University Press, New York.
- Lindbergt, J. and C. Orjuela (2014), 'Corruption in the Aftermath of war: an Introduction', *Third World Quarterly*, 35:5, 723-736.
- Mac Sweeney, N. (2008), *Private Sector Development in post-conflict countries. A review of current practice and literature*, DCED, Cambridge.
- Meagher, K. et al. (2014), *Unravelling Public Authority, paths of hybrid governance in Africa*, Research Brief # 10, IS Academy Human Security in Fragile States, Wageningen.
- Mungiu-Pippidi, A. (2011), 'Contextual Choices in Fighting Corruption: Lessons Learned', NORAD, Report 4/2011, July 2011, <https://www.norad.no/en/tools-andpublications/publications/publication?key=383808> (accessed August 2015)
- Munshi, K. (2007), *From farming to international business: the social auspices of entrepreneurship in a growing economy*, Working Paper 13065, National Bureau of Economic Research, Cambridge (MA).

- The Netherlands Ministry of Foreign Affairs (2013a), *Ondernemen voor ontwikkeling: Investeren in Duurzame en Inclusieve Groei*, The Hague.
- The Netherlands Ministry of Foreign Affairs (2013b), *A World to Gain. A New Agenda for Aid, Trade and Investment*, The Hague.
- The Netherlands Ministry of Foreign Affairs (2013c), *Beantwoording Kamervragen over Beleidsnota 'Wat de Wereld verdient'*, The Hague.
- Naudé, W. (2007), *Peace, prosperity, and pro-growth entrepreneurship*, Discussion Paper, UNU-WIDER, Helsinki.
- Naudé, W. et al. (2011), 'Small Business, Entrepreneurship and Violent Conflict in Developing Countries', *Journal of Small Business and Entrepreneurship*, 24(2): pp. 161-178.
- Naudé, W. (2013), *Bombs and Business How can entrepreneurs in fragile states manage the risks of violent conflict?*, UNU-MERIT's blog posted January 2013, <http://blog.merit.unu.edu/bombs-and-business-how-can-entrepreneurs-in-fragile-states-manage-the-risks-of-violent-conflict/> (accessed August 2014) (accessed August 2015)
- North, D. et al. (2006), *A conceptual framework for interpreting recorded human history*, Working Paper 12795, National Bureau of Economic Research, Cambridge (MA).
- OECD/DAC (2011), *Supporting statebuilding in situations of conflict and fragility: Policy Guidance*, DAC Guidelines and References Series, OECD, Paris.
- OnFrontiers (2014), *Improving SME Investment Strategies in Fragile States: Understanding the Risks and Impact, Consolidated Results*, un-published (available from authors upon request).
- Parker, J.C. (2008), *A Synthesis of Practical Lessons from Value Chain Projects in Conflict-Affected Environments*, microReport no. 105, USAID, Washington, DC. <https://www.microlinks.org/sites/microlinks/files/resource/files/mR-1.pdf> (accessed August 2015)
- Patterson, J. (2010), 'Towards a Post-Conflict Development Doctrine', in Kauffman Foundation, *Proceedings from the Summit on Entrepreneurship and Expeditionary Economics*, Kauffmann Foundation: Kansas City (MO).
- Peschka, M.P. (2011), *The role of the private sector in fragile and conflict-affected states*, World Development Report 2011 Background Paper, World Bank, Washington DC.
- Philip, M. (2013), 'Conceptualising corruption in peacebuilding contexts', in: Cheng, C.S., and D. Zaum (2013), *Corruption and Post-Conflict Peacebuilding: Selling the Peace?*, IPPC, London.
- Reno, W. (1998), *Warlord Politics and African States*, Lynne Rienner Publishers, London.
- Rijkers, B. et al. (2014), *All in the Family. State Capture in Tunisia*, Policy Research Working Paper, World Bank, Washington D.C. [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/03/25/000158349\\_20140325092905/Rendered/PDF/WPS6810.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/03/25/000158349_20140325092905/Rendered/PDF/WPS6810.pdf) (accessed August 2015)
- Ritchie, H. (2013), *Negotiating tradition, power and fragility in Afghanistan. Institutional innovation and change in value chain development*, ISS PhD thesis, Erasmus University, Rotterdam.
- Schiffbauer, M. et al. (2015), *Jobs or Privileges: Unleashing the Employment Potential of the Middle East and North Africa*. World Bank. Washington D.C.
- Schramm, Carl. J. (2010), 'Expeditionary Economics: Spurring Growth after Conflicts and Disasters', *Foreign Affairs*. May/June. 89-99.

- Skyler Fernandes, J. and L. Sene (2010), 'Investing in Africa: Defining the "Missing Middle"', April 2010, in Missing Middle Article Series Featured in *Huffington Post* / Africa.com <http://sacca.jghinternet.co.za/?m=3&s=1&idkey=800> (accessed August 2015)
- Spark (2014), *Tackling Barriers for SMEs in Fragile States*, Discussion Paper at Ignite Conference, 19 November 2014, Amsterdam.
- Stel, N. (2012), *Entrepreneurship and innovation in a hybrid political order. The case of Lebanon*, Working Paper Series, UNU-MERIT, Maastricht.
- Stewart, F. et al. (2006), *Social Exclusion and Conflict: Analysis and Policy Implications*, Policy Paper, CRISE, Oxford.
- Tobias J., and K. Boudreaux (2009), *The role of entrepreneurship in conflict reduction in the post-genocide Rwandan coffee industry: Quantitative evidence from a field study*, Working Paper, Mercatus Center at George Mason University, Arlington (VA).
- UN (2009), *United Nations policy for post-conflict employment creation, income generation and reintegration*, New York.
- UNDP and UNDDR (2012), *Blame it on the War? The Gender Dimensions of Violence in Disarmament, Demobilization and Reintegration*, <http://www.iddrtg.org/wp-content/uploads/2013/05/AWG-UNDP-Gender-Dimensions-of-Violence-in-DDR-Blame-it-on-the-war-2012.pdf> (accessed August 2015)
- UNDP (2013), *Livelihoods & economic recovery in crisis situations*, Bureau for Crisis Prevention and Recovery, New York.
- Waal, de, A. (2009), 'Mission without end? Peacekeeping in the African political marketplace', *International Affairs*, 85 (1), January 2009, 99-113.
- Wood, G. (2003), 'Staying Secure, Staying Poor: The "Faustian Bargain"', *World Development*, 31 (3), March 2003, 455-471.
- World Bank, *Enterprise surveys versus Doing Business*, Washington, DC: World Bank. <http://www.enterprisesurveys.org/Methodology/Enterprise-Surveys-versus-Doing-Business> (accessed August 2015).
- World Bank (2007), *Urban bus operations in Dhaka. Operationalizing political economy*, South Asia Political Economy and Governance Issues Note No 1., Washington, DC: World Bank
- World Bank (2010), 'Unemployment and Participation in Violence', Background paper for the *World Development Report 2011*, Washington, DC: World Bank
- World Bank (2011), *World Development Report 2011: Conflict, Security, and Development*, Washington, DC: World Bank
- World Bank (2013a), *Doing Business 2014. Understanding regulations for small and medium-size enterprises*, Washington, DC: World Bank
- World Bank (2013b), *Doing Business in the g7+ 2013: Smarter Regulations for Small and Medium-Size Enterprises*, Washington, DC: World Bank <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Special-Reports/DB13-G7.pdf> (accessed August 2015)
- World Bank (2014), *The Big Business of Small Enterprises: Evaluation of the World Bank Group Experience with Targeted Support to Small and Medium-Size Enterprises, 2006-12*. Washington, DC: World Bank.

# Annex A: Characteristics of survey samples

This study has gathered evidence through two sets of primary data that can be characterised as follows:

1. The first set of primary data was provided by the *Netherlands Enterprise Agency* (or *Rijksdienst voor Ondernemend Nederland, RVO*). It comprises three sub-data sets, building on five years of experience of implementation in contexts of fragility through its PSI+ programme in the period 2009–14, which resulted in 125 successful PSI+ applications in up to 10 countries:<sup>109</sup>
  - a) two workshops organised at the Clingendael Institute on 10 April 2014 and at RVO on 25 November 2014, drawing on the perceptions and anecdotes of RVO country fund managers, based on their experiences in the 10 PSI+ countries;
  - b) interviews with 14 PSI+ clients and their respective local partner businesses in 4 PSI+ countries (Afghanistan, Burundi, Pakistan and the Palestinian Territories) capturing their perceptions on the interaction between their businesses and the broader environment. Interviews were conducted by RVO country fund managers in the first half of 2014; and
  - c) a random selection of security risk assessments extracted from the regular applications submitted by PSI+ applicants, covering 112 successful applications in eight PSI+ countries (Afghanistan, Burundi, the DRC, Iraq, the Palestinian Territories, Sierra Leone and South Sudan) over the period 2009–14.
  
2. The second set of primary data was provided by *OnFrontiers* in close cooperation with *Building Markets*. It consists of two sub-data sets, based on fieldwork in five countries (Afghanistan, Pakistan, the DRC, Sierra Leone and South Sudan):
  - a) a survey of 48 businesses across the countries surveyed, distributed as follows: Afghanistan (10), Pakistan (11), the DRC (10), Sierra Leone (8) and South Sudan (9).

The business sample was stratified according to:

    - *Economic sector*: about two-thirds of the businesses are operating predominantly in the tertiary sector (67%), with the other businesses fairly equally distributed over the primary (15%) and secondary sector (19%).

---

109 The RVO list of countries that are eligible for the PSI+ programme has been subject to change in the period 2009–14. In 2014 the list included Afghanistan, Burundi, the DRC, Guatemala, Iraq, Pakistan, the Palestinian Territories, Sierra Leone and South Sudan.

- *Size*: the average and number of full-time employees of the businesses is 28, with a minimum of 2 and a maximum of 300.
  - *Location*: all of the businesses are located in urban areas, the large majority in and around the capital city (90%).
  - *Ownership*: more than three-quarters of the businesses are locally owned (77%).
  - *Gender*: just over one-third of the businesses are owned by women (38%).
- b) semi-structured interviews with two locally-based experts in each of the five countries surveyed.

# Abbreviations

DB	(World Bank Group) Doing Business (report)
DGGF	Dutch Good Growth Fund
DRC	Democratic Republic of Congo
IFC	International Finance Corporation
MFA	Netherlands Ministry of Foreign Affairs
NGO	Non-governmental organisation
OECD/DAC	Organisation for Economic Cooperation and Development/Development Assistance Committee
PSI	Private sector investment
RVO	Rijksdienst voor Ondernemend Nederland
SMEs	Small and medium-sized enterprises
UN	United Nations
UNDP	United Nations Development Programme
WB	World Bank
WBG	World Bank Group
WDR	World Development Report