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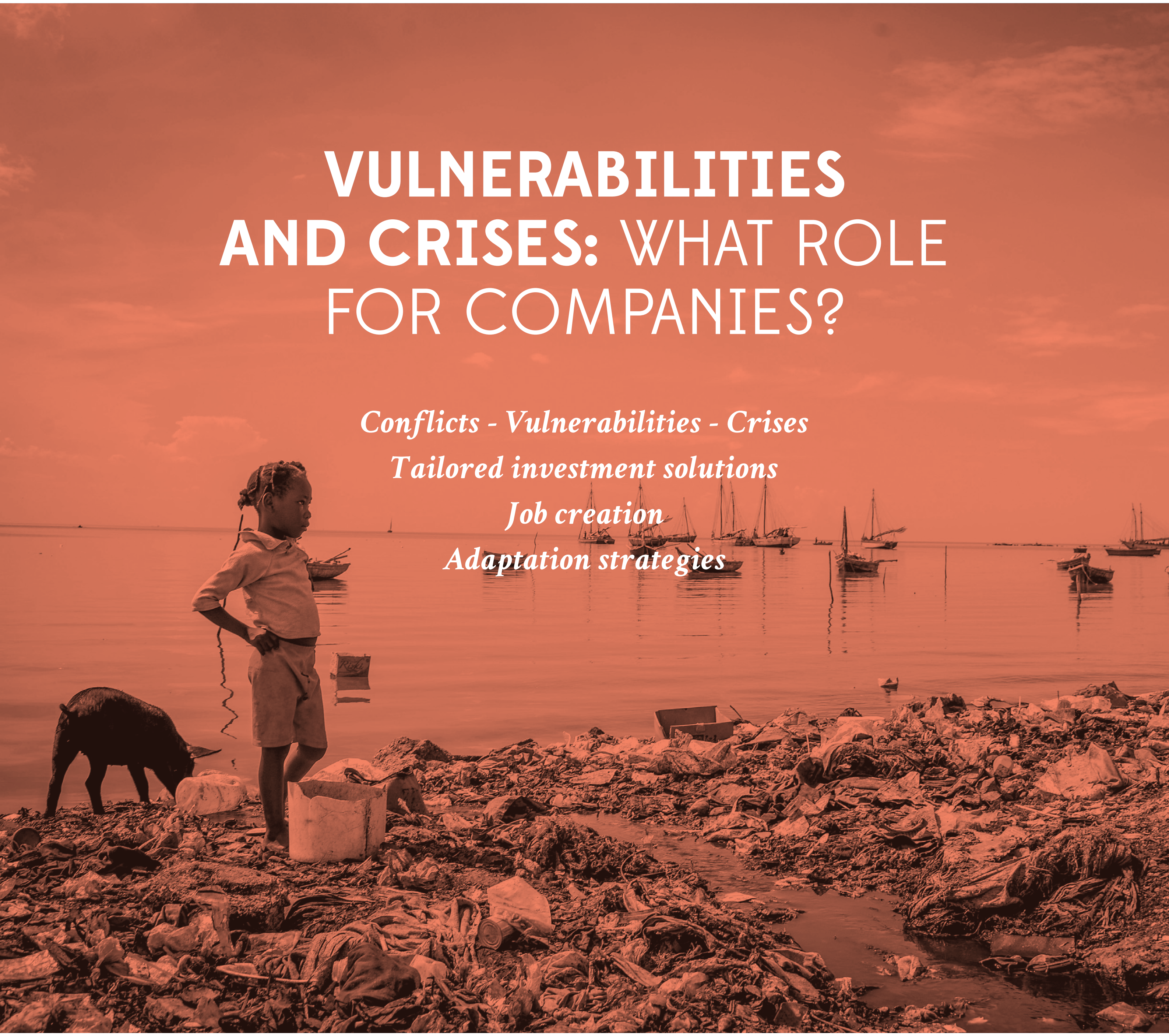
PROPARCO'S MAGAZINE

VULNERABILITIES AND CRISES: WHAT ROLE FOR COMPANIES?

Conflicts - Vulnerabilities - Crises
Tailored investment solutions
Job creation
Adaptation strategies



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E-mail: revue_spd@afd.fr
Website: www.proparco.fr
Blog: blog.private-sector-and-development.com

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Translations
Jean-Marc Agostini
Neil O'Brien/Nollez Ink
Warren O'Connell

Editorial office
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SUMMARY

Fragile countries: a major challenge for the private sector

Grégory Clemente

Chief Executive Officer
of Proparco

Over two billion people throughout the world are currently living in countries in which development is being stymied by situations that are rife with conflict and violence. Moreover, the future provides no great grounds for optimism: the proportion of regions characterised by extreme poverty – fertile ground for situations of violence – is forecast to leap from 17% at present, to almost 50% by 2030. In its 2016 Report entitled "States of Fragility", the Organisation for Economic Cooperation and Development (OECD) stated that 2014 was the "*the second worst year in terms of fatalities since the Cold War ended.*" Consequently, the growing number of both natural and man-made crises and their repercussions makes the theme of fragile countries a key focus of current concerns.

The multiple consequences of these fragile situations are already all too apparent: accentuating contrasts between different regions of the globe; deepening inequalities between different populations; increasing violence and insecurity; the advent of new crises that need to be managed due to displaced populations; or severe strain on political, economic and financial stability.

But what does a fragile country actually mean and when can we consider that a country is in a vulnerable situation? The terminology and concepts employed are extremely important and it is vital to tease out the definitions surrounding these notions. The first thing we think of when vulnerable and crisis-hit countries are mentioned is the intervention of civil society and/or NGOs. But private sector stakeholders also have an important role to play here, both in terms of preventing and surmounting crises and in generating jobs and access to basic goods and services. For companies, one difficulty is having to contend with a frequently adverse business climate (*pages 10-13*) in which many sectors are impacted and a whole host of obstacles lie in the way (lack of basic infrastructure, skilled labour, insecurity, corruption, etc.). For many businesses, the key to negotiating the crisis is bound up with devising adaptation strategies (*p.30-33*). Another difficulty facing private sector stakeholders is the need to effectively analyse and factor in the risks related to their activities which may leave vulnerable local populations exposed if said risks are poorly controlled (*pages 18-21*).

One of the things this issue tries to do is identify the major obstacles facing the private sector in specific contexts in order to point up suitable approaches for partnering these operators as effectively as possible. We thought it essential to listen to what those people actually working in difficult countries have to say in order to take collective stock of the initial lessons and be able to readjust our *modus operandi* in a constant quest for greater impact and effectiveness.

Pierrick Baraton
Consultant, AFD

Pierrick Baraton is a consultant on questions related to private sector involvement in developing countries. His PhD thesis on economics from the University of Auvergne deals with microfinance in Madagascar. Pierrick spent four years working for Investisseurs & Partenaires, a fund that invests in Sub-Saharan African SMEs. He has just completed a study on supporting the private sector in situations of economic vulnerability and crises commissioned by AFD Group.

Michel Botzung
Global Product Specialist, IFC

Michel Botzung is IFC's Manager for Fragile and Conflict Situations in Africa. Based in Nairobi, he leads a pilot program that puts people on the ground, provides funding for both advisory and investments, and drives Knowledge Management.

Rachel Davis
Co-Founder of Shift

Rachel is Managing Director and Co-Founder of Shift. She manages the implementation of Shift's strategy and oversees a wide range of company, government and civil society partnerships. She leads Shift's work with public and private sector financial institutions. Rachel was previously senior legal advisor to John Ruggie, the former UN Special Representative on Business and Human Rights, and she helped develop the UN Guiding Principles on Business and Human Rights. Rachel is an Australian national, based in New York.

Jérôme Pirouz
Senior Vice President, TCX

Jérôme Pirouz, Senior Vice President at TCX, is responsible for transaction origination and structuring and for all of a fund's product engineering. He was previously a senior bond manager and trader for the bank UBS in London and Fortis Bank in Brussels. He graduated in Business Administration from HEC Brussels and holds a Master's Degree from ICMA Centre.

Koloina Razafindratsita
Associate, Adenia Partners

Koloina Razafindratsita has been an Investment Associate at Adenia Partners since 2013. Before this, she worked as a consultant for mergers and acquisitions in Paris and Madagascar and as an analyst for GE Capital. Koloina is a graduate of Paris Dauphine (France) where she majored in both finance and management in emerging and developing countries.

Patrick Safran
Principal Operations Coordination Specialist, Asian Development Bank

As a focal point for fragile and conflict-affected countries, Patrick Safran supports ADB operations in this context. Previously, he helped develop ADB's strategic and results-oriented approach to fragile situations: focal point for disaster and emergency assistance; ICT coordinator; project specialist and focal point for coastal and aquatic resources management. Prior to joining ADB, Patrick Safran was regional manager for Asia-Pacific and Latin America at French agricultural research agency CIRAD. He has PhDs in Agriculture from Tohoku University in Japan and in Natural Sciences from Lille University in France.

Florent de Boissieu
Principal, Adenia Partners

After six years spent as a Consultant with Bain & Co in Paris, Florent de Boissieu has been an Investment Manager at Adenia Partners since 2011. He has been involved in over 20 strategy, operational improvement and private equity consulting missions. Florent has also worked at Eurazeo, one of France's biggest large-cap investors. He is a graduate of Ecole nationale des ponts et chaussées (ENPC), Paris.

Sara Biglary Pesantes
Investment Officer, Proparco

Sara Biglary joined Proparco's Portfolio Division as an investment officer in 2016. She has spent the past seven years between Madrid and Paris developing her expertise in financing renewable energy and infrastructure projects, both in banks (Société Générale, Rabobank) and with developers (Sunedison, Isolux). Sara graduated from Ecole Centrale Marseille and ESCP Europe.

Lorentz Chidue Nwachuku
Investment Officer, Proparco

Lorentz has over fifteen years' experience in structured financing, including the last four years at the International Finance Corporation (IFC) in the Dakar "infra" team. He joined PROPARCO in 2017 for two years, under the 10-year exchange programme with this institution designed to contribute to the expansion of our activities. He holds an MBA from IESE in Barcelona.

Julie Schindall
Senior Advisor, Shift

Julie Schindall is Senior Advisor at Shift. She manages Shift's communications and outreach work, with the goal of making business respect for human rights more understandable and actionable for a range of audiences. Julie began her career in journalism and also worked in humanitarian emergencies in Haiti and Somalia. Julie is a German and American national and resides in Berlin, Germany.

Siby Diabira
Investment Officer, Proparco

Siby is an Investment Officer in the Private Equity Division and the focal point for IFC's fragile states program (IFC SME Venture). Prior to joining PROPARCO in 2014, Siby worked at PWC and BNP Paribas in the structured financing teams. She holds a Master's Degree in Financial and Tax Engineering from the University of the Sorbonne, as well as a Business Management diploma from the University of California, San Diego.

Laure Loaec
Advisor to Proparco's Managing Director

Laure Loaec advises Proparco's Managing Director on numerous strategic aspects (producing memos, preparing meetings, representation, etc.). After graduating from ESCP Europe and London School of Economics, Laure worked for Crédit Coopératif and Dexia before joining AFD Group in 2012.

Ramy Youssef
Chief Financial Officer, Wadi Group

Ramy Youssef is Wadi Group's Chief Financial Officer. Ramy has over 20 years' experience in the areas of financial management, economic evaluations, and restructuring & transformation across various industries and regions, including Angola, UK, and the Middle East. He has worked for global firms including Henkel, Shell and BP. Ramy holds two degrees in Business Administration and is passionate about change management and transformations in developing economies.

Baptiste Tournemolle
Environmental and Social (E&S) Specialist, Proparco

Baptiste has been working as an environmental and social (E&S) specialist in Proparco's Environment, Social, Impact and Governance Division since 2015, where he assesses E&S risks and opportunities for improvement. He was previously a consultant for ten years in an international consultancy firm and also spent two years in Burkina Faso. He graduated as an engineer from INPG and obtained a Master's II Degree in Development in Paris.

The private sector in the midst of crisis situations and economic vulnerability

Pierrick Baraton, *Consultant, AFD*

The private sector is present in most crisis situations that hit fragile countries. To act in an effective manner in such circumstances, development professionals need to juggle between different time horizons (i.e., short, medium and long-term), different-sized businesses (SMEs mostly) and varying degrees of formality. The only constant in all of these situations is the high level of risk involved.

Both the extent and the number of crises appears to be on the rise: the number of natural disasters has more than trebled in the past 30 years while violence in various different forms made 2014 and 2015 the bloodiest years on record since the end of the Cold War. Conscious of the related challenges, the international community has doubled the aid provided to countries in fragile situations: $65 billion were earmarked in 2014 for providing public goods, rebuilding social support structures and for institutional capacity building. In such circumstances, providing support for the private sector has frequently been assigned a lower priority due to a misunderstanding of the role and needs of the stakeholders involved and a general feeling of powerlessness faced with the complexity of the processes at work.

> "Private sector support policies need to become part and parcel of both preventive and curative crisis management."

And yet, the private sector is intimately bound up with processes that culminate in fragile states or, conversely, help countries to emerge from crises. It can be a catalyst for social cohesion and wealth creation or – in the absence of regulation – it may start to engage in predatory behaviour that triggers "destructive destruction" that is far removed from Schumpeter's "gale of creative destruction." As new forms of vulnerability emerge and spread, private sector support policies need to become part and parcel of both preventive and curative crisis management. However, deploying effective private sector development and support in fragile countries in the wake of a crisis first requires a very good understanding of the specific dynamics of these environments as well as the roles and needs of the various different actors.

POST-CRISIS: A SMALLER AND MORE INFORMAL PRIVATE SECTOR

In the wake of a crisis, or in a context of fragile structures, private sector operators frequently have to contend with a very fraught business environment. Access to markets for credit, supplies, external markets, etc., is rendered difficult by a lack of infrastructure and weakened institutions, while the precarious state of central government results in a virtually non-existent judiciary and a constant, residual level of violence. Financial intermediaries who have been burnt by the increase in their non-performing loans are very reluctant to get credit flowing again even though this is a pre-requisite for any economic recovery.

Consequently, businesses begin trading again from a smaller base and find it very hard to grow (Speakman and Rysova, 2015). The level of informal economic activity may also be very significant, either because “formal” businesses adopt “informal practices” in a context of much weaker institutions, or because people set up subsistence micro-businesses activities. Poorly-structured businesses also reflect a lack of financial and managerial expertise and the dearth of qualified workers.

> “Private sector operators frequently have to contend with a very fraught business environment.”

Consequently, the vast majority of private sector operators in fragile countries consist of micro-businesses and SMEs working mostly in the grey economy whose role is just as important as that of much larger corporations.

A FUNDAMENTAL BUT AMBIGUOUS ROLE

The private sector plays a central but ambiguous role in situations of vulnerability and crisis. As the principal economic growth driver, it is fundamental to job creation, generating household and government income and providing access to essential goods and services. Large corporations can act as catalysts for impacting society, especially when they step in to provide public services that would normally be provided by the State – frequently the case in rural areas. The financial sector also plays a key role by giving people access to credit and other products needed to handle crisis situations, such as savings schemes, insurance, remittances from migrants, etc. Lastly, entrepreneurs can play a stabilising role by making a political commitment to conflict prevention or resolution (the Tunisian national dialogue quartet is a good example here).

Conversely, certain private sector players may seek to benefit from crises by actually accentuating vulnerabilities. Such “destructive entrepreneurship” may take a number of forms. Illegal trade (in drugs, arms, people, etc.) or the black market may be a financial boon for rebel or gangster elements. In sectors like the extractive industries, businesses may also increase economic vulnerability and weaken institutions by fuelling corruption. Lastly, a regulatory void may lead certain businesses to trample on ethics, resulting in aggravated social disparities (MacSweeney, 2009). →

FOCUS
AFD

Agence française de développement (AFD) is a public financial institution that implements French government policy to combat poverty and support sustainable development. Its network of 75 offices spread across four continents finances and supports projects to improve living conditions, partner economic development and protect the planet. In 2015, AFD invested €8.3 billion in projects in developing countries and in French overseas territories. For more information, go to www.afd.fr

"The violence and contagiousness of crises require rapid action."

For development partners, the task is one of identifying which economic initiatives to support given the forms of vulnerability that have been identified, and the arrangements that need to be deployed in order to do so. Agence Française de Développement (AFD) and Proparco recently commissioned a study into this whole area.

WHAT TYPES OF INITIATIVE?

Situations of vulnerability and crisis give rise to sometimes contradictory imperatives. The violence and contagiousness of crises require rapid action but the fragile nature of the situation calls for innovative and progressive – and necessarily slow and time-consuming – approaches. Secondly, the sheer scale of what is needed necessitates a massive response whereas the low level of maturity and vulnerability of the actors involved limits the scale of intervention. Finally, the level of unsatisfied local demand promises healthy potential returns on investment and significant societal impacts, but the very high risk considerably reduces the yield to risk ratio and, by inference, the appetite of private sector operators. Work is therefore required on a triple continuum: the impact time-frame, the size of businesses and the degree of business formalization.

"It is essential to focus on structural obstacles by improving the quality of infrastructure and the regulatory framework."

The first finding of the study stresses the need to simultaneously combine approaches that are designed to produce short-, medium-, and long-term impacts. It is vital to quickly limit the consequences of the crisis and to provide vulnerable populations with the means of getting subsistence businesses (back) up and running. More structured businesses will need suitably adapted recovery-type loans with longer grace periods and maturities that give them time to rebuild their assets and working capital. These solutions require close support from financial intermediaries who, because they have borne the full brunt of the crisis, tend to greatly reduce their risk acceptance which obviously hampers any resumption in economic activity. In the medium-term, financial inclusion initiatives can help to bolster the resilience of local populations. Business productivity can be boosted by capacity-building and structuring programmes. In the longer term, it is essential to focus on structural obstacles by improving the quality of infrastructure and the regulatory framework. These highly complementary approaches need to be deployed simultaneously and not sequentially in order to gradually reduce the level of vulnerability on a sustainable basis.

The second finding highlights the need to tailor initiatives to different types of stakeholders. Supporting financial intermediaries is definitely a very effective type of action when the aim is to provide financing for smaller and more informal businesses. Investment funds (for targeting high-potential businesses), banks (for a volume effect), and micro-finance institutions (to develop an offering adapted to the smallest businesses) are complementary players in a global response that embraces all stakeholders.

Finally, it is often necessary to accept a high level of risk, which is the common denominator in all of these situations. New approaches combining public and private funding can be used to cover the additional risk and vulnerability inherent in these situations, either in the form of first loss guarantees or patient capital arrangements that accept lower yield to risk ratios. Grants and subsidies are also needed to structure businesses and make them more suitable for external financing. Indeed, partnering businesses can provide a great opportunity for "bottom-up reform" that fits very well with macro-level initiatives targeting businesses.

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Support for the private sector needs to comply with a number of overriding principles for preventing crises and combating vulnerabilities. A preventative approach is needed that tackles the roots of crises and not merely their symptoms. Rapid impact initiatives must be combined with longer-term action to stabilise situations and battle underlying structural problems. Partnership-based, participative arrangements with all stakeholders (i.e., both local and international) are needed to maximise synergies and build the local foundations for change, together with a regional focus for responding to crises that extend beyond national borders.

These proposed approaches include risk financing, capacity building and business support components and development partners need to be able to come up with suitably adapted resources. All of this constitutes a call for more effective coordination between the private sector support provided by development finance institutions on the one hand, and public development agencies on the other. ■

> "Partnership-based, participative arrangements with all stakeholders, both local and international, are needed."

When the going gets tough: adaptation in times of crisis

Ramy Youssef *is Wadi Group's Chief Financial Officer. Ramy has over 20 years of experience in the areas of financial management, economic evaluations, and restructuring & transformation across various industries and regions, including Angola, UK, and the Middle East. He has worked for global firms including Henkel, Shell and BP. Ramy holds two degrees in Business Administration and is passionate about change management and transformations in developing economies.*

Despite the turmoil, the Egyptian economy is still growing. What are the reasons for this (the diversity of the Egyptian economy? the resilient mindset of the Egyptian people forged by their capacity to get through crises since the dawn of history?) and what can Egypt teach other "fragile" countries? This article attempts to answer these questions from the perspective of the Wadi Food Group and it also has a few things to say about the role of the private sector in driving economic development in general.

With two revolutions in less than twenty-four months, dwindling foreign currency reserves, a delicate security situation, and a relatively high unemployment rate, there is no real consensus on whether or not Egypt is a 'fragile' country. Although the OECD's 'States of Fragility 2016' report classifies Egypt, the most populous Middle-Eastern and North-African state, as moderately fragile, the World Bank did not express a similar view.

> "The Egyptian economy [...] continued to prevail despite a global economic slowdown."

There is always a difference between internal and external perspectives, and working in Egypt after years abroad, I can clearly see first-hand that such an alignment is difficult to achieve. The past six years have proven the Egyptian economy to be more robust than the market expected as it continued to prevail despite a global economic slowdown significantly impacting expatriate transfers, Suez Canal revenues, and tourism income – the Country's top three sources of foreign currency[1].

What makes some economies more robust than others during challenging periods? What is the private sector's role in tough times? And why do some institutions withstand difficult situations better than others?

1 ▸ CAPMAS.

THE EGYPTIAN ECONOMY: OVERVIEW

It is rather baffling to observers as to how the Egyptian economy is still growing when official numbers would suggest a complete slowdown. There are a few reasons for this, some less obvious than others. The key factor is the diversity of the Egyptian economy, which lessens the impact of any particular sector on the overall economy.

Another key reason is the thriving shadow economy. Studies[2] have estimated that the Egyptian shadow economy accounts for 20% to 30% of GDP. This includes most self-employed blue-collar workers (cleaners, builders, delivery staff…etc.) serving people employed in the official economy, and the majority of the cash economy.

A final reason has to do with Egyptians themselves. Since the dawn of time, Egyptians are accustomed to dealing with crises – from Nile floods to various occupations since Pharaonic pre-dynastic times, to modern-day revolutions. This, combined with a civilization built around agriculture, has forged an acceptance of difficulties as part of life and a high level of belief in, and determination to, effect positive change.

EGYPT POST 2011

The past couple of years have witnessed a paradigm shift in fundamental economic reform with a keen focus on building a sustainable model while balancing the immediate needs of lower income brackets of society. With the decision to float the Egyptian pound on 3 November 2016, to cut subsidies and to invest in much-needed infrastructure, Egypt is definitely on track to regain international trust as one of the key potential regional markets.

With significant foreign currency shortages in 2015 and 2016, the $12bn IMF Extended Fund Facility (EFF) was seen as a vote of confidence in the country's efforts to bridge the balance of payments deficit. In itself, the EFF doesn't mean much – it is the accompanying structural reforms that the private sector is keenly awaiting.

The private sector has embraced the newly-introduced VAT, higher utility costs, and inflation as the price of doing business in one of the most promising markets in the medium term. This is driven by confidence in a long-awaited overhaul of investment regulations and better transparency and stability in legislation.

"Egypt is definitely on track to regain international trust as one of the key potential regional markets."

The journey remains long however and all eyes are on the labour law that most investors believe will remove a major obstacle to FDI growth. There is widespread acceptance that an overhaul of this law has to be preceded by the introduction of a social welfare system that offers unemployment benefits that sustain families above the internationally-recognised poverty line; an ambitious target given the current state of affairs.

The private sector is the main engine of economic growth in Egypt, accounting for an estimated 80% of GDP growth (2015) and employing more than half of the 28.4 million workforce in 2015. The private sector is also the biggest exporter, contributing 52% of all exports in 2015, significantly more than the public sector at 36%[3]. →

FOCUS
WADI

Wadi Group is an important player in the agribusiness industry throughout the MENA region. Launched in Egypt in 1984 with a small scale family-run poultry operation, today Wadi operates 12 subsidiaries with ten brands across three sectors: Poultry, Agrifood and Industry. Wadi is a market leader in poultry day-old chick production, olives and olive oil, and poultry feed manufacturing. Wadi also owns a stevedoring & storage port that integrates with its grains logistics activity.

2 › Modelling the Egyptian Shadow Economy. Hassan & Schneider 2016.
3 › CBE Annual Report 2014-2015.

FROM THE MOUNTAINS TO THE VALLEY...

Wadi operates in this very particular economic context which remains dynamic despite the crises. The company was founded in 1958 when, on a cold October morning, a young egg delivery boy pedaling through the narrow streets of Zahlé in Lebanon started planning his future company: a small poultry farm. Fifty-nine years later, Musa Freiji is Chairman of one of the largest groups in the poultry and agrifood industry in Egypt.

Founded with a vision to provide 'affordable protein to the Middle-East', Wadi Group was established in 1984 in Egypt after Musa joined forces with the late Philip Nasrallah, a prominent poultry producer in Lebanon. The Group has an estimated 17% market share of the Egyptian poultry industry[4], 15% of poultry feed production, ten thousand acres of olive trees and grape groves, six factories and a workforce of around 3,500. With turnover of approximately EGP4.8 billion (USD 300 million) per annum, it is companies like Wadi that are driving the Egyptian economy forward.

Over the past 30 years, Wadi has endured various difficult situations, the most significant being the avian flu pandemic in 2006 which changed the face of the poultry industry in Egypt. The Group, like Egypt as a whole, has prevailed through revolutions, currency devaluations, and evolving fiscal policies.

ADAPTATION IN TIMES OF CRISIS

The past six years have been a real test of Wadi's ability to cope with and respond to an ever-changing macroeconomic and fiscal environment. As the second-largest grain importer after China, Egypt's food sector is significantly impacted by foreign currency availability and hence pricing. Demand in the Egyptian poultry sector has fluctuated significantly as roughly 70% of the cost of poultry meat is feed – usually imported yellow corn and soybean.

Our strategy has been to focus on the basics. People need to eat and as a responsible company, we have an obligation to continue to supply the market with an affordable source of protein even if this means compromising on profitability. Our employees need to be looked after in times of crisis and we have decided not to take workforce reduction decisions aimed at cost-cutting. Rather, we have focused on enhancing operating efficiency, "buying smarter" and reducing waste in our factories.

Our flexible financial strategy based around access to foreign currency, export markets, and preferential interest rates, also helps us to continue to compete in difficult times.

Despite investor uncertainty, Wadi has taken final investment decision on a project that aims to double its poultry production by 2020 and our poultry school – which aims to enhance our technical capabilities through vocational training – is fully operational.

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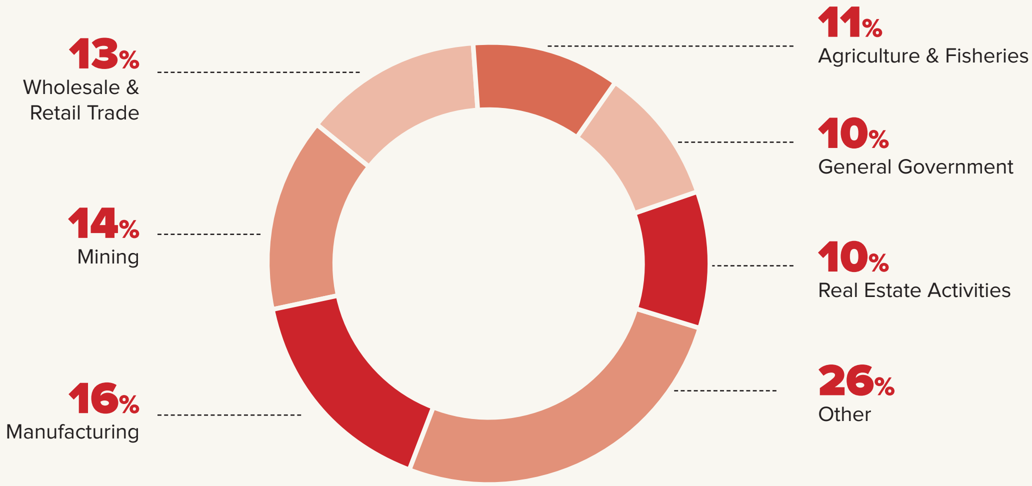
4 ‣ Of Day-Old Chick (DOC) production.

Composition of Egyptian GDP



Source : Central Bank of Egypt (CBE), 2017

PPP SYNERGY IS KEY

Looking back on our three decades of operations in Egypt, we believe the private sector has a key role to play in developing emerging economies. But this cannot be done in isolation as neither the government nor the private sector can single-handedly achieve development. Working through an alternative PPP (Private-public partnership) model could result in significant synergies.

The private sector can be more effective as part of a centrally-orchestrated master plan. Having identified the key growth sectors of the economy, the private sector is best placed to help define the most appropriate investment incentives that need to be offered. The wealth of experience in the private sector – through years of knowing what doesn't work – is a critical factor in shaping a "fit-for-purpose" incentive structure for a given economic sector.

A performance-driven mind-set in the private sector would fit well with a KPI-driven investment plan where investor rewards are linked to achievement of master plan milestones in each sector.

Finally, being the biggest employer, the private sector has a better chance of upgrading the skillset of the workforce. Incentives such as the tax-deductibility of training costs could help the private sector help the country more.

We believe in the fundamentals of the Egyptian economy, our industry, and the country's ability to drive significant economic growth over the coming years. We expect an economic boom in the wake of the flotation of the Egyptian pound, fiscal reforms, and investor-friendly legislation. We continue to back up this belief with investments and we hope that other investors will follow suit.

Currency derivatives: tools for the most fragile economies

Jérôme Pirouz, *Senior Vice President, TCX*

By offering currency derivatives on emerging markets, TCX absorbs the risk related to currency fluctuations and allows the economy to be financed in local currency. This can be essential in the event of an economic crisis. By working with international donors who support local financial institutions and companies, the fund ultimately has an impact on the lives of entrepreneurs in the most fragile countries.

FOCUS
TCX

The Currency Exchange Fund (TCX) is a specialized fund offering OTC derivatives to hedge the exchange rate and interest rate risks which affect international investors and local borrowers on emerging markets. The aim is to promote long-term financing in local currency by helping reduce market risks related to exchange rate asymmetries. TCX consequently works on currencies and maturities which generally have little coverage.

In most cases, entrepreneurs in the most fragile countries do not have access to financing in their own currency and are forced to finance their businesses in hard currencies (euros or dollars). As their incomes are in local currencies, in addition to the risks inherent to their activity, they find themselves exposed to a foreign exchange risk which they are unable to hedge. This exchange risk – which is due to the devaluation of their currency – means that local economic agents are immediately obliged to reduce their costs, defer their investments and, in the most extreme cases, initiate bankruptcy proceedings.

Conversely, implementing local currency financing in the most fragile countries allows companies to generate wealth which will be invested locally, create jobs, and ensure the economic activity is sustainable.

TCX AND BANKS: TRUE COMPLEMENTARITY

It is essential to support private sector flows in local currency. TCX works with commercial and investment banks to meet the local currency needs of their corporate clients and, in certain cases, to hedge its own foreign exchange risk.

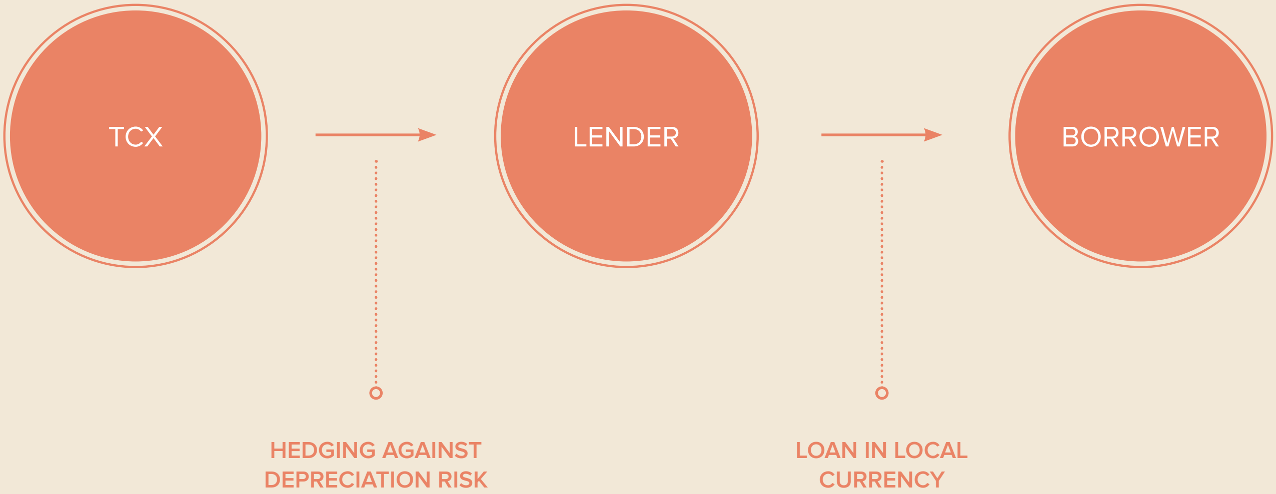
> “Implementing local currency financing in the most fragile countries allows companies to generate wealth.”

At national level, central banks are essential in building a strong and stable economic fabric, which will allow foreign investors to confidently invest their capital. For example, in Georgia, the National Bank of Georgia (NBG) has – with support from supranational organizations – developed a set of tools to increase access to its currency, the lari, and *de facto* “dedollarize” its economy. These measures were taken several years after the depreciation of the lari (-32% between 2015 and 2016) – a situation which especially placed a burden on households and companies, which had had extensive recourse to financing in dollars and had seen their nominal debt increase. NBG is the focal point for this initiative and has forced the banking sector to finance its clients in local currency, which has had the immediate effect of an appreciation of the lari vis-à-vis the dollar (+9% since early 2017).

In this context, TCX responded immediately to the demand of financial institutions by offering external financing in laris. Consequently, TCX's entire available risk appetite for the lari was used up in March 2017 alone – something which had never been seen before! Georgia would currently appear to be well placed to effectively "dedollarize" its economy and protect the entire value chain.

"It is essential to support private sector flows in local currency. It works with commercial and investment banks to meet the local currency needs of their corporate clients."

How foreign exchange derivatives works?



Source: The Currency Exchange Fund (TCX)

WITH MICROFINANCE INSTITUTIONS, PROTECT THE MOST FRAGILE CLIENTS

> “The world’s poorest countries need financing which cannot only be provided by local public funds.”

In the Mekong region, Burma has fully grasped the risks of a “dollarized” economy: microfinance institutions and banks are obliged to finance their clients in kyats. To allow the private sector to respect the conditions imposed by the Central Bank on international donors – which cannot lend over 13% in kyats –, TCX and LIFT[1] have set up a program where funds are made available to TCX to subsidize the cost of coverage offered to its investors. The latter can now finance microfinance institutions in local currencies, thereby meeting the requirements of the Central Bank, which wishes to protect its population against the exchange risk and limit the interest rate on the loans allocated to the latter.

In Haiti, projects are traditionally financed in dollars. The gourde has continued to depreciate sharply since 2014, at an annual average rate of almost 15%. As the default rate of microfinance institutions (MFIs) is particularly high due to years of sharp depreciations, they have raised their lending rates, which can be up to 60%. These huge annual interest rates also take into account the specific operations required in the island’s rural regions (no road infrastructure to reach clients and collect loans, safety problems in branches, high cost of financing MFIs, etc.). By offering MFIs tools to finance themselves in gourdes, TCX ultimately allows them to stabilize the default rates of their clients and, in the long term, make profits which will allow them to normalize the interest rate they apply. A lowering of the interest rates applied to clients is feasible if MFIs manage to use a base of operating costs which is no longer increased by provisions to cover a significant number of defaulting clients. It would also have been possible to significantly reduce these bad debts by financing in gourdes. This would have allowed end clients to be offered loans denominated in local currency, thereby promoting productive and wealth-generating investment.

The foreign exchange derivatives proposed by an increasing number of financial institutions – TCX included – allow services to be provided to entrepreneurs in local currencies. TCX’s mission is, ultimately, to allow the most fragile economies to break out of the impasse and trap of “dollarization” by protecting entrepreneurs against the risk of depreciation, which contributes to the macroeconomic instability of a country.

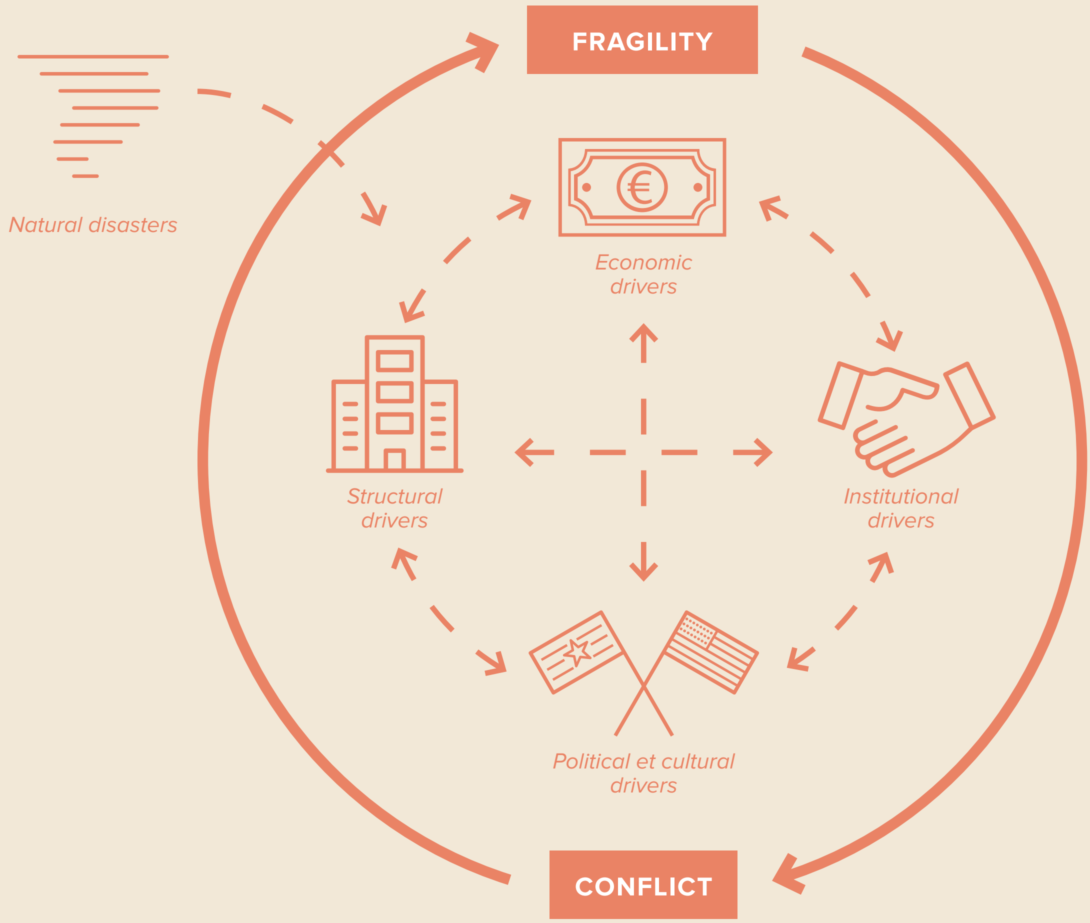
Generally speaking, for each emerging country, the distribution of the foreign exchange risk is a key step in strengthening the absorption and resistance capacity to crises. The fact that this risk is shared between local banks is already remarkable for the stability of these economies. The fact that the foreign exchange risk is transferred to the balance sheets of players who are completely external to these countries

1 ‣ LIFT is a multi-donor trust fund which seeks to improve the lives of rural populations in Burma.

is an additional advantage. It permanently establishes foreign capital flows in local currency which cannot, for the time being, be provided by the local market. The world's poorest countries need financing which cannot only be provided by local public funds. There is a pressing need to develop tools like those offered by TCX, in order to maximize the investment impact and thereby meet the needs of emerging countries in the sectors of entrepreneurship, health, energy, water, infrastructure and education. ■

> "There is a pressing need to develop tools [...] in order to maximize the investment impact and thereby meet the needs of emerging countries."

Cycle of fragility



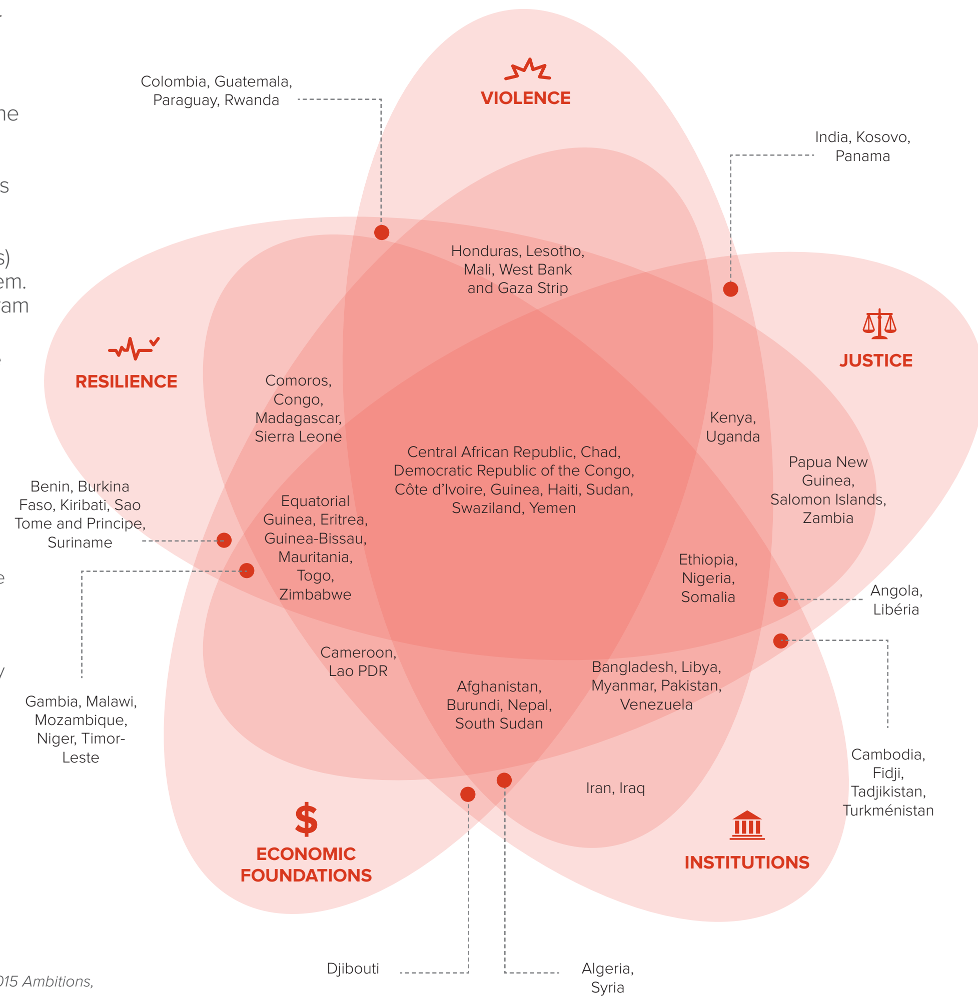
Vulnerabilities and crisis: a summary

Venn diagram representing fragility clusters

A number of criteria may be used to determine the fragility of a state or an economy. When grouped together, these criteria constitute thematic clusters. The Venn diagram presents five thematic clusters (i.e., violence, capacity to adjust to shocks and disasters (resilience), justice, economic foundations and institutions) and represents individual countries within them. The countries at the centre of the Venn diagram rank among the most vulnerable countries.

* The indices are highly volatile from one year to the next. In the diagram, they were determined for 2015 and have not been updated.

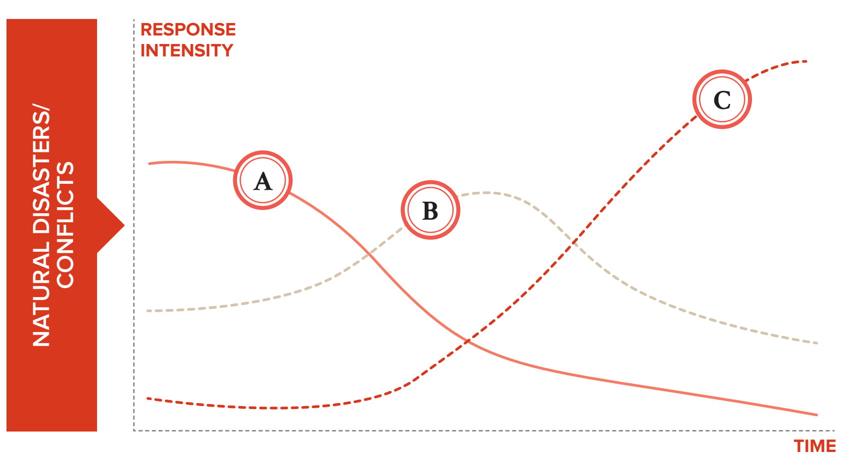
- **VIOLENCE:** Reduce all forms of violence and violent deaths everywhere
- **JUSTICE:** Promote the rule of law at the national and international levels, and ensure equal access to justice for all
- **INSTITUTIONS:** Develop effective, accountable and transparent institutions at all levels; reduce illicit financial flows and combat organised crime
- **RESILIENCE:** Reduce exposure and vulnerability to climate-related extreme events and other economic, social and environmental shocks and disasters; build adaptative capacity
- **ECONOMIC FOUNDATIONS:** Reduce youth unemployment; promote economic, social and political inclusion



Source: OECD (2015), *States of Fragility 2015: Meeting Post-2015 Ambitions*, OECD Publishing, Paris

The three-track approach to post-crisis development

The three tracks are complementary and they need to be programmed simultaneously in order to successfully exit the crisis.



TRACK A: Respond to the immediate needs of populations and the private sector in order to stabilise the situation

TRACK B: Support the re-emergence of the private sector to revive economic activity in the medium term

TRACK C: Boost private sector development by getting rid of structural impediments

Source: UNDP, *Livelihoods & Economic Recovery in Crisis Situations*, New York, 2013

Dimensions and factors of fragility

SOCIETAL DIMENSION
- Inequalities (vertical, horizontal, or gender-related)
- High urbanisation
- Large numbers of displaced people
- Lack of active civil society actors
- Inadequate access to justice

POLITICAL DIMENSION
- Lack of regime change
- State-sponsored violence
- Centralisation of power
- Corruption
- Lack of accountability of the executive

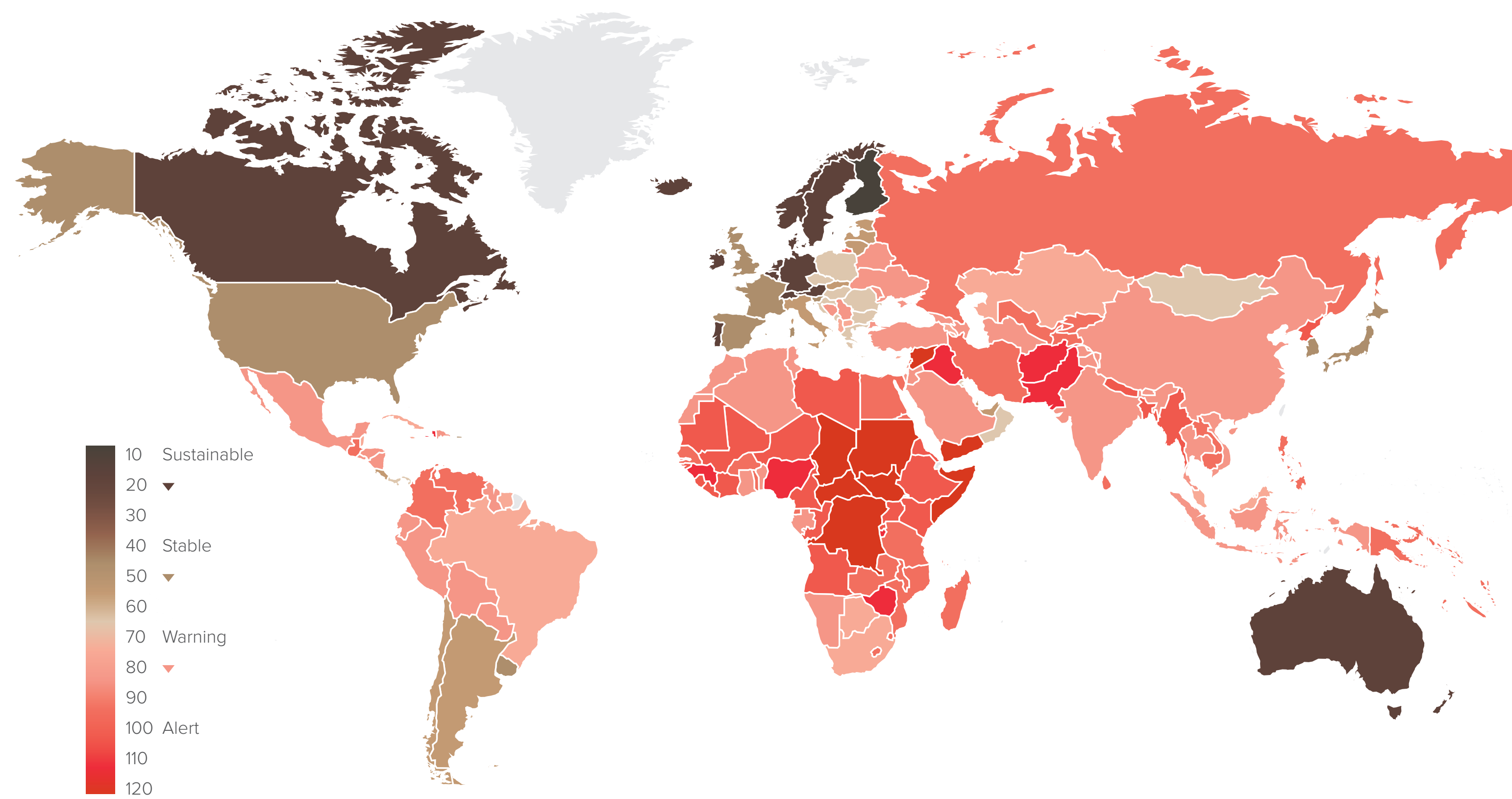
ECONOMIC DIMENSION
- Poverty
- Vulnerable employment
- Unemployment, (particularly youth)
- Dependence on resource rent or on aid
- Government indebtedness
- Remoteness
- Food insecurity

ENVIRONMENTAL DIMENSION
- Natural disaster risk
- Environmental health issues (pollution, lack of sanitation)
- Prevalence of infectious diseases
- Large numbers of displaced people
- Vulnerability of household livelihoods

SECURITY DIMENSION
- Warfare
- Organised crime
- Terrorism
- Interpersonal violence
- Domestic violence

Source: OECD (2016), *States of Fragility 2016: Understanding Violence*, OECD Publishing, Paris.

What are the World's most fragile countries?



Source: The Fund for peace, *Fragile states index*, 2016*

*We were unable to incorporate the 2017 index as it was published after going to press.

What type of fragility?

Violence and conflict in numbers

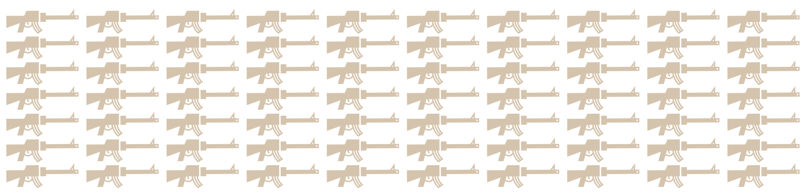
The number of people internally displaced between 2004 and 2014

The Global Peace Index plunged between 2008 and 2015

Political violence is targeting civilians

People were forcibly displaced by war in 2015

Worth of humanitarian aid needed in 2015

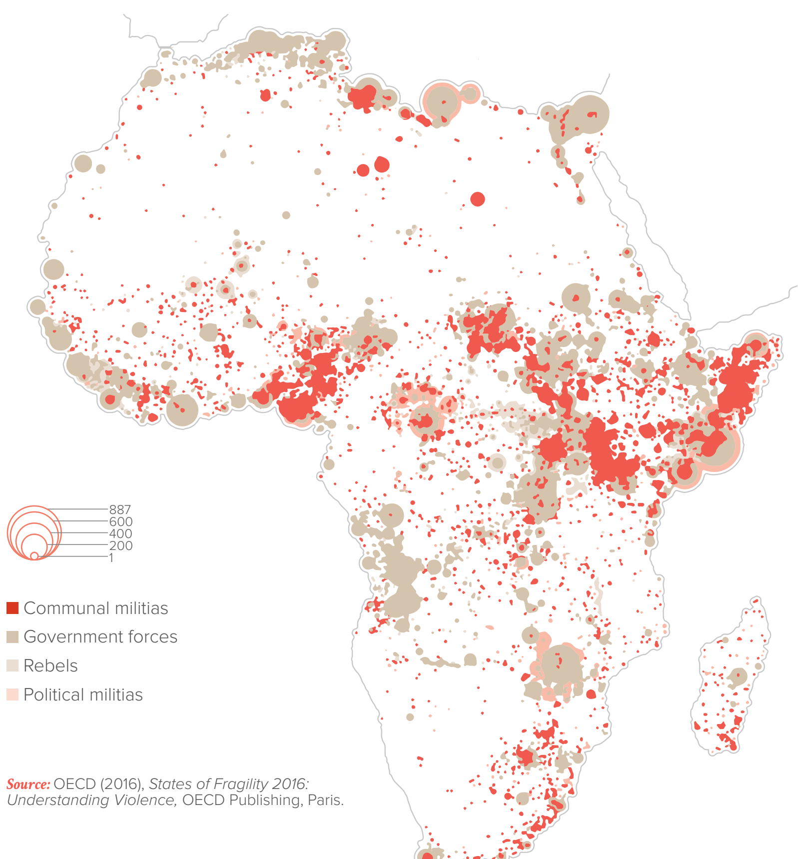


In 2014, at least *70 discrete non-state armed gangs* were recorded as active in Democratic Republic of the Congo

In 2014, in Central African Republic, State forces were active in less than *2% of all recorded political violence*

Source: OECD (2016), *States of Fragility 2016: Understanding Violence*, OECD Publishing, Paris.

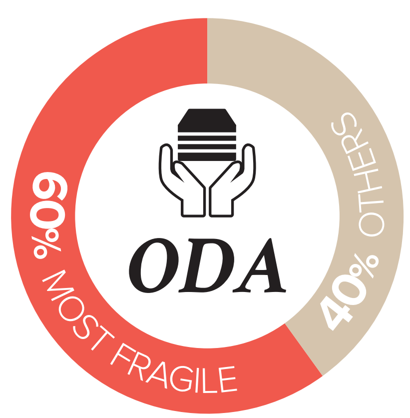
Conflict events in Africa, 1997-2015



Source: OECD (2016), *States of Fragility 2016: Understanding Violence*, OECD Publishing, Paris.

Official Development Assistance (ODA), 2011 – 2014

The most fragile countries are the main recipients of Official Development Assistance (ODA). According to the OECD, since 2011, they have been allocated more than 60% of global ODA.



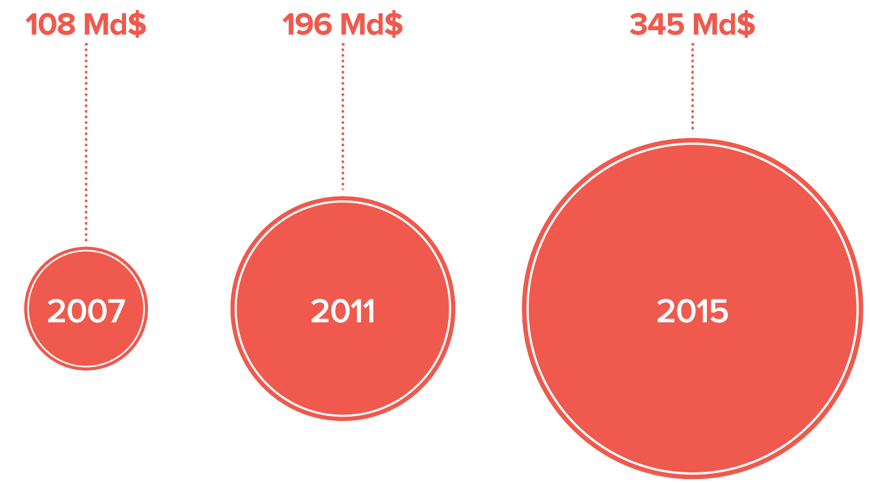
Source: OECD (2016), *States of Fragility 2016: Understanding Violence*, OECD Publishing, Paris.

Extreme poverty and vulnerability

In 2015, a little under 800 million people were living on less than $US 1.90 a day. Even though this number is projected to fall, the impact of extreme poverty is still set to be even greater in contexts of extreme vulnerability.

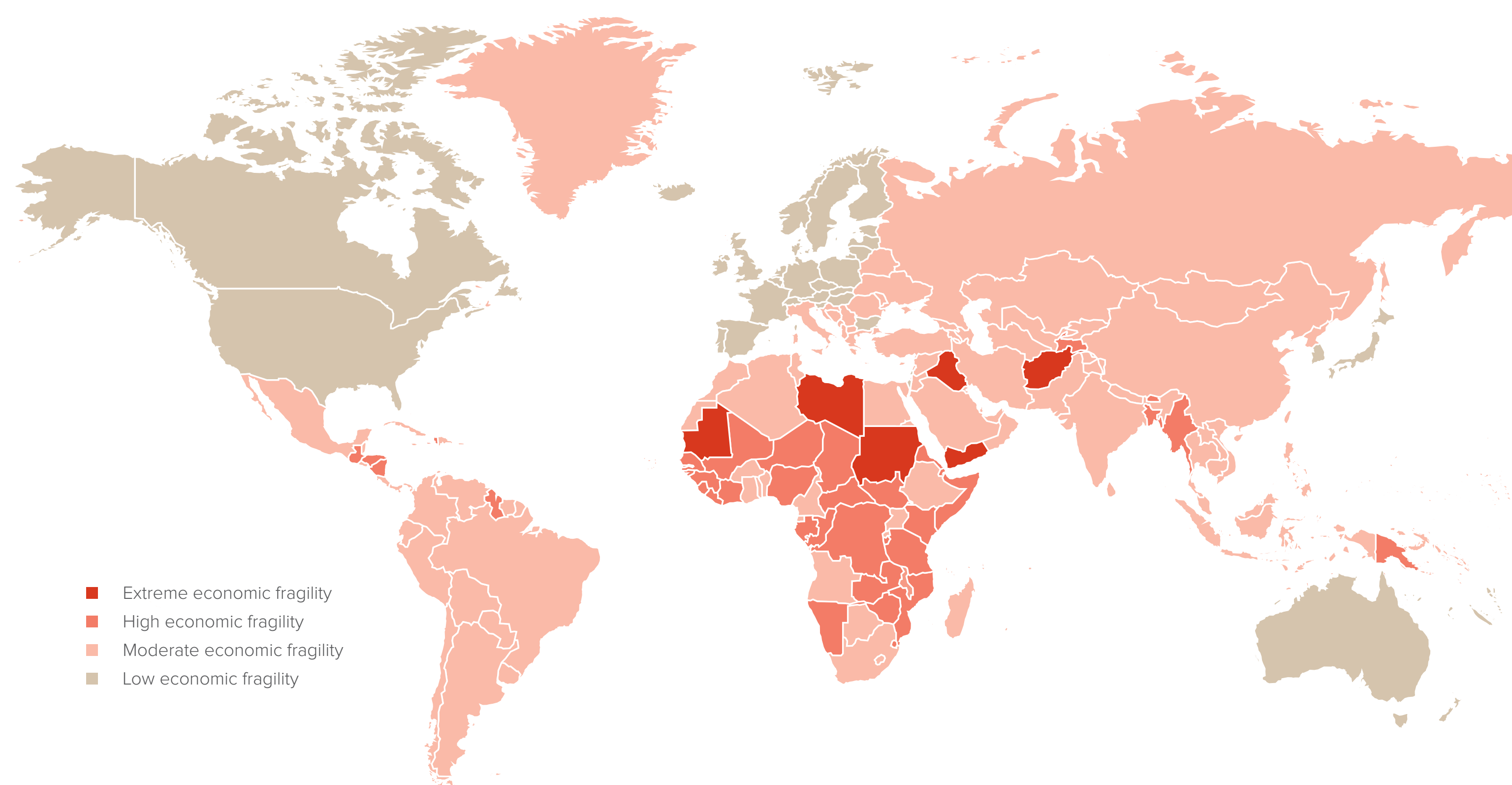
Source: World Bank, 2016

Violence and vulnerable situations have a real economic cost



Source: OECD (2016), *States of Fragility 2016: Understanding Violence*, OECD Publishing, Paris.

A map of economic fragility throughout the world



Source: OECD (2016), *States of Fragility 2016: Understanding Violence*, OECD Publishing, Paris.

The need for corporate human rights risk management in fragile contexts

Rachel Davis, *Co-Founder of Shift*
Julie Schindall, *Senior Advisor, Shift*

Companies that operate in or are connected to fragile contexts – and the financiers that back them-need to have a strong understanding of the risks to people that those companies' operations may pose. They need to conduct due diligence to manage those risks in line with the leading international standards.

FOCUS
SHIFT

Shift is the leading center of expertise on the UN Guiding Principles on Business and Human Rights. Shift's global team facilitates dialogue, builds capacity and develops new approaches with companies, government, civil society organizations and international institutions to bring about a world in which business gets done with respect for people's fundamental welfare and dignity. Shift is a non-profit, mission-driven organization. www.shiftproject.org

All businesses may be involved in harm to people – in other words, in negative impacts on their human rights. But some of the most acute risks to people connected to business activities arise in fragile contexts. Fragile contexts may frequently involve least developed countries, but not always so. Generally speaking, heightened risks to human rights tend to occur in places where rule of law is weak, legal as well as informal discrimination against particular groups in society is widespread, there is no or limited recourse to effective state-supported remedy, and where raising your voice to complain may lead to swift repression or even amount to a crime.

For companies that operate directly in such contexts, and also for the many thousands of companies whose value chains may be linked to such contexts,[1] these risks need to be identified and acted on as part of how business gets done, not as an afterthought.

INTEGRATING A HUMAN RIGHTS FOCUS INTO ENVIRONMENTAL AND SOCIAL RISK MANAGEMENT

Traditionally, many companies understood risk management as an exercise purely in managing risk to the business itself. As awareness of environmental and social risks of business operations has grown, companies have increasingly sought to manage those risks also, though often with a tendency to focus on the risks that are largely under their control, such as labor conditions inside the four walls of the company's own facility, or the amount of effluent the company's plant releases into local waterways.

1 The numbers of people directly affected by global supply chains is estimated to be around one billion. See "Making Economic Globalization Work for All: Achieving Socially Sustainable Supply Chains," John G. Ruggie, http://www.shiftproject.org/resources/viewpoints/ruggie-address-responsible-supply-chains-g20/.

When it comes to the most acute social impacts – those that amount to human rights abuses – companies need to ensure that they are focusing on the greatest risks to people wherever they are occurring, in their own operations or in their value chain. This can mean prioritizing some of the most acute and challenging problems for attention, whether at the furthest reaches of a company's supply chain (for example, impacts connected to the extraction of conflict minerals), or in the most complex contexts where government action creates very significant risks to human rights.

In the international development finance context, the key standard for private sector investment is the International Finance Corporation's Environmental and Social Performance Standards. In fragile and other high-risk contexts, it is clear that implementation of the Performance Standards already requires heightened attention and greater effort.

> “When it comes to the most acute social impacts [...] companies need to ensure that they are focusing on the greatest risks to people.”

But even with the most robust implementation, there are important lessons that human rights due diligence can teach us when it comes to managing risks to people in such complex environments. →

The costs of company-community conflict in the extractive sector[2]

While human rights risks are not always the root cause of a financial risk for the company, issues that started as "non-financial risks" can most definitely translate into hard costs.

Take, for example, findings from a 2014 study by Harvard Kennedy School, Shift and the University of Queensland, looking at the costs of conflict with communities in the extractives sector. The study found real financial costs associated with conflicts between communities and companies – conflicts with a basis in human rights abuses.

- **The most frequent costs** were those arising from lost productivity due to temporary shutdowns or delays in operations – up to US$27 million per week in Net Present Value terms in the case of a world-class mining project.
- **The greatest costs** were the opportunity costs in terms of the lost value linked to future projects, expansion plans, or sales that did not go ahead.
- **The costs most often overlooked** by companies were indirect costs resulting from staff time being diverted to managing conflict – particularly senior management time, including in some cases that of the CEO.

2 ‣ See "Costs of Company-Community Conflict in the Extractive Sector," Rachel Davis and Daniel Franks, http://www.shiftproject.org/resources/publications/costs-company-community-conflict-extractive-sector/

CONDUCTING HUMAN RIGHTS DUE DILIGENCE IN HIGH-RISK CONTEXTS

> "The UN Guiding Principles are the global standard on business responsibility for human rights."

Human rights due diligence is defined in the UN Guiding Principles on Business and Human Rights, which were unanimously endorsed by the UN Human Rights Council in 2011.[3] The Guiding Principles are the global standard on business responsibility for human rights and have been embraced by business, government, civil society, investors and other stakeholders around the world. They are reflected in other international standards on responsible business conduct, such as the OECD Guidelines on Multinational Enterprises.

> "Applying a human rights focus to risk management means testing the robustness of a company's (or financier's) existing environmental and social due diligence."

There is extensive guidance for companies about how to implement the UN Guiding Principles[4], including in high-risk circumstances[5]. While we're not going to repeat that in-depth guidance, we can distill key elements of it here. Applying a human rights focus to risk management means testing the robustness of a company's (or financier's) existing environmental and social due diligence in three primary ways:

- Expand the scope of due diligence: does the scope include the activities of other actors connected to the business's operations (i.e., its business relationships, including joint venture partners, suppliers at every link in the supply chain, or the government where a company has been granted access to land by the government or relies on public security forces to protect its assets) that could be generating significant risks to people (assessed using internationally recognized human rights standards)?
- Prioritize on the basis of severity: does the due diligence prioritize which risks to address first based on the severity of risk to people, not just risk to the business alone? This means ensuring that risk identification is informed by the perspectives of those who are or could be affected by the business and takes account of where impacts may occur on those who are the most vulnerable.

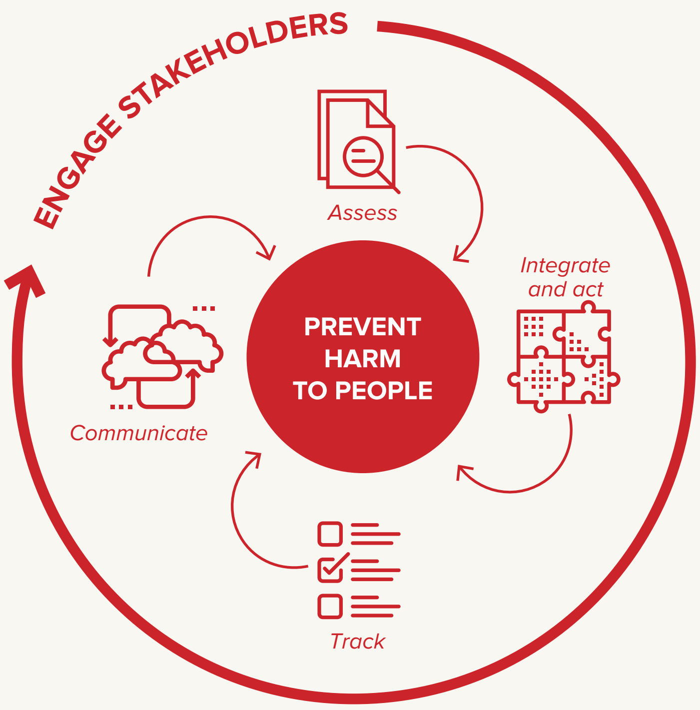
3 ‣ See "UN Guiding Principles," Shift, http://www.shiftproject.org/un-guiding-principles/.
4 ‣ For example, see "Doing Business With Respect for Human Rights," Oxfam, Shift, UN Global Compact Netherlands, https://www.businessrespecthumanrights.org/.
5 ‣ For example, see "Human Rights Due Diligence in High Risk Circumstances," http://www.shiftproject.org/resources/publications/human-rights-due-diligence-high-risk-circumstances/.

- Identify opportunities to take action, including using leverage: does the due diligence identify steps that a company should take to address the most severe risks and impacts that it is connected to using its existing leverage, if other actors are involved, to try to get them to change their behavior?[6] This means understanding the operating context and what is likely to make effective action challenging in practice, particularly where government action may be the primary source of human rights risks.

By bringing these aspects into the company's overall risk management system, companies help ensure they are prepared for where the most severe risks to people may occur in connection with their business and have developed realistic responses, including in fragile and other high-risk contexts.

Human Rights Due Diligence

Source: Shift, 2017



Extract from "IFC Performance Standards on Environmental and Social Sustainability, January 1, 2012"

The International Finance Corporation Performance Standards (IFC PS) are directed towards clients, providing guidance on how to identify risks and impacts, and are designed to help avoid, mitigate, and manage risks and impacts as a way of doing business in a sustainable way, including stakeholder engagement and disclosure obligations of the client in relation to project-level activities. Together, the eight IFC PSs establish standards that the client has to meet throughout the life of an investment by IFC. In addition to meeting the requirements under the IFC PS, clients must comply with applicable national law, including those laws implementing host country obligations under international law.

6 This text is drawn from "ESG Toolkit for Fund Managers - Human Rights Briefing Note," authored by Shift and published by UK Development Finance Institution CDC, http://toolkit.cdcgroup.com/e-and-s-briefing-notes/human-rights.

What tools to finance the private sector in fragile states? The experience of the International Finance Corporation

Michel Botzung, *Global Product Specialist, IFC*

Over half of the world's poor will be living in fragile and conflict-affected situations by 2030. Addressing the challenges of poverty and human development is impossible without taking into account the urgent needs of these regions. In its decades of field experience, IFC has found that the private sector can drive growth and create markets in fragile and conflict situations.

FOCUS
IFC

IFC, a member of the World Bank Group, is the largest global development institution focused exclusively on the private sector in developing countries. We utilize and leverage our products and services to provide development solutions customized to meet clients' needs. We apply our financial resources, technical expertise, global experience, and innovative thinking to help our partners overcome financial, operational, and political challenges. In FY16, IFC has committed USD1Billion in investments in FCS[1] globally, including USD250Million in Africa.

Fragile and conflict-affected places need investment to create jobs, spur economic growth, rebuild infrastructure and create a sense of hope for their people. Simply put, a society with an economic stake in peace may be less likely to return to conflict.

Still, investors, particularly foreign ones, including development finance institutions, approach fragile environments with caution. Not only must they contend with instability and weak institutions, more prosaic problems, like lack of market information, also deter deal-making. This article will share some of the lessons we have learned, in the hope that they can be of value to other development institutions and private investors moving into fragile markets.

WHY FOCUS ON FRAGILE AND CONFLICT SITUATIONS?

Over half of the world's poor will be living in fragile and conflict situations by 2030. Conflict is increasingly expanding beyond national boundaries and leaving a regional footprint. In Africa, over the last decade, several conflicts have taken on a sub-national dimension (take north-eastern Nigeria as an example, where crisis unfolds in the midst of a middle-income country). Then, there are regional conflicts that impact not one but several nations – in the Sahel, for instance, the impact of strife can be felt across borders from Mali to Central African Republic – both amongst the lowest ranked countries in the Human Development Index.

Ending extreme poverty will not be possible if global development leaders do not address the drivers of conflict and instability. As conflict evolves, so must our approaches, so that we are more flexible and adaptable. The key however, is to tap into the dormant potential of the private sector. Studies have shown that in fragile and conflict-affected states, up to 90% of all jobs are created by the

1 FCS = Fragile and Conflict Situation countries

private sector. A dynamic private sector also can help restore key amenities like roads, ports, electricity, transport, and services, while generating tax revenues for the government.

> "Studies have shown that in fragile and conflict-affected states, up to 90% of all jobs are created by the private sector."

BUSINESS AMIDST FRAGILITY

"If you don't have guts, don't look to do business in fragile countries" declared Momudu Kargbo, Sierra Leone's Minister of Finance, at a recent World Bank Group forum. Doing business in fragile and conflict situations is not business as usual. Conducting due diligence is tough when young businesses lack track records, when family holdings rely on opaque governance, and there is limited market intelligence. Even when opportunities are found, investors may have difficultly leveraging them. Local partners might lack capacity, infrastructure might be weak, and political backing can be tenuous. Investors must be resilient, and adopt a long-term approach. Bearing in mind the following principles can help gain a foothold in fragile markets:

1. BE PRESENT ON THE GROUND

One cannot develop local market intelligence, liaise with authorities, companies, local business groups, and finance, customs or judiciary bodies without being in the field, close to clients, partners and key stakeholders. More than 80% of IFC's FCS investments are made in countries where we have a presence. This has financial implications, as operational costs are more expensive in fragile countries, and institutions need to identify, attract and incentivize staff to relocate there.

The profile of staff also matters – waiting for projects to be submitted to one's attention may not be the most effective way of building the portfolio. People stationed in fragile countries need to be entrepreneurial, passionate, and be able to weather the ups and downs of such markets.

2. COMMIT FOR THE LONG HAUL

Fragile and conflict situations require long term investors who can adjust instruments, innovate and pilot, understand contexts, build relationships, and overcome challenges. Opportunities in fragile markets take time to cultivate, and are linked to political stability. In IFC's case, four years ago our portfolio for investment in fragile countries in Africa was driven by Cote d'Ivoire and large infrastructure projects; while in recent years, we have increasingly been focusing on Democratic Republic of Congo and (more recently) Madagascar and have diversified the industry focus, with a fast growing Manufacturing, Agricultural and Services portfolio, including with smaller local sponsors. Adjusting to changing markets and redeploying resources calls for long term institutional commitment. →

> "Doing business in fragile and conflict situations is not business as usual. Conducting due diligence is tough when young businesses lack track records, when family holdings rely on opaque governance, and there is limited market intelligence."

3. LOWER THE RISK

High levels of risk are both endemic to fragile countries and poisonous to investment. Development finance institutions should seek to leverage private capital and avoid depending on the government's sovereign guarantees. Local currency financing also goes a long way in reducing foreign exchange risk for sponsors in fragile countries.

IFC's IDA 18 Private Sector Window (PSW), for example, sets aside 2 billion dollars through innovative financial tools to mobilize private capital and de-risk private investments in fragile countries. The IDA 18 window offers a blended finance facility that will spur investment across sectors, an infrastructure window and a local currency facility.

4. LEVERAGE TECHNICAL ASSISTANCE

Providing hands-on advice to clients in fragile markets can help them become investment ready by improving their governance, increasing operational efficiency, and becoming compliant with international environmental and social standards. Development institutions can also use their advisory services to encourage responsible investment. Environmental and social sustainability have become increasingly important for the private sector, especially in fragile countries. An investor who respects the society, culture and environment of a fragile country earns its license to operate in this complex environment. As of April 2017, IFC has an active portfolio of 56 advisory projects (for a total value of USD 72 million) in African FCS with on average 12 new projects approved every FY.

5. UNDERSTAND THE HISTORY AND DYNAMICS OF THE CONFLICT(S)

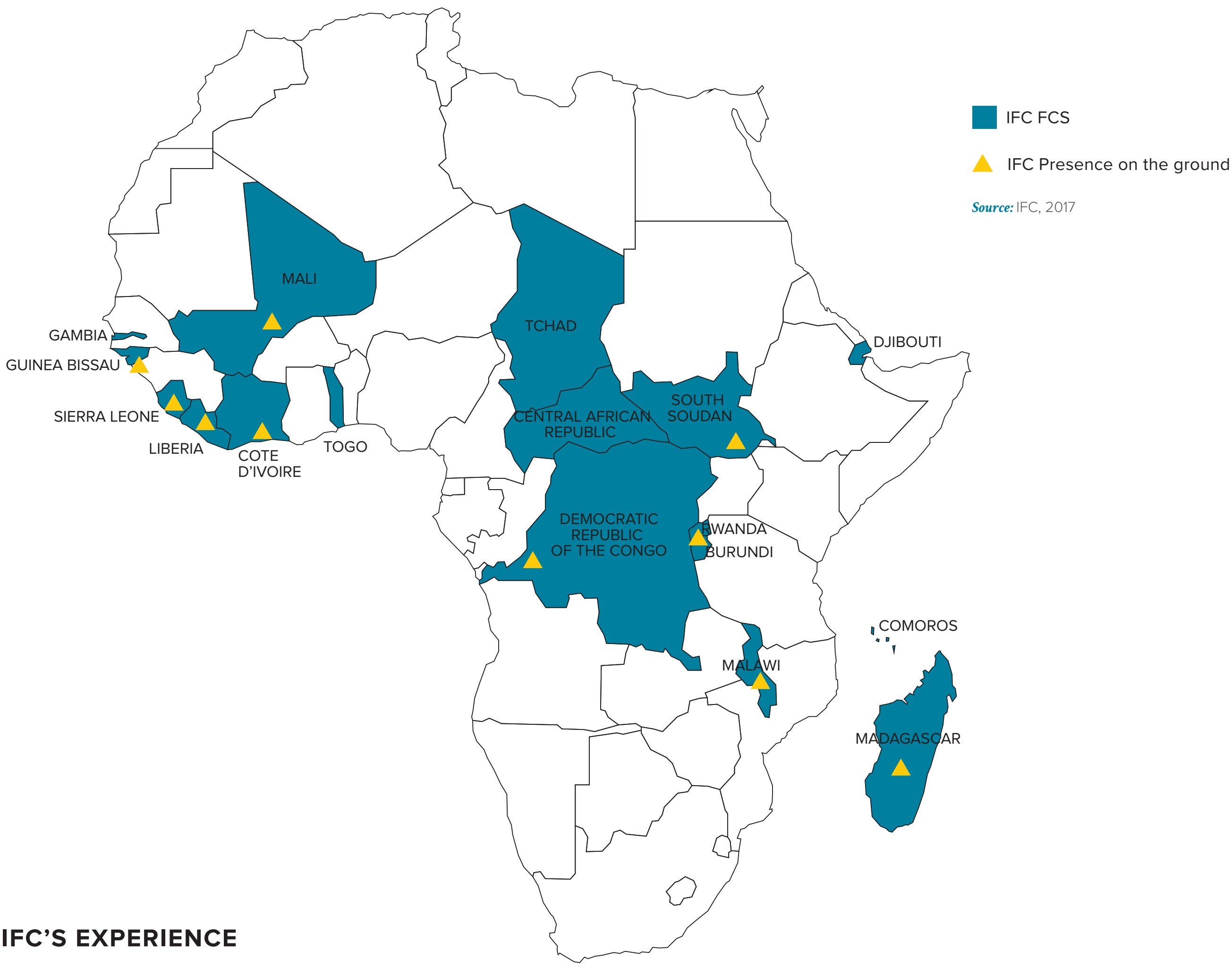
The political economy of fragile and conflict situations involves complex connections between business and politics. Investors should be mindful that their investments do not reinforce – or ignore – old antagonisms and trigger new ones.

Investors must rigorously assess the impact their operations may have so that they do not cause further harm to the delicate social fabric – although this political economy assessment may be costly, it is best done before, as opposed to after investing, when the damage control is far more difficult, and the impact on the investor's reputation and market value may be very high. This means considering competition over resources, value chain structures, the roles of ethnic or rebel groups, and women.

> "The political economy of fragile and conflict situations involves complex connections between business and politics. Investors should be mindful that their investments do not reinforce – or ignore – old antagonisms and trigger new ones."

IFC, a member of the World Bank Group, has long been promoting private sector development in conflict-affected countries that show an appetite for reform and growth. During the past fiscal year (2016), IFC invested over one billion dollars in fragile countries, in projects that are generating power, reviving telecommunications, increasing food security, helping entrepreneurs access finance, and creating jobs for women and youth. We have also mobilized another 375 million dollars from other investors. Every fragile situation has a complex set of trials, but IFC's experience in the field has found that businesses can thrive, and partnerships can be built, even in the most challenging environments.

IFCs Fragile and Conflict Situation African Countries



Source: IFC, 2017

IFC'S EXPERIENCE

Amongst development finance institutions, IFC is today the largest investor in fragile and conflict situations, accounting for 42% of cumulative DFI investments. Getting here has required dedication, as well as innovative approaches. IFC's "Fragile and Conflict Situations in Africa" program, for example, puts people on the ground in FCS Markets to provide market intelligence, facilitate engagement with sponsors and key stakeholders and support business development **(map ➔ above)**.

Partly donor-funded, the program allocates between 5 to 7 million dollars on a yearly basis to finance advisory services that support existing and potential clients in fragile countries, and and help to improve the business environment.

The program also has an increasingly keen focus on cultivating and disseminating knowledge on how to do business in these environments.

While IFC has made strides in fragile and conflict situations, we understand that the heavy lifting requires the hands of many investors and institutions. This spreads the risk, but also brings a greater depth of experience and funding to projects. Investors who are eyeing fragile markets, but not sure that they want to take the risk, should remember that despite the challenges, fragile states are not prisoners of their history. With the right reforms and investment, they can lay the foundations for growth, and maybe even become tomorrow's leaders.

Socolait: using counter-cyclical investment to emerge stronger from a crisis

Florent de Boissieu, *Principal, Adenia Partners*
Koloina Razafindratsita, *Associate, Adenia Partners*

By investing in plant renovation and new products, restructuring its distribution system and deploying a local milk collection network, the Malagasy agri-food operator Socolait has managed to contend with the difficulties arising from the 2009 institutional crisis. The strategic decisions taken, together with a counter-cyclical investment strategy, are now beginning to pay off handsomely.

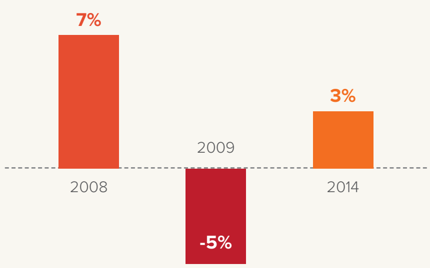
FOCUS
ADENIA PARTNERS

Adenia Partners is a private equity fund manager specialised in investing in high-potential African businesses. Since it was set up in 2002, it has invested in over 20 companies, including Socolait, a Malagasy business acquired in 2012 by four different funds. Adenia currently has USD 500 million worth of assets under management and four offices in Mauritius, Madagascar, Côte d'Ivoire and Ghana.

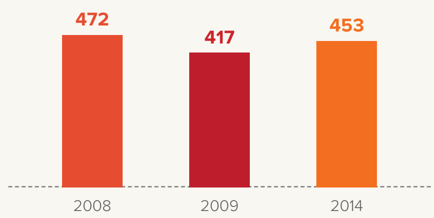
Socolait is one of Madagascar's flagship companies and its 1.2 hectare plant at Antsirabe, 160 kilometres from the capital Antananarivo, has been keeping Southern Africa supplied with sweet concentrated milk and infant flour – its two core products – since it was built by Nestlé in 1975. After it was nationalised in 1981, the company changed hands twice before being acquired by Adenia in 2012. With quality production facilities and a solid, well-known brand, it had begun to develop a range of fresh products which, although they were only of marginal importance in terms of total sales, already had very high growth potential. Adenia and the company's own management planned to harness these competitive advantages to turn Socolait into Madagascar's undisputed No. 1 dairy product producer.

But Socolait also had to deal with an economic crisis and the fallout from regime change in 2009 which culminated in the "High Transitional Authority". Following the suspension of international aid and economic partnerships (SADC, AGOA, etc.), domestic purchasing power collapsed. In late 2013, Madagascar was one of the poorest countries on the planet with 92% of its 25 million people living below the poverty line, GDP per capita of USD 462, and – paradoxically – one of the world's lowest levels of international aid **(diagrams ➜ opposite)**.

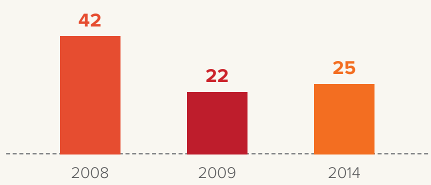
Growth in GDP (at constant prices)



GDP per capita ($ US)



International aid per capita ($ US)



Source: IMF 2016, World Bank 2016

AFTER THE RECOVERY, "COUNTER-CYCLICAL" INVESTMENT

By 2012, the company had recruited a complete management team and deployed a new strategy: major renovation work was carried out to bring the factory into line with international food safety standards and set up the cold chain needed to develop a range of fresh products, including one of the national favourites, yoghurt. The company also launched the "Milk Road" project to develop a fresh milk collection network involving 1,400 farmers in the Vakinankaratra region in which Antsirabe is located. The project resurrected a local network that had been abandoned in 2009 following the closure of Tiko, the group owned by Madagascar's former President. In addition to providing these farmers with a stable income, this project enabled Socolait to reduce its exposure to currency fluctuations and dependence on imported milk powder which they had been using practically exclusively in their products.

The company also enhanced the recipes and packaging of several products and launched a number of new ones (cheeses, new product formats, etc.) and completed the diversification of its customer base. A major promotional campaign was initiated. For the first time ever, Socolait used direct marketing – featuring TV and radio ads – to boost its brand image. Distribution, which had been concentrated among a handful of wholesalers, also became increasingly direct as the company began delivering directly to retailers, hotels/restaurants and even to local authorities. Socolait identified a small number of wholesalers as potential partners who they could use to distribute their products over the "last few kilometres" of the food chain.

> "Major renovation work was carried out to bring the factory into line with international food safety standards."

Nevertheless, purchasing power had been severely weakened by the crisis and these efforts took time to pay off. A plethora of low-cost imports – mostly from Asia – eagerly taken up by a population on the lookout for cheap goods and facilitated by a much weakened central government, began competing directly with Socolait's concentrated milk, which had previously had a virtual monopoly on the domestic market. Sales of concentrated milk, which accounted for 65% of the company's sales in 2011, plunged by 25% a year over the two years that followed the acquisition. Unfortunately for the Company, this drop was not offset by the increase in sales of fresh products which grew by 15% a year thanks to Socolait's efforts in this segment. →

Even as thousands of Malagasy people were losing their jobs, jeopardising the purchasing power of entire families, Socolait doubled its workforce and pumped over €2 million in "counter-cyclical" investments into its plant and facilities in anticipation of future growth.

DECISIONS IN SUPPORT OF SOCOLAIT'S DEVELOPMENT

2014 was a major turning point for Socolait. In late 2013, relatively trouble-free elections held out hope of a gradual return to stronger government while key strategic decisions made within the company led to renewed growth after years of decline.

> "In Madagascar [...] distribution remains one of the major challenges for local businesses."

In the first-quarter of 2014, Socolait cut the price of its yoghurts by 25% and doubled its sales in six months. This decision had a "halo effect" on the entire fresh product range which grew by 5% a month over the next three years. New distribution solutions were also developed. Madagascar's road infrastructure, which was basic to begin with, is deteriorating even further from a lack of investment and distribution remains one of the major challenges for local businesses. Socolait opened a number of distribution platforms both in the capital and the main towns which it operates either directly or with local operators. It also began daily delivery rounds to retailers whose cash constraints and limited ability to store fresh produce had been limiting the value of each unit purchased. These models helped to restore Socolait's control over the distribution of its products: it now distributes 70% of these directly or semi-directly, compared with a mere 25% in 2013. Buoyed by these investments in its distribution network, sales of milk have gradually climbed back to what they were before the political crisis.

As sales began to take off, Socolait continued to enhance its production processes and it obtained HACCP certification in 2014, followed by ISO 22000 certification in 2016, making it the only business in the Indian Ocean with two food security labels. At the same time, the company is looking to the long term. It continues to develop its fresh milk collection network which it sees as a solid competitive advantage and protection against fluctuations in the price of powdered milk. Local milk now comprises Socolait's main raw material.

Lastly, Socolait has kept up its marketing efforts and backed up advertising and regular roadshows with a major point-of-sale rebranding campaign. Between 2014 and 2016, Socolait's sales grew by 30% a year. At the same time, Madagascar returned to the international fold. Although poverty is still alarmingly high, the organisation of a number of international summits (e.g. meetings of French-speaking countries and the SADC) and renewed dialogue on international aid have paved the way for a number

1 ▸ HACCP (Hazard Analysis Critical Control Point) is a food safety management system.
2 ▸ ISO 22000 is an international food safety standard applicable to all companies that do business in the agri-food sector.

of construction projects and the reopening of factories (e.g., textiles). Certain administrative functions, notably customs, are also working better. And purchasing power has improved, as borne out by the 2016 figures for Madagascar's major consumer businesses.

A STRATEGY VALIDATED BY RESULTS

Socolait now has a well-balanced range of products, produced in a renovated factory and distributed through a network that covers a large part of the island. It has consolidated its market share for its core products and become one of the island's market leaders for yoghurt. Obviously, Socolait continues to optimise its product range and invest in its factory, its collection and distribution networks and its marketing campaigns.

The early months of 2017 have been promising: sales have increased by nearly 40% despite growing competition, especially in the yoghurt market. Now that the distribution network is firmly established, the company is looking at a number of projects to extend the product range. An infant flour-based yoghurt was launched in Q1 2017 and new product launches are in the pipeline for the remainder of the year.

The development of the product range, enhanced infrastructure and deployment of an effective distribution network have given Socolait better visibility over the future and provided it with a solid base and fresh resilience. Socolait is aware of its commitments to the people of Madagascar and the challenges they face: the company is active in a private sector humanitarian platform and it has set up the Soco'Tsiky programme to partner a number of associations that work with small children. Moreover, its commitment to the country's farmers through its local milk collection network also make it a key stakeholder in improving the social situation on the island. Madagascar's economy is starting to grow again, albeit slowly, and its GDP is expected to increase by 4.5% in 2017 (IMF, 2017). Socolait, together with the other Malagasy companies that proved their resilience during the crisis, are poised to support this growth over the coming years and contribute to making Madagascar a more prosperous country.

> “Madagascar's economy is starting to grow again, albeit slowly, and its GDP is expected to increase by 4.5% in 2017.”

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IMF, World Bank, 2016

Public infrastructure: a key driver in supporting private players

Patrick Safran, *Principal Operations Coordination Specialist, Asian Development Bank*

In situations of vulnerability and crisis, investment in infrastructure by international development institutions can provide a solid base to support the recovery and reconstruction of a State.

This article was initially published by Patrick Safran on the "Asian Development Blog", on Tuesday, 19 November 2013. The author has authorized its reprint in this journal.

Transport, energy, information and communication technology (ICT), and water infrastructure enable a State to grow its economy and provide a quality life for its citizens. Infrastructure, especially in fragile and conflict-affected situations (FCAS), contributes to rehabilitation and/or reconstruction efforts supporting state building. Infrastructure is important to counteract diseconomies of scale, isolated communities, high costs of accessing markets, and allow people to access basic services.

Is it really worth investing in infrastructure in situations of political instability, weak governance, economic insecurity, conflict, and vulnerability to natural disasters? Yes. The Asian Development Bank (ADB) has long been an important development partner for countries experiencing FCAS and has helped some of these States to make a successful transition out of fragility and conflict. ADB's experience shows that infrastructure investment can deliver greater economic returns in fragile States, if the work is done right.

INFRASTRUCTURE DEVELOPMENT SUPPORTS STATEBUILDING EFFORTS

State building in Cambodia began from a very low base after decades of armed conflict, extreme loss of human life and capital, and widespread destruction of public institutions. Since 1992, ADB has helped Cambodia to transform itself from a post-conflict country to a market-oriented economy that has achieved steady economic and social development. ADB's work initially focused on rehabilitation in response to the country's emergency needs in three priority areas: physical infrastructure, social infrastructure, and capacity building and institutional strengthening. This focus was later broadened to poverty reduction, broad-based economic growth, inclusive social development and good governance.

To strengthen coordination of assistance and improve aid effectiveness, ADB engages in technical working groups with government institutions and development partners, and civil society. ADB partners with civil society organizations in Cambodia to strengthen the effectiveness, quality, and sustainability of the services it provides. For example, nongovernment organizations were engaged to implement a program on gender capacity development under the Rural Road Improvement Project. An independent evaluation of the country program in 2009 concluded that ADB's investment in physical assets and sector reforms boosted connectivity, lowered production costs, and encouraged foreign direct investments. Support to agriculture and rural infrastructure, despite implementation difficulties, paid off in the form of higher yields and extended markets. Regional cooperation initiatives, particularly through the Greater Mekong Subregion program, enhanced connectivity and information exchange between countries of the subregion.

In Afghanistan, ADB has provided assistance for the construction or upgrade of roads; rehabilitation of four regional airports; construction of a cross-border railway line; and power generation, transmission, and distribution. In 2012, the road from Yakawlang to Bamyan extending over 88 km was completed, reducing travel time by more than half. All four of the regional airports are now fully operational. Over 4 million tons of goods have been transported through the first railway line between Hairatan on the Uzbekistan border and Mazar-e-Sharif, and the line is part of a larger rail network planned across the northern and other regions of the country, including Herat, as well as to Pakistan and Tajikistan. ADB-assisted projects have added 510 km of power transmission lines, providing electricity to more than 5 million people.

The security situation in Afghanistan still makes it difficult to implement infrastructure projects. Security concerns also raise costs, partly by reducing consultants' and contractors' interest in implementing projects, limiting competition, and raising quality concerns. Lack of capacity in government agencies compounds the problem. ADB has addressed these by outsourcing project preparation and implementation to design engineers and supervision consultants engaged on long term contracts and placed within relevant Ministries with the dual role to build capacity. Turnkey contracts or design/build contracts are also used to implement large infrastructure projects rather than separating consultancy and construction, which is common

"Turnkey contracts or design/build contracts are also used to implement large infrastructure projects."

in most ADB-funded projects elsewhere. These approaches can yield results without compromising principles of governance, transparency, competition, and efficiency.

In Timor-Leste, early projects administered by ADB and funded from the Trust Fund for East Timor prioritized ensuring peace and stability by quickly restoring the delivery of basic infrastructure services. Public investment projects—mostly roads, electricity, and water supply and sanitation—were undertaken in towns and remote villages; basic public services were restored where infrastructure had been destroyed, or where it became unusable due to lack of maintenance or staff and other resources. Part of Dili Port was rehabilitated to handle larger volumes of freight. Roads were also rehabilitated to allow the movement of goods, people, and security forces. In Timor-Leste, ADB has consistently been supporting the road sector to unite the country and contribute to the country's efforts in state building.

The Pacific islands are small and geographically isolated with largely scattered low density populations, underdeveloped markets and high vulnerability to climate change. Here, ADB emphasizes climate-resilient infrastructure investments, such as water supply, roads, and ports, to increase regional and national connectivity, productivity, and food security. Investments are climate-proofed to ensure their intended outcomes and benefits are not compromised. Infrastructure investments are also complemented by capacity development and institutional and policy reforms. →

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The Asian Development Bank was conceived in the early 1960s as a financial institution that would be Asian in character and foster economic growth and cooperation in one of the poorest regions in the world. ADB assists its members, and partners, by providing loans, technical assistance, grants, and equity investments to promote social and economic development. ADB is composed of 67 members, 48 of which are from the Asia and Pacific region.

> “Early deterioration of infrastructure also affects people’s lives, limiting their access to health clinics, schools, and markets.”

ENSURING LASTING BENEFITS

Public works in fragile states have generally helped secure peace and stability through job creation in the short term. However, the longer term challenge for these countries includes infrastructure maintenance. Lack of maintenance is costly in both an economic and social sense. Failure to manage and maintain infrastructure can contribute to economic loss. Early deterioration of infrastructure also affects people’s lives, limiting their access to health clinics, schools, and markets. Studies show that preventive maintenance provides a better financial return than investment in new infrastructure.

> “Public works in fragile states have generally helped secure peace and stability through job creation in the short term.”

For example, comprehensive transport sector asset management arrangements have been included in all transport projects in the Solomon Islands where the National Transport Fund Act (developed with ADB support) was passed in 2010. This provides a long-term, sustainable mechanism for the rehabilitation and maintenance of transport infrastructure using donor and government’s own funding.

More importantly, for the benefits of infrastructure investment to last, both development and maintenance of infrastructure have to be accompanied by sound policies, capable institutions, and better governance, including community participation and ownership. ■

Working in fragile States: Lessons learned by the Asian Development Bank

This article was published on the "Asian Development Blog" by Patrick Safran, on Wednesday, 12 August 2015. The author allowed us to publish it in this journal.

"Without addressing fragility we cannot achieve sustained development progress." This statement was made recently by Dr. Rui Maria de Araújo, Prime Minister of Timor-Leste, one of several countries in Asia and the Pacific where development progress has traditionally been hampered by fragile and conflict-affected situations. In fragile states such as Timor-Leste, which gained its independence in 2002, achieving development gains is particularly challenging due to weak institutions, political instability or long exposure to internal conflict, and vulnerability to economic shocks or climate change in the form of natural disasters.

Most of Asia's subnational armed conflicts—many of which have been running for generations—take place in generally stable, middle-income countries, with relatively strong governments, regular elections, and capable security forces. This demonstrates that large-scale, armed violence can occur and endure in strong states as well as weak ones, and presents development organizations with a distinct set of challenges that demand a new way of thinking about fragility in the post-2015 Sustainable Development Goals (SDGs) era. The OECD has long recognized this, and came up with a new tool for assessing fragility that is more comprehensive than the traditional single categorization of "fragile states," and finally acknowledges the diversity of risks and vulnerabilities that lead to fragility. The tool helps identify "fragile" countries as those highly prone to five dimensions of risk and vulnerability linked to fragility, and asks how these will affect the chances of meeting the new Sustainable Development Goals: (i) violence; (ii) access to justice; (iii) effective, accountable, and inclusive institutions; (iv) economic foundations; and (v) capacity to adapt to social, economic, and environmental shocks and disasters.

The fragility index developed by ADB is in line with the OECD tool and considers fragility as a complex and multidimensional issue with four core dimensions (economic, state, security and peace, and conflict and justice) and two additional dimensions (environment and world risk) to incorporate environmental and climate change aspects [...]. The guide also draws from lessons we've learned on how to do development work in fragile and conflict-affected situations:

1. Make the right call

Fragility assessments are typically viewed as an added burden for project design and implementation, but if they are done properly, these evaluations can help shape the program and enhance impact. Fragility assessments were introduced in ADB's 2016-20 Country Partnership Strategy for PNG.

2. Identify fragility at an early stage

Early recognition of fragility, its drivers and causal factors, and adapting the project to that specific context, helps allocate resources better, and avoids many potential problems later on. In Afghanistan, we have learned for instance that resettlement plans in road projects are best prepared and implemented with the close participation of communities and affected persons in a seamless process, immediately after funding approval.

3. Apply a context-sensitive approach

Understand dimensions of fragility in the local context and incorporate them at the concept stage before project design, and keep those dimensions in mind during the implementation phase to prevent operational risks that may result from ignoring local fragility dynamics and how they interact with societies, institutional cultures, structures, and systems. ADB's conflict-sensitive approach piloted in Nepal has shown promising results.

By Siby Diabira and Lorentz Chidue Nwachuku, *coordinators of this issue, Investment Officers in the Proparco Private Equity and Energy & Infrastructure divisions*

This issue focusing on crises and vulnerabilities highlights not only the multi-dimensional nature of fragile situations but also dispels any rigid notions of what actually constitute "fragile" countries. We are dealing with environments that cannot be circumscribed either in time or space. Because the origins of the vulnerability of a State or a region are often multi-faceted, they often require carefully adapted, relevant approaches. In such contexts, the private sector sometimes plays an ambiguous role that can straddle two diametrically opposed viewpoints. Private sector players doing business in crisis situations may be singled out (unjustly or otherwise) as at best, profiteers who take advantage of vulnerable situations and, at worst, managers who are guilty of sharp practices, greed and corruption. However, as Pierrick Baraton explains, the private sector can be a *"catalyst for social cohesion and wealth creation."* It is high time to jettison these extreme viewpoints in search of a middle-ground that reconciles the two perspectives.

One of the first lessons we need to learn is to abandon the idea that the private sector is an isolated entity and see it rather as a link in the chain that includes governments and society: as Ramy Youssef contends in this review, *"the private sector is much more effective when it is incorporated into a blueprint that is managed centrally."* Each link in the chain needs to be coordinated in order to provide adapted solutions, especially in these types of circumstances. Indeed, vulnerability, weakness and conflict form a self-perpetuating "viscous circle": weakness generates conflict situations which themselves culminate in weaker countries. And this is why businesses need to be capable of considerable agility in adapting their *modus operandi* to such circumstances. The essential prerequisites are to marshal extra capacity (infrastructure) and then to work on regulatory frameworks over the longer term.

Therefore, crisis situations require very specific strategies. Rapid action is needed to deal with the emergency at hand together with large-scale solutions in a fraught business environment, while also accepting a very high level of risk. Faced with such fragile, tricky situations, some stakeholders prove more resilient than others as borne out by our two case studies. Take Egypt – whose status as a fragile country is not universally accepted – as an example. Since 2011, it has been rife with problems that impact many aspects of everyday life but this has not stopped certain businesses from proving their resilience by focusing on the basics and demonstrating flexibility. Socolait provides another striking example. This Madagascar-based agribusiness, which experienced both an economic and political crisis in 2009, has been partnered by Adenia since 2012. It has taken strategic decisions and made *"counter-cyclical"* investments (*pages 30-33*) that now hold out the promise of double-digit growth over the coming years.

Moreover, the salvation of developing countries resides in infrastructure investment *inter alia* and the private sector will reap the rewards of this. As Patrick Safran of the Asian Development Bank (ADB) points out, developing the public infrastructure of fragile countries is not only desirable in itself, it can also serve as an essential catalyst for boosting private sector operations (*pages 34-37*). Building roads, schools or hospitals not only generates wealth but contributes to the process of building (or rebuilding) states while also creating local employment.

Despite the colossal needs in terms of development aid – which are unfortunately projected to grow even further – vulnerable and crisis-prone countries are still struggling to attract investment from either the private sector or financial institutions. And yet, a lasting commitment by the private sector to partnering government and government bodies is undoubtedly one of the key solutions. Major private sector operators must now put everything on the table and rethink the ways in which they do business in fragile countries. Concessional financing facilities, which are often the first solution that comes to mind when action is needed in a vulnerable environment, are only a tiny part of the solution and in certain cases they can even have unexpected consequences. The article by Patrick Safran (*pages 34-37*) gives an insight into the culture and institutional systems at play which, from our standpoint, are essential for effective private sector involvement. ■

Private Sector & Development

Private Sector & Development (PS&D) is a quarterly publication that provides analyses of the mechanisms through which the private sector can support the development of southern countries. Each issue compares the views of experts in different fields, from academia to the private sector, development institutions and civil society. An extension of the magazine, the PS&D blog offers a wider forum for discussion on private sector and development issues.

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