International companies creating jobs in fragile settings

The case of Dutch small & medium sized enterprises in Africa

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Final report for the Netherlands Ministry of Foreign Affairs

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Cover photo by Sven Torfinn

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List of acronyms and abbreviations

DCED	Donor Committee for Enterprise Development
DDE	Department for Sustainable Economic Development (Netherlands Ministry of Foreign Affairs)
DFID	Department for International Development (UK)
DGGF	Dutch Good Growth Fund
EU	European Union
ICCO	Interkerkelijke Coordinatie Commissie Ontwikkelingssamenwerking (Dutch NGO)
IFC	International Finance Corporation
IOB	The Netherlands Department for Policy and Operations Evaluation
ILO	International Labour Organisation
NL MFA	Netherlands Ministry of Foreign Affairs
NGO	Non-governmental organisation
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
SMEs	small and medium sized enterprises
PSD	private sector development
PSI	Private Sector Investment programme (of Netherlands government)
PUM	Programma Uitzending Managers
SIDA	Swedish International Development Agency
SOMO	Stichting Onderzoek Multinationale Ondernemingen
USAID	US Agency for International Development
UN	United Nations
UNDP	United Nations Development Programme
WDR	World Development Report

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Executive summary & recommendations

Fragile regions offer a serious challenge to the international community as they are home to the world's poorest, experience cycles of conflict and pose threats to global security. The resources and efforts of all relevant actors are needed to address this challenge.

One of those actors are international small and medium sized enterprises (SMEs), a small but growing group of actors generating development impact through local job creation, crucial in fragile settings with high unemployment levels. One of the aims of the newly created Dutch Good Growth Fund (DGGF) is to support Dutch companies with development potential, as part of the wider Netherlands policy to promote sustainable economic growth in developing countries.

Among those countries, arguably most added value is in fragile regions. However what is lacking are three things:

- an understanding of the role of international small and medium sized enterprises there;
- how such companies might best be harnessed to wider development and peacebuilding efforts;
- what will help them move forward on this.

This empirical research for the Netherlands Ministry of Foreign Affairs looks into the incentives, obstacles and needs of Dutch SMEs[1], drawing on in-country interviews with 27 entrepreneurs investing in different types of fragile settings in Africa: Mali and South Sudan, but also regions of Kenya, Rwanda and Uganda.

Findings

It is clear that Dutch entrepreneurs are well capable of developing profitable businesses which also contribute to development[2] in difficult places; together they created thousands of local jobs. The fact that they invest in settings which turned turbulent was not always a conscious choice, but their experience offers interesting lessons for newcomers on what it takes to succeed.

Geopolitical risk and fragility are realities to cope with and an ever more important factor in companies' decision making, not only in 'fragile states' such as Mali and South Sudan but also in regions of Kenya, Uganda and other parts of Africa. Companies, especially the small and medium sized, need partners to mitigate these risks together.

Role of government

If the Netherlands government wishes to work with these smaller companies as partners in development cooperation and harness their **potential for local job creation** in fragile settings in Africa, it needs to build solid relationships based on **what works best there**, and amend its policies and adapt instruments accordingly.

[1] Concerns Dutch-owned and/or Dutch-led: the sample also includes a few companies that have no formal links (anymore) with the Netherlands, but have been founded and managed by Dutch entrepreneurs.

[2] This research has not measured development impact but selected companies with development potential, see also the chapter on methodology

It is clear that the Netherlands government, combining aid, trade and investment, is playing a unique role in partnering with Dutch companies: the role of **broker.** This role is key for them in these fast-changing, fragile settings and is referred to in this paper as **GeoPolitical Risk Support Diplomacy – GPS diplomacy.** This is a process of building coalitions on issues of shared interest between private sector and other stakeholders, such as local government, NGOs, knowledge institutions and media. This is done through lobbying, mediation, matchmaking and negotiation, leveraging what diplomats do best.

<u>Lessons learned</u>
The best practices in this paper provide a number of lessons learned on how to work with small and medium sized companies in these settings:

- Local jobs cannot be created through supply-driven approaches, rather the NL government needs to be **demand-led**: to place the right entrepreneurs in the driving seat of the cooperation and respond to what they need and when;
- The aim should be to anticipate what entrepreneurs will require at **critical crisis junctures** and then offer a **package** supporting but also influencing companies. Financing is part of this service package: a means to achieve a result; its success is not to be measured by the amount spent;
- This package needs to be more comprehensive than is currently the case with traditional business diplomacy and financing, as companies require more to get them through these critical junctures: **knowledge and contacts**;
- As most SMEs need to mitigate risks at **lower and local levels,** but still require the **trust factor** that the Netherlands government brings, the opportunity is in facilitating partnerships and cooperation at those levels – if need be through intermediairies that know how to operate and do business in fast-changing environments.

<u>Recommendations</u>
The **Dutch Good Growth Fund** (DGGF) can build on these partnerships. However the fast-changing yet fragile settings require a different approach:

- Whereas financing is one of the needs, typically, only relatively **small** amounts of funding will be required;
- That funding needs to be **quickly** available through **flexible** procedures, and over **longer terms** than those of regular banks;
- There is, moreover, a need to **stand with entrepreneurs** at the moment when (local) banks threathen to worsen loan conditions or even withdraw financing, which is often what mainstream banks do when geopolitical shocks strike;
- In promising value chains and regions, **focus and synergies** should be sought with:
    - o **local** entrepreneurs supported by DGGF and relevant PSD programmes which build their skills;
    - o investments by multinationals, potentially maximising local benefits of foreign investment, as the local sourcing best practice from Rwanda shows;
- There is need for **quick wins** demonstrating that DGGF, unlike other revolving funds, supports *high risk low return* initiatives: this research has identified a number of

candidates who know how to grow their business, developed **resilience** towards political risk and adequate **coping mechanisms** to sustain development impacts so far**;**
- Do no harm should be an important principle – due to sensitive issues such as land ownership - within the corporate social responsibility standards. Companies have been partnering with NGOs on these as well as on development impact; crucial to monitor, since making money remains companies' first goal.

In Africa's fragile settings, there is potential for growth of the Dutch business sector, but it is limited. Attracting **more Dutch entrepreneurs**[3] and companies genuinely interested in inclusive and sustainable business requires a concerted effort from the Netherlands government:

- bring out **realistic success stories** of entrepreneurs who have built successful and durable businesses there. Visualising this 'story telling' will help mitigate the disproportionally high risk perceptions that persist about the continent.
- Address actual obstacles and geopolitical risks - as experienced by companies currently investing outlined in the findings – in the strategy to promote an **enabling environment,** including not only specific approaches for different (priority) sectors but also regions; this requires a high degree of **policy coherence** as recommended in IOB evaluation report 'In Search of Focus and Effectiveness'.
- Meanwhile increased support for local small and medium sized enterprises, in particular women and youth entrepreneurs, paves the way for inclusive and sustainable business and investments, promoting development impact and peacebuilding in fragile settings.

[3] Our findings indicate what the main perceived obstacles and risks of currently investing companies in these settings are, but the research does not look into what exactly holds back Dutch companies to engage and invest in both fragile states and transitional countries. More empirical data on this would help make relevant Dutch government instruments more effective.

1. Introduction

The levels at which Dutch small and medium sized enterprises (SMEs) trade with and invest in developing countries have historically been low but are expected to rise, albeit modestly from 7% of Dutch SMEs in 2013, to 11% in 2014[4]. The interest for the African continent has been growing, but risk perceptions continue to be high among Dutch SMEs[5].

The Netherlands government seeks to promote these investments through track one of the Dutch Good Growth Fund (DGGF) aimed at local job creation, increased productivity and knowledge transfer through investments and exports by Dutch SMEs. It aims to invest 20% of the resources of the DGGF in fragile states. However, at present information and insights into what prompts companies to engage and invest in these regions is unclear. This research paper seeks to cast light on this issue through analysing perceptions of entrepreneurs themselves who have engaged and are investing in Africa's fragile settings[6].

The second chapter reviews relevant literature on the topic of international SMEs in fragile settings and their development impact, in particular through job creation. The third chapter describes the findings from interviews with 27 entrepreneurs operating in fragile settings in Africa, South Sudan, Mali, Rwanda and parts of Kenya and Uganda. The data are presented in bar charts distinguishing two categories of countries which the Netherlands government applies: aid countries, so called 'fragile states' (including Mali, South Sudan and Rwanda) and transitional countries (Kenya and Uganda). The chapter will describe what their incentives were and what they perceive as obstacles and geopolitical risks in running an inclusive business. It also includes perceptions on the newly created DGGF and working with government and NGOs. The fourth chapter analyses the findings, including how resilience and coping mechanisms increase over time to deal with obstacles and risks. The fifth chapter describes best practices and recommends a way forward on how the Dutch SMEs development impact can be promoted best with the help of the Netherlands government.

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[4] IMVO Thermometer, July 2014, http://www.mvonederland.nl/sites/default/files/media/IMVO-Thermometer%202014%20MVO%20Nederland.pdf

[5] Tulder, R. van en M.Lem, *Doing Business in Africa,* January 2013

[6] The term 'fragile settings' has been used to best reflect the perceptions of the entrepreneurs interviewed and the terminology they used. This takes the fragility definition of the OECD as a basis, recognising 'fragile regions' – which could theoretically be part of a non-fragile state. See also the chapter on methodology.

2. Literature review

a. Achieving development impact in fragile settings and the role of FDI

Fragility makes Africa an unpredictable place to invest, with demographic pressures, conflict, environmental shocks and other potentially destabilising factors always likely to rear their heads.

Before moving onto the question of what value small and medium sized enterprises (SMEs) might be able to add in fragile contexts, it is important first to consider what host governments and the international community are trying to achieve in such environments. What key tasks exist which seek to build peace and encourage durable pro-poor growth development? Surprisingly, given that the international community has been engaging regularly in these activities for many decades, it is only reasonably recently that the sets of activities involved in such work has been codified. A number of frameworks have been proposed for the impacts that the private sector has on fragile states. One of these is that of the Donor Committee on Enterprise Development (DCED), an organisation based in the UK which acts to promote best practice in private sector development (PSD). Its members are the main donor agencies including the Netherlands Ministry of Foreign Affairs (NL MFA). The DCED identifies four areas in which companies can impact on development in fragile states;

DCED Framework for Private Sector Development in Fragile and Conflict Affected States[7]

- **Building security, stability and trust**: From dismantling armed groups, to the development of rules-based society
- **Fostering good governance:** Institutional arrangements in both public and private sector to ensure stable, durable governance
- **Infrastructure:** The development of networks such as in education and commerce as well as physical 'stuff'
- **Economic development**: Generating wealth creation that is equitably distributed

Historically, development of the private sector has not been seen as a priority for those embarking on peace-building in conflict-affected locations. Typically the early stages of post-conflict reconstruction have been led by development actors in more mainstream functions such as humanitarian relief, rural development and education. More recently, however, the realisation has grown that a failure to focus early-enough on developing a thriving private sector actually risks undermining a country's longer-term stability. As a background paper to the 2011 World Development Report argued, "it is important to move away from any argument under which sequencing would imply that security comes first, while private sector development-related reforms come later."[8]

There is a growing recognition that the absence of a private sector causes an unhealthy reliance on donor funding, which is not sustainable. As USAID points out, "conflict-affected environments often experience large inflows of aid assistance early on in the post-conflict

[77] Davis P *PSD in Conflict: Strategic Statement of the DCED Working Group* DCED, Cambridge 2010
[8] Peschka M. *The Role of the Private Sector in Fragile and Conflict-affected States*. World Bank 2011

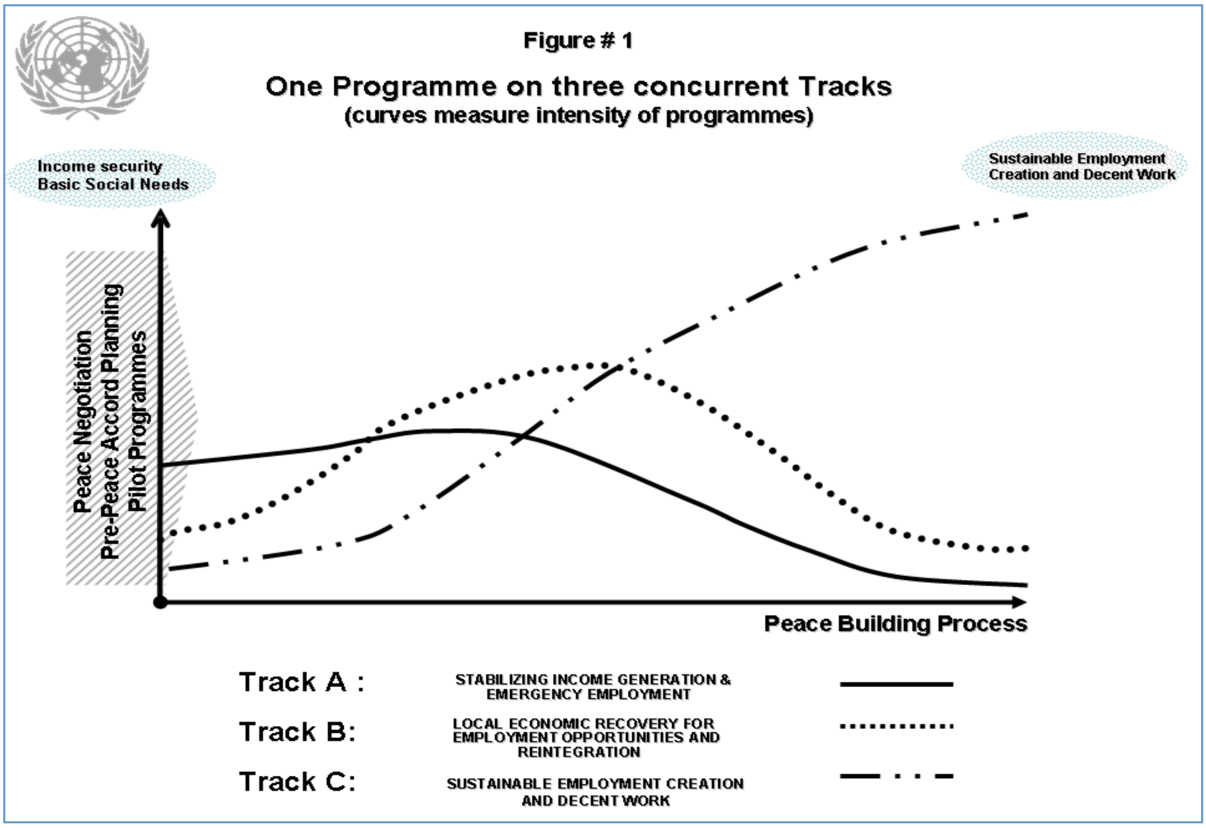
phase, which drop sharply as soon as the conflict has drifted from public and political attention. Too often, there are no systems or strategies in place to build on these initial subsidies to create lasting economic growth."[9] Therefore, as was argued in the 2011 World Development Report, "we need to put greater emphasis on early projects to create jobs, especially through the private sector."[10] An important pre-condition for this is the presence of private sector and their capacity to absorb, grow and expand in order to create jobs.

The importance of early action on private sector-led job creation is demonstrated by the ILO's strategy in post-conflict environments. The ILO model, recently adopted by 20 further UN agencies, including the UNDP, advocates a 3-track process to job creation in conflict affected states:

A. Stabilization: Stabilizing income generation and promoting emergency employment as a way of consolidating peace, security and stability by meeting immediate needs and providing basic services.
B. Local Re-integration: Begin the process of local economic recovery and of the growth in incomes by small-scale livelihood activities.
C. Transition: Begin to develop an enabling environment for employment. As part of this private sector development activities will be essential, in particular policy advice and training, fiscal policy and financial incentives to market development.

As the following chart demonstrates therefore, private sector development (PSD) activity focussed on job creation needs to be a priority activity if stability is to be maintained

[9] USAID. *Accelerating the Transition from Conflict to Sustainable Growth*. 2007 USAID, Washington DC.
[10] World Bank. *World Development Report 2011* pxiii



Although the role of the private sector in fragile contexts is increasingly acknowledged, it remains controversial, with critics pointing to instances where companies have caused harm in these settings. As a recent paper observed, an historic view has been "that foreign investors can do harm in the socio-economic development of fragile states, and have repeatedly done so in the past". [11] The do-no-harm principle continues to be important in Corporate Social Responsibility Standards, especially in fragile settings, with sensitive issues such as land property.

Opinion is gradually shifting, with the result that it is increasingly seen that the private sector "has the capacities (human, resources, managerial and technical, among others) to intervene in different ways"[12] in peacebuilding.The shift in attitude towards the private sector as a positive factor in fragile settings reflects a broader recognition that foreign direct investment (FDI) – if managed effectively – can provide highly beneficial impacts in developing countries. Most studies on this concern large multinational firms, but some findings are relevant for international small and medium sized enterprises (SMEs) as well. Some even reaffirm the importance of focussing on these SMEs, since foreign investment has greater developmental impacts when the technological gap between domestic firms – which are usually small in these contexts - and incoming companies is smaller.[13] Narula and Dunning therefore advocate that host governments use an industrial policy to ensure that they accept foreign investments appropriate to the stage of development of their economy[14].

[11] Hoffmann A. *Policy Review: International and Dutch Policies in the field of socio-economic development*. IS Academy, 2014 p42
[12] Tripathi S & C Gunduz. *A Role for the Private Sector in Peace Processes*. International Alert London. 2008
[13] 'Zhang Y, et al. 'FDI spillovers in an emerging market: the role of foreign firms' country origin diversity and domestic firms' absorptive capacity'. In *Strategic Management Journal*. Vol 9, pp969-989. Sept 2010.
[14] Narula. R & J H Dunning. p13

In practice, what is beginning to happen is much greater sensitivity in managing inward investments, especially in fragile settings, so that they have the greatest possible beneficial impact on the host state. The evidence from this study suggests that investments from SMEs can have highly positive knock-on effects in the local economy.

The NL MFA's policy document, issued last year, heralded "It is our task to encourage investment and trade that benefit people and planet, create jobs and, preferably, are accompanied by the transfer of knowledge and skills."[15]

b. Harnessing the role of the private sector in fragile settings

In fragile settings, the donor community has focussed increasingly on working with the private sector in the broader framework of peace-building, crucial as renewed conflict negatively impacts on development. Much of this has focussed on working with large international companies, for example the Voluntary Principles on Security and Human Rights which is mainly aimed at large companies to improve their impacts on different important aspects of developing and maintaining stability and peace. The same goes for 'Business and Peace', also one of the 9 'issues leadership' priorities for the UN Global Compact[16] and the OECD Guidelines for Multinational Corporations.

The recently developed UN Guiding Principles for Business and Human Rights (under the leadership of Professor John Ruggie) were adopted by the UN Human Rights Council in 2011 and are widely accepted, also by the private sector, as the most authoritative and internationally recognized framework for business and human rights, backed by UN member state governments and based on extensive consultations over a period of 6 years.

It is important to recognize that the guiding principles still have many weaknesses, including the fact that it is a voluntary mechanism, but it provides at least a common ground for the discussion around the responsibility to respect human rights by business enterprises[17]. The IFC Performance Standards are particularly helpful to address issues such as land rights, crucial in fragile settings and provide a good basis for risk analyses within the DGGF.[18]

The focus now is on developing a more collaborative approach which draws on the different capabilities of governmental, corporate and NGO entities and public private partnerships (PPP). The most common collaboration is for business as a delivery mechanism, servicing donors and NGOs, such as Dutch SMEs in South Sudan (see 'findings'). Private sector actors are also a primary delivery mechanism, also for other donors such as DFID – in healthcare and educational activities in Africa. However there are growing efforts to develop links between international investors and local firms. This follows the recommendation of the 2011 WDR to draw on the potential for foreign investors "to create links with local entrepreneurs" in the form

[15] Ministry of Foreign Affairs of the Netherlands. *A World to Gain: A new agenda for aid, trade and investment.* MFA, The Hague 2013.

[16] UN Global Compact. Issues https://www.unglobalcompact.org/Issues/index.html

[17] See SOMO's publications: http://www.somo.nl/publications-nl/Publication_3899-nl

[18] Both Ends, Action Aid and SOMO. *Het Dutch Good Growth Fund: winst in ontwikkelingssamenwerking, maar voor wie?* November 2013

of local procurement and local supply and distribution chains.[19] The Dutch government supports this type of collaboration through Heineken's local sourcing in Rwanda, as described in 'best practices'.

The literature on a specific role for SMEs in peacebuilding is small but growing, however mainly regarding local SMEs. The most significant review of the impact of local businesses is the international Alert report *Local Business, Local Peace*, which "highlights the potential of the domestic private sector to contribute to lasting peace."[20] Based on very varied examples, this report argued that local small businesses had both the incentive to contribute to peace, and unique skills that made them useful in doing so. Given that in many fragile contexts, foreign direct investment (FDI) may be limited, the focus on domestic SMEs is growing. A good illustration of this is the recent report from Dutch NGO, Cordaid, which focuses on "the importance of fostering entrepreneurship in fragile and post-conflict situations." This report argues that support to local small businesses "not only helps to create jobs and fight poverty, but also to build trust, reduce inequalities and increase social cohesion between and within communities."[21]

Whilst the report provides some interesting examples of local SMEs' work, the wider literature on the role of international SMEs is limited. However, the International Council of Swedish Industry recently published guidance for any Swedish companies working in fragile contexts[22]. This publication both provided a 'how to' guide to companies on understanding and responding to fragility, and contained anonymised examples.

At one point in its report, Cordaid refers to its approach as 'co-creation'[23] – bringing together different relevant parties to address key challenges. This more joined-up approach is also advocated in our previous report on business versus development approaches on employment creation: the reality on the ground [on co-creation] is well-ahead[24].

c. Government and donor instruments for the corporate sector (SMEs) in fragile settings

Although a more collaborative approach is to be encouraged, it is also important to focus on the question of who, in a conflict-affected environment, is best placed to do what. As this year's review of DFID's private sector development work concluded, "DFID needs to identify and focus on its core strengths and the areas of PSD work where it can add most value in its role as an aid agency."[25] Donors therefore need to focus on those issues where they have a unique role to play. A 2013 Eldis report looked at the various constraints on the private sector in fragile states and identified at least two areas where there is a strong role for governmental actors:

[19] At present the IFC, in conjunction with Dutch NGO Spark, and other partners are working on the development of a set of principles and a process to engage 'anchor investors' as a core element in developing the wider economy, and in peacebuilding.
[20] International Alert. *Local Business, Local Peace: The peace-building potential of the domestic private sector.* International Alert, London 2006
[21] Cordaid. *Entrepreneurs: Fostering economic opportunities in fragile contexts.* Cordaid, The Hague 2014, p5
[22] NIR. Leadership in complex markets. NIR, Stockholm 2013
[23] *Ibid*, p24
[24] Balt, M and P Davis, 'Business vs Development Approaches on Employment Creation in Fragile Contexts', Knowledge Platform on Security & Rule of Law, January 2014
[25] Independent Commission for Aid Impact. *DFID's Private Sector Development Work.* ICAI, London 2014 p33

- "legal reform requirements in the legal framework of fragile states to boost PSD are often underestimated and deserve greater attention within the realms of development assistance. Law-making, however, is a long-term process and should not violate the tenets of legitimacy and representation
- lack of access to finance and capital to launch businesses as well as dearth of local financial institutions (e.g. reliable central banks) remain one of the major constraints to PSD (in particular in sub-Saharan African fragile states)."[26]

Although correct, this is limited in our view as the Dutch approach combining aid and trade makes clear: donors can move beyond these structural issues and work directly with the private sector. The Swedish government agency SIDA takes a similar position, and have engaged in what they term 'Business for Development'. They make clear that, central to the success of such partnerships is finding an intersection between the company's interests, and those of the development community**. "**A carefully designed… project can therefore alleviate business constraints to production, provide access to a market or generate visibility for a company while having clear benefits to people living in poverty."[27]

The UK too is looking to provide funding directly to companies to encourage their growth and consequent development impact. For example, in November 2013, the British Secretary of State for International Development, Justine Greening travelled to Tanzania to announce a "High Level Prosperity Partnership [to] boost trade, investment and economic development"[28] DFID has since launched an ambitious new Economic Development Strategy, which places work with the private sector firmly at the centre of its development efforts.

The unique role governments can play – beyond the areas mentioned earlier - is through bringing together the diplomatic, development and commercial communities in an integrated manner. Commercial or business diplomacy[29] is part of this integrated approach. According to Ruel, there are a number of reasons why public and private actors work together in unfamiliar markets and use diplomatic means and channels for commercial reasons. First, diplomatic networks generate economic intelligence [or **knowledge**] that would have otherwise been unavailable. Second, diplomatic activities are usually more visible in the media and may thus draw attention (marketing) at a relatively low cost. Third, diplomatic networks usually have easier and influential access to high-level **contacts** than most businesses do individually, especially small and medium-sized firms. Fourth, diplomatic networks have a high '**trust factor'** and that makes it easier to attract foreign direct investment. Fifth, intelligence gathered by foreign missions and diplomatic networks is centralized, and this creates efficiencies for the sector; it keeps businesses from reinventing the wheel.

This growing attention on 'business diplomacy' reflects the fact, both that more companies are operating in more challenging environments, and that these companies increasingly recognise

26 Datzberger S & M Denison. *Private Sector Development in Fragile States*. Eldis 2013
[27] Sida. *Potential and opportunities for private sector cooperation in Swedish Development Cooperation with Uganda*. 2014
[28] DFID *Tanzania and the UK forge new partnership on trade and investment.* https://www.gov.uk/government/news/tanzania-and-uk-forge-new-partnership-on-trade-and-investment. UK Government website 5th November 2013.
[29] Ruel H *Diplomacy Means Business.* Windesheim, November 2013

the need to manage the 'non-technical' risks that they face in these places. It "seeks to transfer and adapt the techniques and mind set of the diplomat to the needs of the firm. It centres on the strategic use of coalitions of state and non-state actors to shape the firm's risk environment."[30] Riordan (2014) argues that firms should adopt and integrate these ways of working themselves and points to limitations of working with government. However this paper recognises the indispensable role of government, especially because of the trust factor it creates, much needed in fast changing environments and fragile settings with weak and unreliable institutions; and therefore has a different interpretation of 'business diplomacy'.

There is an increasing interest from the corporate sector in a more joined-up approach between themselves and government bodies[31]. The findings in this paper confirm that that interest, or even need might even be more acute for SMEs, and in particular Dutch SMEs in fragile settings in Africa, but this requires focussed policies and tailor made services (see 'recommendations').

[30] Riordan S. B*usiness Diplomacy: Shaping the firm's geopolitical risk environment*. Netherlands Institute of International Relations, The Hague October 2014.
[31] See for example, from the experience of the authors of this paper, http://www.reading.edu.my/web/FILES/corporate/cl-The_Henley_Partnership_Events_Calendar_2014.pdf and http://www.abdn.ac.uk/aberdeen-partnership/prospective/feedback/corporate-foreign-policy/

3. Methodology

a. Selection of companies

As the Dutch Good Growth Fund (DGGF) pledged to commit 20% of its resources in fragile states, the sample included three countries which have an aid relationship with the Netherlands government[32], and are called 'fragile states'[33]: Mali, South Sudan and Rwanda[34]. However our sample goes beyond this geographical list and takes the OECD definition of fragility as a basis (2012a):

A fragile region or state has weak capacity to carry out basic governance functions, and lacks the ability to develop mutually constructive relations with society. Fragile states are also more vulnerable to internal and external shocks such as economic crises or natural disasters. More resilient states exhibit the capacity and legitimacy of governing a population and its territory. They can manage and adapt to changing social needs and expectation, shifts in elite and other political agreements, and growing institutional complexity. Fragility and resilience should be seen as shifting points along a spectrum.

Regions that have experienced this kind of fragility to such an extent that it influenced motivations, challenges and needs of companies to engage or invest, were therefore included in the sample, such as Kenya and Uganda which are ranked by the Netherlands government as 'transitional countries'. Each of the aforementioned five countries has a partnership with the Dutch government in the framework of its development cooperation policy.

Entrepreneurs were asked how they perceive fragility in their area of operation, regardless of what category their country of operation is in[35]. The SMEs of the sample for this research were pre-selected on the basis of their development potential[36], either through local job creation, knowledge transfer and/or raising productivity, in line with the criteria for the Dutch Good Growth Fund. Some companies do not meet the SME definition of the EU, being 50-250 employees, turnover 10-50 mn Euro and balance sheet total 10-43 mn Euro. In highly conflict-affected environments such as Mali and South Sudan, some Dutch companies selected would be defined as micro companies. In more developed economies such as Kenya, horticultural companies for example employ a much higher number of employees, but do not fall in the category (yet) of multinationals.

Our focus is on companies with fixed assets in a fragile location, since they both have capability to create development impact, but also have their own vested interest in addressing issues of conflict and instability. As the ILO chart demonstrates, a key factor in contributing to

[32] http://www.government.nl/issues/development-cooperation/partners-in-development
[33] OECD 2014 Fragile States Report,website: http://www.oecd.org/dac/incaf/FSR-2014.pdf . Rwanda was recently taken off the fragile states list of the OECD.
[34] The authors do not necessarily concur with this categorisation, especially as regards Rwanda
[35] Categorising countries in Africa creates artificial divisions as conflict tensions can ebb and flow in any given country. Research commissioned by The World Bank found "that post-conflict countries face a 44% chance of reverting to conflict during the first five years following the onset of peace."From: *The role of the World Bank in conflict and development: an evolving agenda*. World Bank, Washington. 2003
[36] see 'constraining factors for the research'

long-term stability and development is engagement over time. This is something that donors find hard to achieve as their policies fluctuate. Our assumption therefore is that those companies able to cope well with fragility will have the potential to generate more development impact, simply by that longevity alone.

We excluded companies in the extractive sector, as these are often job poor and whose size is beyond the scope of a small and medium sized enterprise (SME). We therefore shortlisted companies across the following sectors: agri-business and horticulture, tourism, solar energy, logistics as well as some in (financial or ICT) services.

Interview questions

The interviews centred around the question of what companies' motivations, challenges and needs are when investing in fragile settings. In our previous work we used an analysis undertaken in 2011[37] which identified four phases in companies' decision making in such contexts:

1. Commercial analysis: Is the potential opportunity sufficiently interesting from a financial perspective and does it fit with a company's strategy and business plan?
2. Managing physical security risks: Can staff and physical assets be protected in a cost-effective way?
3. Managing risks associated with political, ethical and societal issues: Is it possible to operate to international standards, and what might be the consequences of political instability?
4. Mitigation, management and minimisation of risk: What can be done to manage the risks identified?

This set of questions identified examples of where and how donors and other relevant actors have been able to influence corporate processes, decisions and behaviours to optimise developmental impact. These were categorised under three headings:

- Competencies: What skills, processes and capabilities does the Dutch government and others possess which companies find valuable in developing their business. For example: economic diplomacy, instruments such as the Dutch Good Growth Fund.
- Actions: What have the Netherlands government and others been able to do which companies believe to be valuable: for example, financial support, but also knowledge and contacts.
- Interaction: What approaches and attitudes of mind work best in encouraging and enabling companies to collaborate with the Dutch government, other donors as well as NGOs.

Methods of data collection and analysis

The empirical reseach was conducted according to the methodology of focussed interviews (see inception report for elaboration).

[37] Davis P. *Boardrooms and Bombs 2* PeaceNexus, Geneva. 2011

b. Constraining factors for the research

The team was dependent on the willingness of companies to share their experience and dedicate time to this research. SMEs in general are low on capacity and do not have departments for external relations dealing with these kind of queries. We therefore utilised our professional networks to get the best sample possible in the short timeframe available. The SMEs willing to cooperate concern mostly either those from our professional networks or those who see an interest in strengthening the relations with the ministry and/or the embassies; a relatively (disproportionally) high number have benefited from the PSI programme or other instruments. Many entrepreneurs based their assumptions on experiences with PSI, whereas this programme is different from current instruments such as DGGF.
However we also reached out to those companies 'deep in the field' that do not have a regular relationship (yet), or anymore, with the embassy and/or ministry. This way we tried to strike a balance in our sample in order to attain the best results and most interesting information. The companies were interviewed under Chatham House Rules, and have been listed in an annex for the Netherlands Ministry of Foreign Affairs.

With regard to Kenya, Uganda and Rwanda most interviews have been conducted in-country. However Mali and South Sudan were not visited during the research period itself, as these countries and relevant companies had been visited in 2013 and earlier in 2014 by the director of SpringFactor. These interviews were updated either on other locations or by Skype.

The team selected SMEs that have development potential - or at least meet one of the DGGF criteria - but cannot in any way judge about the actual development impact of any of the companies interviewed. Assessing this would have required an impact evaluation, which would have gone far beyond the terms of reference of this assignment. Equally, corporate social responsibility standards and principles, very relevant for fragile settings, were not part of the terms of reference of this assignment; how exactly these are being respected and implemented by international SMEs should be topic of further research.

4. Findings

This chapter outlines incentives of Dutch entrepreneurs who lead small and medium sized enterprises in fragile settings in Africa, as well as perceived obstacles and risks. It describes how they cope with these and whether the Netherlands government's support is part of their coping mechanisms. These data are presented in two groups: countries with an aid relationship, the so-called 'fragile states', Mali, South Sudan and Rwanda, and countries with a transitional relationship, Kenya and Uganda.

a. Incentives

The five most important incentives range from commercial to personal drivers, which are common particularly among founders and owners of SMEs investing in fragile settings.

Most entrepreneurs interviewed mainly have commercial incentives. One example is the horticultural sector in Naivasha. This sector has been developing since the 1970s where some first movers led the way as market educator, attracting more Dutch entrepreneurs, often via their headquarters in the Netherlands. This sector is now well established and resourced as one of the main foreign currency earners for the Kenyan economy. More recent examples of commercial incentives are in South Sudan, where the latest crisis offered opportunities for companies serving as providers for the NGO and UN community: three out of five companies interviewed experienced a 'business boom'. One of them served as a market educator, being a South Sudanese diaspora who returned some years ago, offering 'stepping stones' for other Dutch companies to start a branch of their business there. This group forms a sort of 'cluster' in Juba, and being Dutch is an important characteristic of this group.

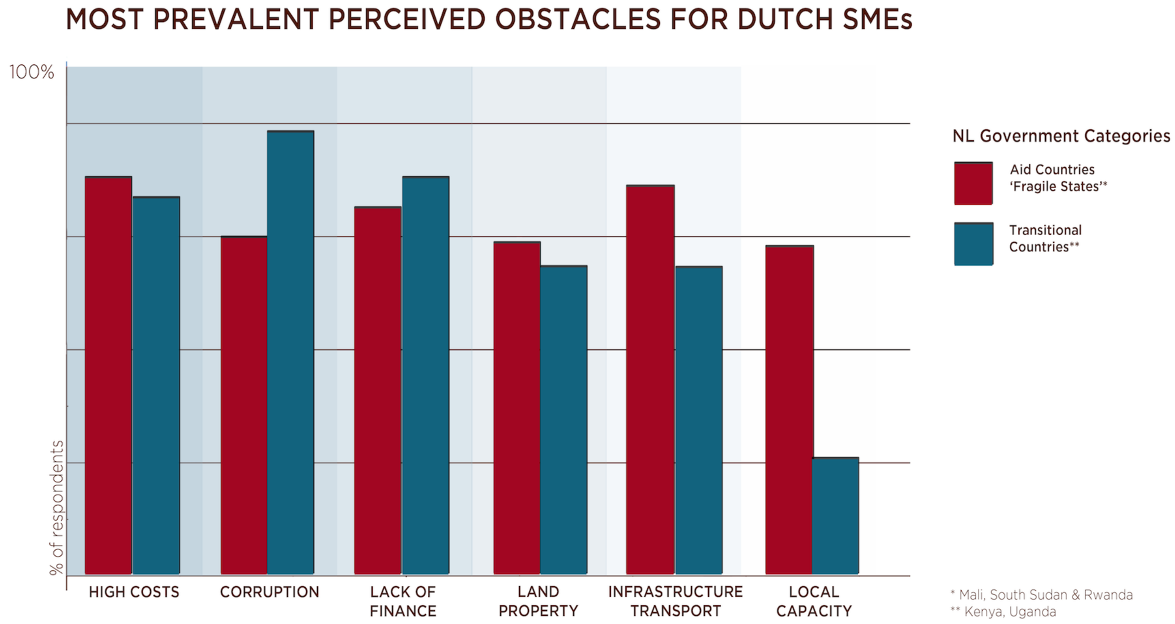
However commercial reasons only do not explain why these Dutch SMEs continue investing, as profitability fluctuates heavily in these environments mainly due to fragility and significant other obstacles and risks to doing business. An important difference with the incentives that are common among larger multinational companies is that these entrepreneurs have had specific personal reasons to opt for investing in these particular fragile settings. These factors encompass having developed a greater willingness to operate in risky settings, to personal incentives such as relationships with locals. A considerable number of entrepreneurs had been posted in Africa by a NGO before and decided to stay or come back to start a company. Among them are a number who have started more socially-oriented enterprises, focused on environmental sustainability, renewable energy, transparency etc. Among the generation of newcomers (within last 5 years), there is a majority of social entrepreneurs which were included in the sample, such as the solar energy companies in South Sudan and Rwanda.

Lastly, important incentives for Dutch entrepreneurs in the sample are independence and autonomy. This points to another difference with large multinational companies, referring to their governance structures: most small and medium sized companies are owner-run and not being held by the policies of their boards at headquarters. This grants a large degree of freedom in taking decisions, crucial to adapting flexibly to the dynamics of fragile settings.

b. Obstacles

The five main obstacles as experienced by entrepreneurs in the sample regions concern the (immediate) business environment, and these are set against the Doing Business Indicators ranking of the World Bank.

Figure 2



Among the entrepreneurs interviewed, the most significant obstacle experienced in fragile settings is **high costs**. This relates to issues such as transport and high living costs (eg. in booming capitals such as Nairobi). Extra taxes for the tourism sector in Kenya explain part of the percentage, as well as the new layer of institutions created by the new constitution, called 'counties' that levy extra taxes on top of national taxes. In Rwanda companies cite high costs as their main obstacle, perceiving a tendency of strictness or even repression by the authorities, targeting mainly those companies with penalties and fines that do not fit exactly within governments' policies, agenda's and plans. A significant degree of control exercised over the private sector by the government.[38]

The second obstacle cited is **corruption**. Even with more experienced entrepreneurs (>30 years in operation) this is mentioned as the key obstacle. An exception to this is what entrepreneurs experience in Rwanda where corruption is not an issue; and this is why the percentage for aid countries is lower than for transitional countries. This absence of corruption makes Rwanda an attractive destination to do business. The country has again moved up the rankings in the 2015 'Doing Business Indicators' of the World Bank and is attracting many trade missions, such as the November 2014 mission by Minister Ploumen with 20 Dutch companies.

Other obstacles experienced were **lack of access to affordable finance**. In all countries covered in this research, interest rates of local banks were very high (eg. 18% in Uganda) loans of short duration, and collateral requirements high, making it less attractive to borrow from local banks.

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[38] Davis P *Corporations, Global Governance and Post-conflict Reconstruction*. Routledge, London 2013

Foreign banks such as Rabobank were mentioned as an option by a couple of entrepreneurs in Kenya and Uganda.
Land property issues are also significant obstacles for those companies with fixed assets, such as in agriculture, food industry, tourism or renewable energy. As part of the larger problems around the regulatory framework and weak rule of law in these settings, it turned out to be a constraining factor for obtaining finance in some cases, impacting negatively on the company's commercial viability. It is also a sensitive issue for the relationship with local communities, which most entrepreneurs manage carefully as a risk mitigation strategy.

As often the case in developing countries but even more so in fragile settings characterised by poverty, **transport and infrastructure** are a major constraining factors for doing business. The alternatives to road transport are perceived to be too expensive, resulting in high costs that weigh heavily on the company's budget. This goes mainly for those countries that are landlocked such as Rwanda, Uganda, South Sudan and Mali, being dependent on the ports in Mombasa and Dar Es Salaam. Corruption in the ports is also an important negative factor mentioned by entrepreneurs. Another important obstacle mentioned was **lack of local capacity**, mostly in Mali, Rwanda and South Sudan. This concerned not only skills of staff and limited capacity of local companies and entrepreneurs in their value and supply chains, but also affordability. This was a problem for entrepreneurs in South Sudan who cannot match the salary levels skilled staff are offered by the UN and NGOs.

<u>Doing Business Indicators of the World Bank</u>
The World Bank's Doing Business (DB) Indicators have been widely criticised[39], and indeed the methodology for the most recent report has been amended. The main criticisms made have been that the DB Indicators are too easy for countries to 'game', and that therefore improvements in DB rankings do not necessarily reflect the reality of doing business on-the-ground. The results of our survey reflect that a good position on the DB indicators is not the same as a good operating environment for real businesses and investments, with the exception of Rwanda that tops the list of our sample regions, ranking 46th. Our respondents confirmed that it is relatively easy to start a company (and the government puts much effort into attracting more companies). However, the reality is that to run a company in Rwanda is rather costly (see 'high costs' above) and concerns a relatively small market with low skilled staff. In terms of prospects, some entrepreneurs anticipated tensions in the coming years when young voters would stand up for change, while the government's security regime is rather strict.
The next sample country to follow is Kenya at 136th position. Although Kenya still attracts far more investors than Rwanda, respondents confirm that Kenya is a mixed case according to respondents, with some companies being stuck in regions which are being neglected by the Kenyan government in terms of public sector investments, such as the coast and Turkana, and those in Nairobi having all the facilities. The overall picture is that corruption worsened across the line due to the creation of counties recently, on top of the usual political corruption and petty corruption. The main concerns about Kenya however are in the sphere of geopolitical risk (see next chapter).

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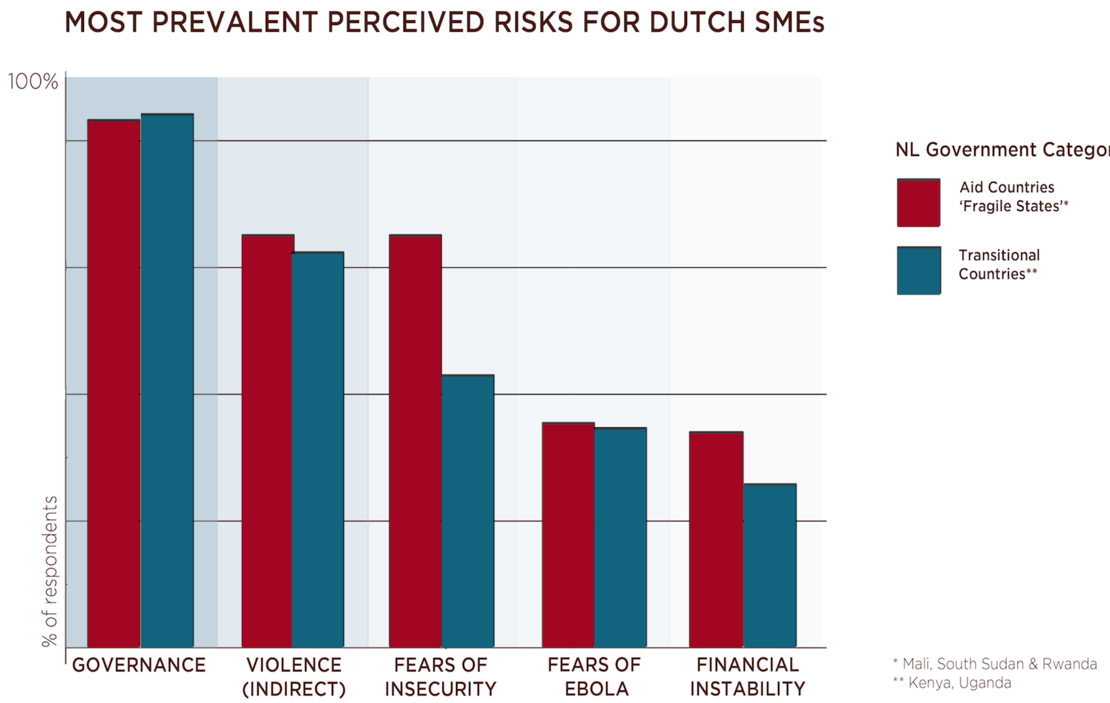
[39] Donnan S. ''Doing Business' survey at World Bank has a new look, but China will still not be happy'. *Financial Times,* London. October 29th 2014

Mali at 146th position ranks higher than Uganda at 150th, which does not concur with the perceptions of companies in our sample. There is no single company interviewed that is not challenged severely by the obstacles of doing business in Mali, however this might be more related to the geopolitical risk, which is not at all reflected in the Doing Business Indicators.
South Sudan at 186th position is at the bottom of the sample list according to the DBI ranking. However most of the companies interviewed experienced the 2013 crisis in South Sudan as an opportunity and have grown over the last six months, as their business case fits with the influx and needs of incoming humanitarian NGOs and UN organisations. The geopolitical risk in South Sudan is severe, but has also offered a niche to those companies familiar with operating in fragile environments (eg. an educational materials company, coming from Uganda). The DBI ranking should therefore not be interpreted without the contextual dynamics, opportunities and risks.

c. Geopolitical risks

The perceptions of geopolitical risks range from real-life risks such as violence to those feared such as Ebola, which demonstrates the region's reputational vulnerability affecting business and investments negatively. It elaborates on the role of government and in particular the risk of weak or repressive governance.

Figure 3



<u>Role of government</u>

Governance, and more specifically weak or repressive institutions were regarded by respondents as a major geopolitical risk. If institutions such as the justice system cannot be relied on, the company has no benchmark for compliance, but worse, is not sure of its license to operate in the country, or the reliability of any contractual arrangements. In South Sudan, one entrepreneur described a situation of lawlessness and impunity when it came down to issues such as acquiring land. As government hardly had any legal framework in place, the entrepreneur had to negotiate with several non-state actors, such as local frontmen and armed groups. This resulted in such unethical practices that she decided to sell her shares and get out of the business (and the country). In Kenya one company wanted to address social issues such as land ownership and promoted open data sourcing, which was not picked up by the Kenyan government; rather weariness from their side. There was even intimidation of colleague-entrepreneurs working on similar issues. Entrepreneurs in Rwanda had also experienced intimidation. Whereas in Rwanda government institutions are not weak, government tends to apply ways to restrict business, at times in a repressive manner.

As most entrepreneurs we have interviewed have lived and worked in these fragile regions for years, many had experienced **violence of different sorts,** albeit indirectly**.** Most recent example is South Sudan, when the conflict re-erupted in December 2013 and many expats fled the country, including a company in solar energy. This company was just in time to secure their assets in the remote region they worked. In Mali, violence erupted also fairly recently, with a military coup (2012), an independence declaration in North Mali (2012) and a jihadist invasion (2013). Subsequently a UN mission was deployed called Minusma. Although these developments had not physically affected assets in southern Mali in as much as central and northern regions, it had a huge effect on companies. The credit rating of Mali went down in a short amount of time and credit lines were withdrawn. This affected those entrepreneurs who had borrowed from international and local banks, as in the case of a company in biodiesel production. A chain reaction was prompted by one agency withdrawing their loan, followed by two local banks doing the same.

However, also transitional countries experience quite some violence as perceived by the respondents. In Kenya, entrepreneurs indicated that the post-**election violence** in 2007 was severe, but also part of their reality of doing business in that country. Many elections in the past have led to violent eruptions. However this time it affected operations, eg. in Naivasha in the horticultural sector, forcing one entrepreneur to stop operating for three days, which was extremely costly. The inter-ethnic nature of the violence was and is also a difficult dimension to deal with, as this affects the employees (around 1400) and surrounding communities. At such moments, politics enters and disrupts the 'work floor'. The high alerts around the 2013 elections, with a slowdown effect on many investments (being withheld or withdrawn), show that fears of election violence are recurrent. Whereas most entrepreneurs anticipate this type of violence, another type of violence has emerged and is perceived to be getting worse: **terrorism and religious/ideological violence**. After Kenya invaded Somalia and took the Kismayo port (which it still controls) in 2011, the security situation deteriorated with several terrorist attacks in metropolitan and tourist centers. The 2013 terrorist attack on the Westgate shopping mall in Nairobi hit the heart of the international business centre and has greatly impacted on Kenya's reputation abroad, also with investors. At the coast regions several attacks were conducted before and after the Westgate attack, mainly targeting tourists, but also locals as with the Mpeketoni attacks in the coast region. This affected companies who engage in local sourcing.

One company worked with 7.000 local farmers with the help of an NGO to address tensions with surrounding communities. Two of the entrepreneurs interviewed have decided to withdraw from the coast region, preparing to sell their company interests.
In Uganda, only one company experienced political violence as a result of contested election outcomes, in 2007, and has been evacuated by the embassy. In Rwanda there were no mentions of open violence affecting companies in the post-1994 genocide years.

However, it is not just the presence of current violence which is problematic**: fears of insecurity** are also a major geopolitical risk to investing in these fragile settings. Again, it is not a straightforward picture between 'aid countries/fragile states' and 'transitional countries'. In Kenya, 75% of entrepreneurs fears insecurity in the next coming years. One entrepreneur in the real estate business in Kenya's coast region mentioned that due to fears of insecurity, the project he recently finished experienced very low sales. Foreign buyers have withdrawn almost completely due to the continuous flow of security incidents that have hit the coastal region recently. However also local buyers are not keen on investing in this region, although the exact locality of the project has not experienced much physical violence. Another symptom of fear of insecurity is seen in Rwanda, which still suffers from negative perceptions due to the 1994 genocide and keeps away investors.

Fears of Ebola - a virus that has been around in Africa for decades, having turned into a geopolitical risk recently, merely based on perceptions than reality - has greatly affected the tourism business. Fears of Ebola are not just affecting West African countries such as Mali, where one tourist agency interviewed is no longer having any income from its business, but also Ebola-free countries such as Uganda and Kenya, the latter of which is highly dependent on foreign currency earnings from tourism. Not only tourists are cancelling their flights, also (potential) investors in an equity fund for local firms decided to postpone their visit to Kenya, which affects the likelihood of attracting new investments. This demonstrates how vulnerable some sectors are for fears of disasters such as Ebola, even if this virus has not spread to this part of Africa, the 'transitional countries'. It is worth observing that, whilst Ebola is the current risk, the presence and fear of unexpected shocks will be a factor in Africa's attractiveness as an investment destination even after the current Ebola threat is eradicated.

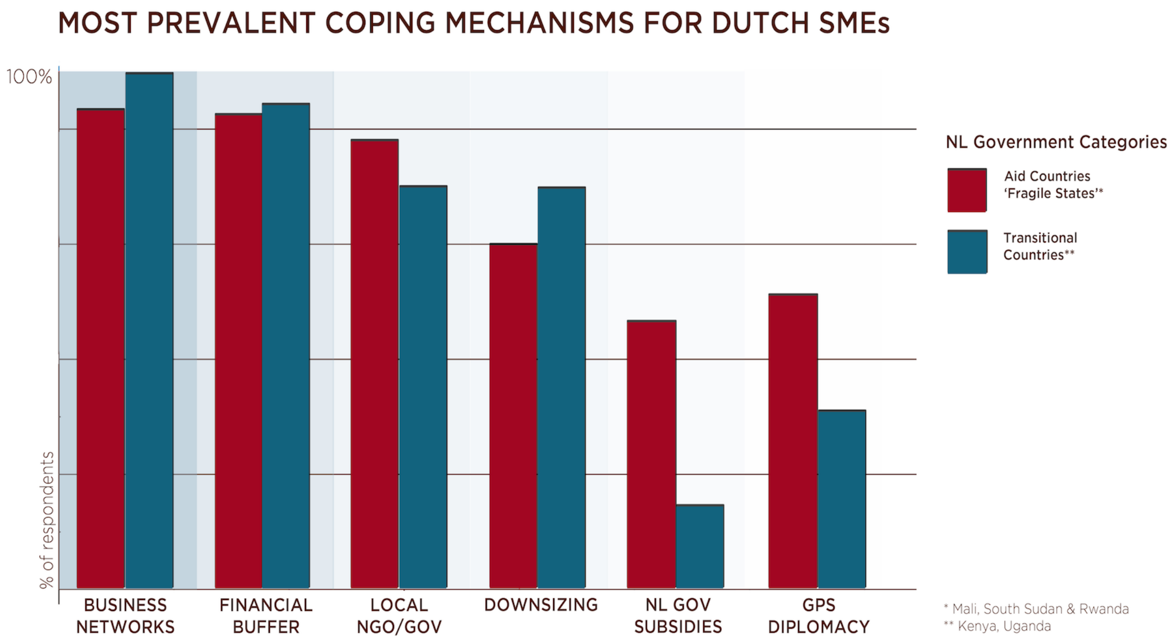
Most of the above mentioned risks have been included in the indicators of the Fragile States Index of the Fund for Peace, which ranks every country included in this sample.[40]

d. Coping mechanisms

The most prevalent coping mechanisms range from financial buffers and downsizing to Business to Business (B2B) contacts and networks: cooperating with other companies and stakeholders, important to prevent and address obstacles and political risks when they occur. Going local through communities, NGOs, as well as through local government authorities), is also a common coping measure of SMEs.

[40] The highest ranking of our sample countries on the Fragile States Index 2014 is South Sudan, followed by Kenya, Uganda, Rwanda and Mali. See http://ffp.statesindex.org

Figure 4



Most companies cited **business-to-business contacts** as the most effective way to address obstacles and geopolitical risk. Business people perceive that other entrepreneurs speak their language and understand their dilemmas best. An example of how that network functioned in emergency mode was during the post-election violence in Kenya in 2008, when the physical assets and staff were attacked by roaming armed groups. One company transported fish products from Entebbe, Uganda. His trucks were set on fire. As formal institutions such as police could not be relied on to protect assets, a network of Dutch entrepreneurs started an informal emergency roundtable to address emergencies on ad hoc basis. Security groups were hired to protect convoys, in coordination with Asian businessmen from Uganda, who had experience in dealing with previous breakdowns of law and order in Kenya. The company survived and sailed through the crisis[41].

Investing in fragile regions requires preparing for crisis to occur, also in financial terms. Those coming in without a (personal) **buffer** are highly likely to fail, according to a number of entrepreneurs. Furthermore, companies have to earn high margins in order to build a buffer to see them through the bad times which will inevitably occur.

A common coping measure which each of the more 'mature' entrepreneurs - which have gone through the motions in these fragile settings - have adopted is **downsizing**. This refers to all kinds of measures to reduce costs in order to maintain the commercial viability of the company and overcome particular obstacles and risks. One particularly painful downsizing measure according to respondents is firing staff or letting go of local suppliers, as this is a major element in the development impact of foreign SMEs. One company in Mali was forced to let go of 200 employees in one go, forced by its financial crisis after it had lost its loans from banks.

[41] the Kenya branch of this company later closed due to shifts in the market and rising operation costs in Kenya

Many entrepreneurs had good experiences with investing in **local structures, authorities, NGOs and communities** as a preventive measure for problems to occur, especially in the 'fragile states'. In Mali most companies have a social entrepreneurship profile and working with NGOs and communities is part of their business model. SMEs in agricultural, tourist and renewable energy sectors often have fixed assets and are therefore bound to certain localities where they have to protect their assets and staff. The tourism companies interviewed in Uganda, for example, are both working with local tour leaders and local partners.

NGOs play an important role in building the bridge between local communities and companies, such as the NGO in the coast region of Kenya, working with thousands of local farmers on the supply chain for their product, red chillies. When the Mpeketoni crisis occurred (see geopolitical risks), this company relied on its contacts with local authorities and the NGO in order to ease the tensions, so the work could continue interruptedly. Another company worked with a Dutch NGO and supermarket on standards for workers and fairtrade produce campaign. A company in Mali also partnered with an NGO on implementing standards: a collaborative kind of advocacy and watchdog role.
Many companies worked with NGOs on capacity building, mainly in agriculture. In value chain development NGOs fulfill an important role in their view, however should be guided more by market opportunities (for local entrepreneurs) than donor priority sectors. In all countries except for South Sudan, entrepreneurs engage in local sourcing and provide jobs to thousands of farmers or (construction) workers.
Some companies mentioned the different perceptions of NGOs, having difficulty understanding why companies resort to downsizing and fire local staff. Entrepreneurs felt that this dilemma should be highlighted before donors commission NGOs to assess social impacts.

Netherlands government subsidies, such as the Private Sector Investment (**PSI)** programme, was mentioned a number of times, especially by those from 'fragile states' (52% versus 16% in 'transitional countries') as a coping mechanism. Even a commitment towards a PSI can be helpful in establishing a business, as it provides a trust factor, credibility and legitimacy for the entrepreneurs to have the backing of a reputable government such as the Netherlands, as was the case for the supermarket in South Sudan.
Other entrepreneurs (non-beneficiaries) criticised this instrument, as it would not be additional and distort markets and competition, as well as credit good paper work but not necessarily promote good business cases. It would have allegedly enriched a couple of entrepreneurs together with a group of consultants, according to some respondents.
The logic of the DGGF was therefore lauded, as it would deal directly with companies. In addition, the revolving nature of the fund was an asset in their view, not giving out grants which had in the past been market distorting.

When asked what other support entrepreneurs had received from the Dutch government, they came up with several examples which we refer to as **Geo Political Risk Support (GPS)** [42]**diplomacy** (see 'way forward'). It concerns a particular role that the Dutch government has

[42] Riordan S. B*usiness Diplomacy: Shaping the firm's geopolitical risk environment*. Netherlands Institute of International Relations, The Hague October 2014.

played during times of crisis and need, outside of the regular support channels (such as consular services, assistance programmes and traditional business diplomacy) and fora (such as networking groups) (see chapter 'analysis'). In Kenya 50% of respondents have had good experiences in working with the embassy or ministry in that regard, 40% in Rwanda and 20% in Uganda (the latter concerns a cooperation experience in 2008). In South Sudan, 60% of respondents had been assisted by the embassy or ministry when needed most, and 50% of entrepreneurs in Mali. In addition, one entrepreneur in Mali was greatly helped by the activities of the Netherlands Ebola envoy (see 'best practices'). These percentages are relatively high due to the sample taken (see 'methodology'), however most Dutch SMEs prefer not to work with government; their reasons are outlined in the next chapter.

e. Why is not more support sought from government?

To develop 'staying power' or resilience which companies need to create development impact in these fast-changing environments, companies need support. The sample includes a relatively high number of entrepreneurs who have obtained a PSI subsidy, as this was the main programme for Dutch and other entrepreneurs in fragile settings. Even if the DGGF is a completely different instrument, in the entrepreneurs' perception the Netherlands government and RVO still being associated with the PSI programme. This chapter also includes these perceptions.

In order to address obstacles and political risks when they occur, companies prefer to work through other channels than the Netherlands government and embassies. There are a number of reasons for this which can be explained under two headings.

The first set of reasons have to do with the way companies operate, and the way they see themselves. To begin with, companies prefer to solve problems with their like: with other companies. Experience with running a business and entrepreneurship is crucial to address difficult issues that companies run into. Companies generally feel that civil servants do not have that experience, which makes it difficult to speak the same language and collaborate. On top of that, attitudes can also differ, eg. risk avoidance cultures in public sector which do not resonate well with how businesses survive: by taking risks.
This is just one of many differences which explain silo approaches between private sector, government and NGOs. Another reason is that companies intuitively prefer to stay away from politics. One entrepreneur even stated that it does not matter who is in power, as long as stability continues – instability is bad for business. Another entrepreneur admitted that he has been risking his license to operate by working on 'disruptive innovations', an international trend among social entrepreneurs in information & communication technology (ICT). This does not resonate well with some authorities in these regions. There is also a widespread concern that to engage too closely with politics would 'raise our head' and render the company subject to unwanted scrutiny by government officials - which is what some fear when working with NGOs. Lastly, some entrepreneurs especially in remote regions were simply not aware yet embassies 'had opened the doors' marking the switch in policy towards pro-business, as only a few years ago private sector was a 'posteriority' (ie. not a priority); companies remember being approached in a different manner.

The second set of reasons has to do with how companies generally perceive government. When asked how they experience working with government, most if not all companies cite the long, bureaucratic and demanding procedures for financing; this is mostly related to the PSI programme. This is particularly difficult for SMEs as they lack extra capacity to address these demands. Many companies hesitate for this reason to work with government and do not have much confidence it will get less. Some entrepreneurs mentioned a group of consultants well versed with these demands.

Another impression that experienced entrepreneurs have from government is that they prefer to work with start-ups, without much entrepreneurial experience or track record in the field. They stressed that financing should be made available to established businesses, which have already proved the workability of their business, rather than to start-ups, ('but have not made their hands dirty yet, which is what government prefers', as suggested by one entrepreneur).

An important reason cited by respondents is that embassies and governments have little regional or local outreach and concentrate their efforts on the capital where the host government sits. By contrast, SMEs operate in very particular localities elsewhere in the country, especially those with fixed assets such as hotels, farms and plants. Some entrepreneurs live in the capital but are experts on the local dynamics, because that is crucial for running the business. In their view, many ambassadors work hard to change this ivory tower image and make extra efforts for their staff to reach out and travel.

Last, but perhaps most crucially, is the lack of understanding among civil servants of how business works and entrepreneurship in general, as was cited in the beginning of this chapter. For issues with local government and other stakeholders, SMEs need the trust factor and reliable help, and end up hiring private risk agencies and law firms to mitigate risks. Usually issues tackled in this manner are being not solved in a sustainable and cost-effective manner.

In order to support business in addressing obstacles and political risks, it is important to understand how exactly business takes decisions. Some civil servants and ambassadors are quite talented in assessing what business needs and these persons are continuously being mentioned by the entrepreneurs. Entrepreneurs felt it was important for other diplomats to attain these skills.

Consequently the above findings indicate a number of issues to work on in order to promote more and better collaboration with Dutch SMEs in fragile settings in Africa in order to help them promote development impact.

f. Perceptions of DGGF

This chapter concerns the feedback that entrepreneurs provided on the concept of DGGF, based on the information that was available to them at that moment.

In broad terms, the entrepreneurs interviewed felt the logic of the fund was good. Since it is a revolving mechanism it might lead to less market distortion. Furthermore, its ambition of 'high risk low return' investments was much needed in fragile settings, according to respondents. However they shared a couple of issues with how it is designed and implemented:

- **Link to risk rating of banks**: The fund depends on the risk rating processes of commercial banks: these are generally conservative. Guarantees and other measures can moderate these to a certain extent, but investments in fragile contexts are always going to be seen as highly risky by a risk-averse banking sector. Entrepreneurs felt that it requires tackling root causes on risk aversion of the banking sector when dealing with SMEs. Entrepreneurs so far resorted to other types of financing which seem to be better geared towards 'high risk low return' such as impact investors, which tend to be more flexible, quick and engaged.
- **Assets in NL**: entrepreneurs feared their companies would be disqualified for DGGF track one as some companies do not have HQ – or indeed any representation – in the Netherlands. Conversely, through PSI, Dutch SMEs without headquarters in the NL were able to start operations elsewhere in the region.
- **Local link**: a joint venture with a local company is no longer a requirement for DGGF (although it is being encouraged). Entrepreneurs found this strange, since better connections with the local private sector have significant advantages in addressing obstacles and risks and create development impact.
- **Input oriented**: Entrepreneurs fear the long vetting procedures during the application phase, which are costly for them in both money, but more importantly, in time.
- **Distance**: DGGF was perceived as designed to be also managed from a distance, by RVO from the Netherlands. However when crisis hits and risks have to be mitigated (called 'critical junctures' in next chapter), support is needed in order to avoid measures by local banks which take businesses in a downward spiral, such as was the case for a company in Mali.

5. Analysis

a. Why Dutch entrepreneurs invest in fragile settings

What distinguishes SMEs from multinationals in decision making is that other factors than solely commercial drivers prompted them to start investing in a particular region - and makes them stay (see 'findings'). Most entrepreneurs interviewed are 'path dependent', having ended up in these environments which turned turbulent and fragile. This sheds another light on how to explain the decisions that SMEs take to invest in fragile regions and their respective life cycle or 'path'; it depends on a myriad of factors.

Apart from personal reasons, many stated that establishing a business seemed to be a logical step on their path. One entrepreneur had worked in South Sudan for a humanitarian NGO, and felt he could contribute better to development by starting a company in solar energy. He created a basis in the Netherlands, but went back as soon as he could via a trade mission of the Netherlands African Business Council. He used several stepping stones to start operating in South Sudan, being the next, logical step in his career, engaging with the networks he wanted to reconnect to. The importance of these personal networks underlying and preceding choices for certain geographies is also stressed by authors Koch & Ruben, applying the path dependency theory, in their case of NGOs, however helpful to understand these entrepreneurs' choices[43] as well.

Why do Dutch entrepreneurs not invest in fragile settings

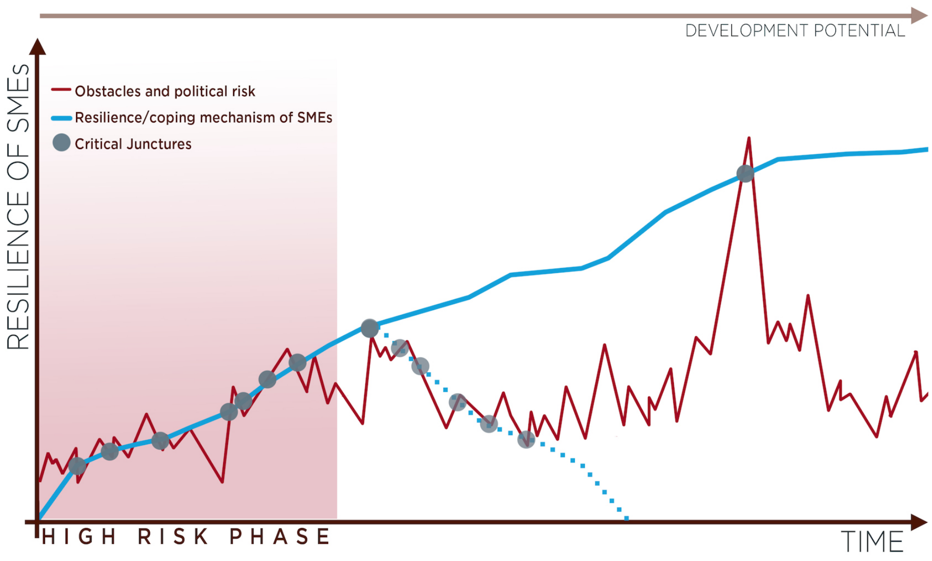
Our sample only includes currently investing SMEs. The research does not look into what exactly holds back Dutch SMEs to engage and invest in both fragile states and transitional countries. More empirical data on their incentives would help make Dutch government instruments more effective. A study[44] by Berenschot and Erasmus Univerity from 2013 of 106 companies active in Sub Sahara Africa concluded that there is a large gap between the socioeconomic realities in Africa and perceptions of Dutch entrepreneurs. NGOs and media have emphasized Africa's problems for so long that the negative image persists and is only slowly changing for the better (not helped by fears for Ebola).

b. How SME's learn

Whatever their motivations, SMEs in fragile settings still need to cope with the vicissitudes these countries present. Fragility means that shocks happen unpredictably with varied intensity. The evidence from our interviews is that companies learn over time how to address these challenges: a learning process that makes them more resilient over time. The following figure illustrates this process:

[43] Koch D. & R Ruben *Spatial Clustering of NGOs: an economic geography approach* August 2008
[44] Tulder R. van & M Lem K Geleynse (2013), *Doing Business in Africa,* Partnership Resource Centre at RSM Erasmus University

Figure 5 Resilience of SMEs over time



As the graphic shows, younger companies (*towards the left of the figure*) are at higher risk, because they have less experience, hardly any contacts and knowledge and fewer mechanisms to cope with crises (*shown by the red line*). However, as they endure, so they learn coping mechanisms, which they are able to deploy as new shocks and crises occur. This is not to say that these companies are immune to these crises (*see the spike in the red line at the right of the diagram*): it is that they are better able to withstand the impacts of them.

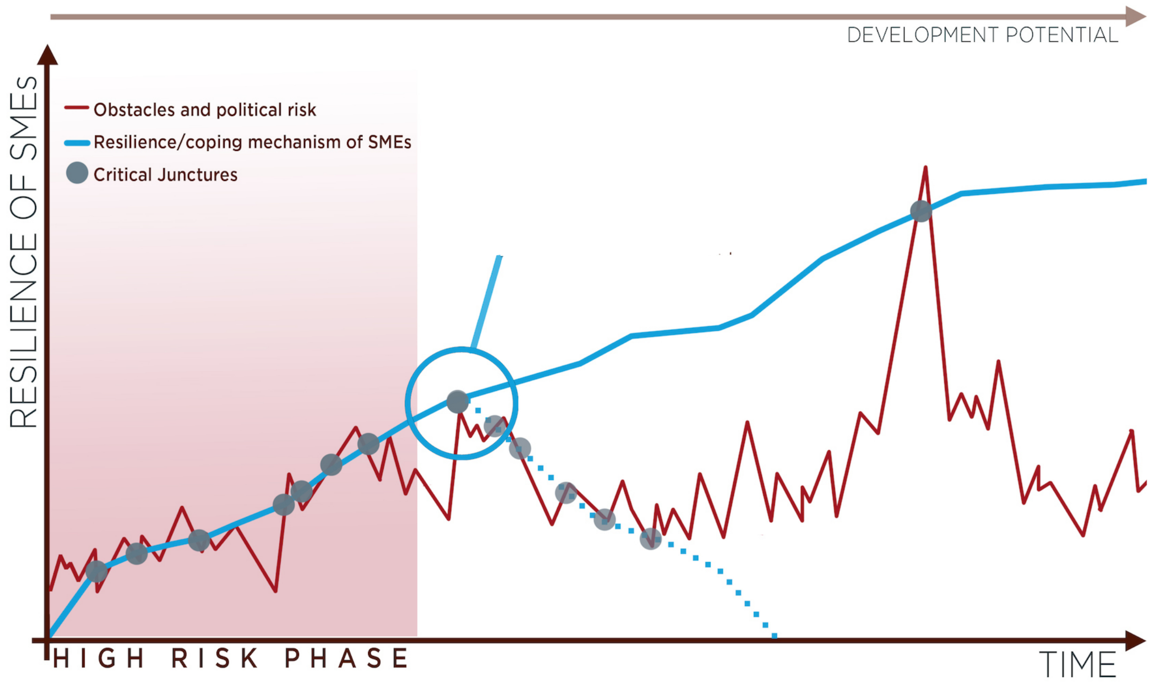
What is clear is that the longer companies continue investing, the more their resilience increases and the stronger their development potential. However their context is being characterised by fragility, as many of the regions in which these SMEs invest are characterised by cycles of crisis and/or conflict, reflected in obstacles and political risk for the SMEs. When companies are confronted these, they find themselves at a critical juncture at which they have to take decisions in order to cope. When starting operations, companies will soon be confronted with this context and learn how to cope.
If this learning capacity is insufficient and the entrepreneur does not take the right coping measures, he or she might prove not resilient enough to cope with the context. The early phase of investment is the high risk phase with a higher probability of failure, as in the case of the solar company in South Sudan described above, which was determined to follow this path, however was not able to mitigate the political risk from the 2013 crisis effectively.

c. Critical junctures

Also after the high risk phase SMEs can take a downward path from a critical juncture (*see dotted blue line*) prompted by a spike in fragility, in the form of an obstacle or risk. Even after 30 years, entrepreneurs can be confronted with huge challenges, such as the hotel owner at the Kenyan coast, having to deal with substantial loss of business and customers due to recurrent terrorist attacks, violent conflict and abductions of tourists at the Kenyan coast. On top there were (unsubstantiated) fears of the Ebola epidemic in Kenya. This forced him to take rigid coping measures in order to stay in business.

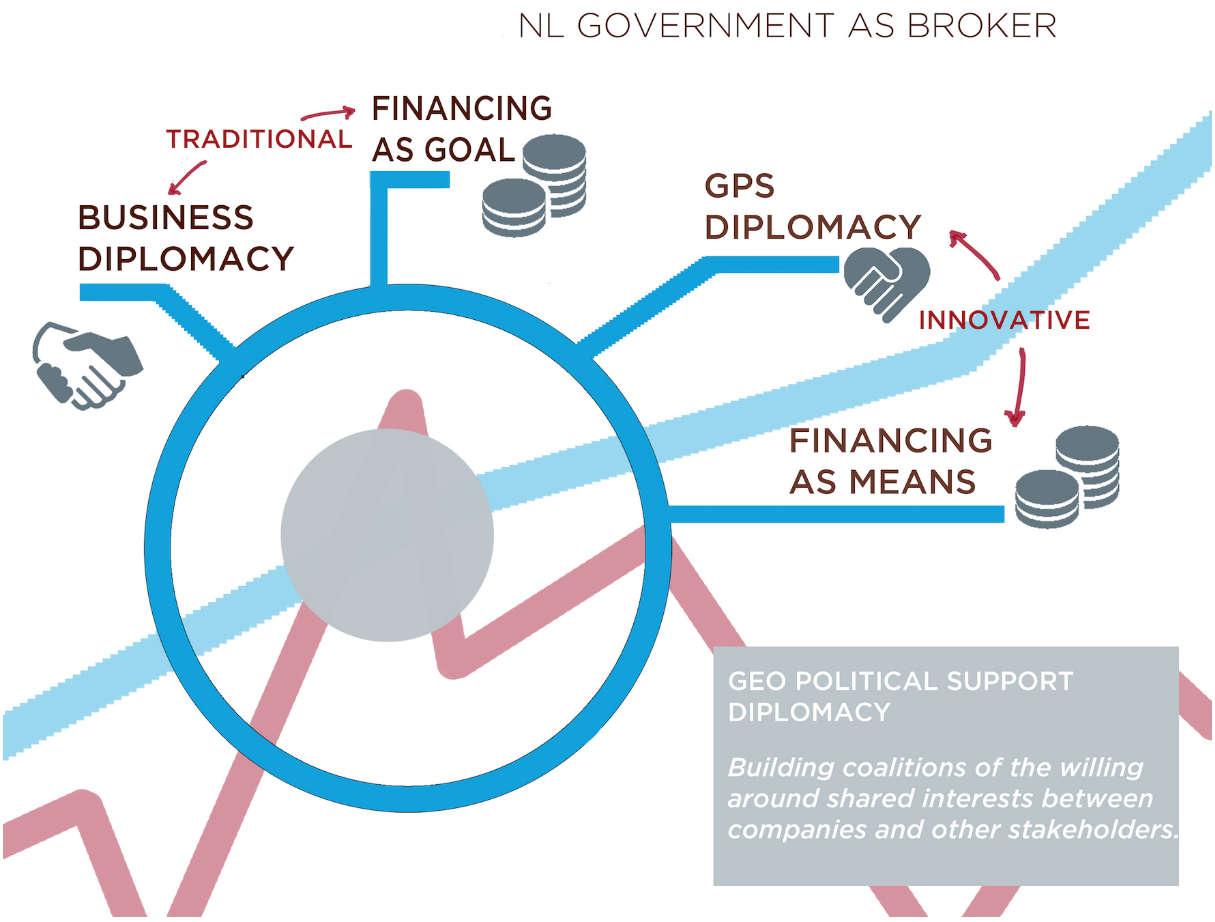
When emergencies arise and companies find themselves at critical junctures, working with Netherlands government is not general practice - apart from traditional core services such as use of consular services – even if figure 4 on coping measures might give that impression: this is because our sample includes a high percentage of close networks of the embassies.

Figure 6 – package to support and influence SMEs at critical junctures



Part of the explanation is that embassies and government used to work in a more supply-driven manner: events according to the government's or embassies' agenda (eg. trade missions, business groups, minister's visit, national days) and grants available according to the planning of the government. Donor programmes are usually subject to headquarters spending pressures. Therefore their focus ends up to be on disbursing funds, whether or not this is actually what is most needed by entrepreneurs on the ground. There was (and still is) a lack of demand-led approaches in business diplomacy and financing (with some notable exceptions as cited in 'why not work with NL government'), which is reflected in the graph below with the term 'traditional'.

Figure 7 – Netherlands government as broker



6. Way forward

a. The Netherlands government and 'GPS diplomacy'

Therefore in order to facilitate companies generate development impact, it is important to support companies at critical junctures, in a demand-led manner instead of according to the supply-side drive of government planning. This requires designing a package which builds on the particular skills that the NL government has in fragile settings: their role as a broker. It goes beyond the traditional instruments of business diplomacy and financing as a goal. It takes an integrated approach to business diplomacy, taking the challenges that companies deal with and need help for, as a basis. These challenges are not only in a narrow business definition, but are much wider, including geopolitical risk, as argued in the chapter on findings. This links to what the Netherlands government and its embassies have proved to do best: building coalitions of the willing around shared interests between companies and other stakeholders.

At present this type of activity happens, but it appears to depend more on motivated individuals than on clear policy. **There is a clear need for a more comprehensive approach to supporting companies: what is called here geopolitical risk support[45] – or GPS Diplomacy. It links to the competences and tools which diplomats have, such as lobbying, mediation, matchmaking, advice and negotiation – providing knowledge, contacts and the much-needed trust factor - strengthened with financing: as a means to reach a goal: for the company to sustain its development impact.** It builds on the networking role of embassies and government, bringing together several stakeholders such as the host government, local authorities, NGOs, other companies, media and others together on neutral ground, providing a platform to address challenges.

b. Six best practices

What does GPS diplomacy look like? A number of examples have emerged from our research of instances where the recommended approach has actually happened. This paper advocates that more of this type of activity should be attempted, as a core service offered by the Netherlands government and its embassies. The following list illustrates how such diplomacy might be applied to each of the risks or obstacles the companies interviewed had faced:

1) ***Violence. Tool: lobbying***. Many companies were caught by surprise by the post-election violence in 2007-8 in Kenya. Due to the threat to the physical premises and staff, many in Naivasha had to stop operating which was very costly. The embassy however had invested in the local private sector alliance (KEPSA) bringing together local and international companies. Through that network Dutch companies were able to voice their concerns. This had an effect: after one month of violence, KEPSA put such pressure on the politicians and other stakeholders that, together with other lobby groups, it managed to bring in more effective mediators, who managed to forge an

[45] Riordan S. B*usiness Diplomacy: Shaping the firm's geopolitical risk environment*. Netherlands Institute of International Relations, The Hague October 2014.

agreement between the warring parties. This investment indirectly paid off for the Dutch companies, which were able to continue their operations. This case also demonstrates the strong drive of private sector for peace and stability, as the best basis to do business.

2) ***Weak institutions. Tool: mediation***. Three Dutch entrepreneurs and an informal investor started investing in a joint venture with an Ugandan company. Together they set up a new company, a limited venture, which wanted to preserve the Mabira Forest through building a ecological lodge in 2007. They linked with the embassy and got connected to the Ugandan partner at first and later got their buy in for the plans. During the election violence the entrepreneur got evacuated from the site and continued building the site after the violence had stopped. They applied for a PSI grant and got the support. They invested a great deal of effort in local NGOs and communities with the help of the NL embassy. When at some point an oligarch close to presidential circles claimed the land in order to flatten it and build a biodiesel plantation, they mounted a campaign together with local communities and NGOs to stop this, strengthened by a media campaign. They did this because they knew the formal institutions and justice system would be too weak to avert this fate. Thanks to the broker role of the NL embassy, she was able to save the lodge and that part of the forest from destruction; and it is still in operation.

3) ***Fears of insecurity***. ***Tool: financing as a means***. In one of the most fragile regions of Kenya, Turkana, one entrepreneur decided to build a wind-power park. However he had to deal with armed communities which were raiding each-other's territory on a regular basis, impeding his investment plans. He needed a way to bring them together and convinced the embassy to give seed funding to do initial exploration and investments, whereas his other firms were having some problems. In spite of this, the embassy agreed to the funding. Now, after eight years, the communities agreed to the project and the entrepreneur has able to lever the initial Dutch funding now having plenty of funding sources to choose from. He will start building 365 turbines from 2015 on, providing green energy for Kenya's power network.

4) ***Fears of Ebola. Tool: negotiation***. As the epidemic started spreading in Mali, an increasing number of investors and NGO workers chose to refrain from travelling there. One of the reasons was insurance costs and liability issues, which could not be covered by companies and organisations alone. One company managed to be keep insurance costs manageable thanks to a package negotiated by the Netherlands Ebola envoy with insurance companies and Dutch government's efforts at EU level in this regard. This allowed the company to continue operating in Mali.

5) ***Financial instability. Tool: advice***. As foreign currency stocks started to decrease in South Sudan, a Dutch South Sudanese diaspora entrepreneur feared the risks of instant inflation of the local currency would evaporate all his capital. He had not diversified his client base sufficiently yet and was dependent on the South Sudanese government as a client. With the help of the PUM programme he got advice on how to grow his company and client base beyond this. The ambassador introduced Dutch Minister

Ploumen to him on her visit. He started attracting more Dutch entrepreneurs resulting in a 'cluster' of companies in Juba. His company won a PSI grant and recently grew to almost 200 staff. This growth was partially catalysed by the PUM programme started a couple of years ago.

6) ***Capacity. Tool: matchmaking/financing*** Dutch brewer Heineken wanted to develop a local supply of sorghum and maize and invest in local sourcing, which it promotes in many other areas of operation as well. The embassy was seeking ways to improve the Rwandan agriculture sector. By providing a PSI, a Dutch-led SME invested in local farmers and a mill in collaboration with Heineken, and as such a solution was developed which met both commercial and developmental aims.

These best practices demonstrate the need in fragile settings for greater collaboration between commercial, governmental and NGO partners: each one doing what it is best placed to do. In order to attract new investments in these fragile settings, it is important to bring out these **realistic success stories** of entrepreneurs who have built successful and durable businesses there with the help of the Netherlands government and other stakeholders. Visualising this 'story telling' through documentaries will help mitigate the disproportionally high risk perceptions that persist about the continent.

c. Way forward

The Dutch approach of combining aid, trade and investment has gathered new momentum through the establishment of the Dutch Good Growth Fund. This momentum builds on years of working in an increasingly integrated manner[46], not only at headquarters level but also in-country. And it builds on a track record of the Dutch government with regard to private sector development programmes, economic diplomacy, trade missions, the PSI programme and public private partnerships.

However in fragile settings these initiatives and programmes require a more demand-driven and flexible approach, as fragility can lead to a quickly changing context and to problems that need to be tackled immediately. An understanding of the way companies take decisions and what the entry points are - for other actors such as government - is crucial.

As demonstrated in 'best practices' the NL government has a good record of working with Dutch SMEs in fragile settings, applying all the instruments, policies and skills available, which is what has been referred to in this paper as GeoPolitical Risk Support (GPS) Diplomacy. This way of working provided the basis for building sustainable relationships and partnerships with a number of small and medium sized enterprises.

In Mali, South Sudan and Rwanda companies from the sample have benefited more from this type of support (58%) than in Uganda and Kenya (35%). For Kenya, this can be explained by

[46] IOB stresses that much remains to be done in order to achieve greater synergy in its 2014 report, p. 20

the fact that there is a relatively high number of Dutch SMEs, more than a 100[47], as compared to other African countries. Some embassies invest more in this type of diplomacy than others.

The best practices demonstrate that it requires a substantial (capacity) investment from embassies to support SMEs with specific issues. Understandably this capacity cannot be easily made available due to budget and staff cuts. However SMEs highly value and need to be working with the NL government for the trust factor it provides, crucial when doing business in fragile settings with weak and unreliable institutions – and actually overcoming the companies' critical junctures; so it should continue to do so.

It is key for the Netherlands government to strengthen its broker function and catalyse networks and services that perform the GPS diplomacy functions, backed by the embassy and/or ministry. Working through intermediairies (through professional commissioning) could be an option, however these would require a track record demonstrating their experience in both entrepreneurship and building local networks in fragile settings. In case of emergencies it might be necessary to escalate these to a higher, diplomatic level, such as was the case with the forest lodge in Uganda (see 'best practices').

These strategic working relations with SMEs are key to start working together in the framework of the Dutch Good Growth Fund. The agency managing track one of DGGF (for Dutch companies), Rijksdienst voor Ondernemend Nederland (RVO), built an impressive network with Dutch SMEs through managing earlier and other private sector related programmes and is key in this process. While recognising that this will continue to be managed from headquarters of the NL government and RVO, we argue that it is important to have a presence on the ground: as counterparts for the entrepreneurs, local banks and others; available in case of emergencies and at critical junctures.

As mentioned before, ideally an equity model of financing would cater for this kind of engagement, as follow up monitoring and ad hoc coaching is crucial for the SMEs to reach their targets and commitments, especially in these fast-changing environments. However since this option is not feasible for the NL government, it might need to work together with other investors and intermediairies to mitigate risks within the DGGF.

Conversely, financing for other Dutch(-led) SMEs with development potential but insufficient collateral nor headquarters in the Netherlands might best partner with local companies within track two; on an open, competitive basis. As an ancillary, this could also improve the synergies between the two groups of companies, both Dutch-led and local, in promising value chains and sectors, strengthening locally based partnerships in development cooperation, and above all promote their potential for local job creation in fragile settings in Africa.

[47] Multi-Annual Strategic Plan 2014-2018, Netherlands Embassy Kenya, Netherlands Ministry of Foreign Affairs, p. 4

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Annex: overview of entrepreneurs interviewed

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