EXECUTIVE RETREAT FINDINGS

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Building the Middle

Global Cooperation at the Frontier: Innovative Finance in Fragile Contexts

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InterAction
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SUMMARY

From November 16-18, 2018, The Annenberg Foundation Trust at Sunnylands and InterAction co-convened non-profit and private sector leaders to advance a new conversation about scalable market-oriented investments in fragile contexts that support inclusive growth. The retreat began from the premise that, based on most predictions, countries experiencing high degrees of fragility are not likely to meet the Sustainable Development Goals (SDGs) by 2030; moreover, 80% of the world's poor will likely be living in 58 of the most fragile countries by 2030 according to the OECD. The international community is "off track" in fragile states and is currently lacking the international leadership and collective motivation needed to make progress.

Given the highly connected and decentralized world today, there are incredible business opportunities in fragile contexts that can build on local creativity and vitality to stimulate economic development. However, there are some systematic challenges and barriers to entry. For one, only 1% of foreign direct investment (FDI) is made in fragile states, while the vast majority of venture capital is still concentrated in economically-developed countries. This severely hamstrings access to capital to generate growth. This problem stems from concerns among investors about political, security, foreign exchange, and other risks which often times result in lower risk-adjusted returns than investments in more stable contexts. In addition, market failures and incomplete value chains abound in fragile contexts, resulting in potential customers remaining disconnected from suppliers in key development sectors such as agriculture, telecommunications, and health. These two dynamics contribute to low levels of investment in fragile environments.

Broadly, retreat participants outlined a theory of change for why more and different types of investment are needed in fragile contexts and discussed how to catalyze these changes. They also identified the need to "build the middle," which refers to bolstering a largely unexplored range of investment vehicles, financial tools to reduce risks, scaling approaches, and brokering institutions that fall between first-loss and commercial investors. Associated efforts span, for example, first-loss investments, such as those provided by humanitarian and development non-government organizations (NGOs), public-private partnerships, and more commercial investments. Participants concluded that "building the middle" could build resilience and grow markets in fragile contexts.

The discussion highlights, emerging principles for investing in fragile contexts, questions for future discussions, and actionable ideas and recommendations are built out below. Toward the end, this brief includes country case examples of market failures as missed opportunities, successes in financing in fragile states, and examples of how domestic resource mobilization and broader policy could be strengthened vis-à-vis private investment in fragile contexts.

DISCUSSION HIGHLIGHTS

UNDERSTANDING THE RISK, PAYOFF, AND TIME CONTINUUM

Investing in fragile contexts takes place within a series of continuums across which different investment actors play distinct roles. The first continuum is of risk and potential payoff, and the second of timeframe for payoff (Figure 1). First-lost investors are critical to get commercial investors interested; however, the activities and actors between first-lost investors and commercial investors in fragile contexts has largely been neglected. The retreat focused primarily on the left side of the continuum, including the roles of advisory firms and firms specializing in ripening the country governments' responses to such investment.

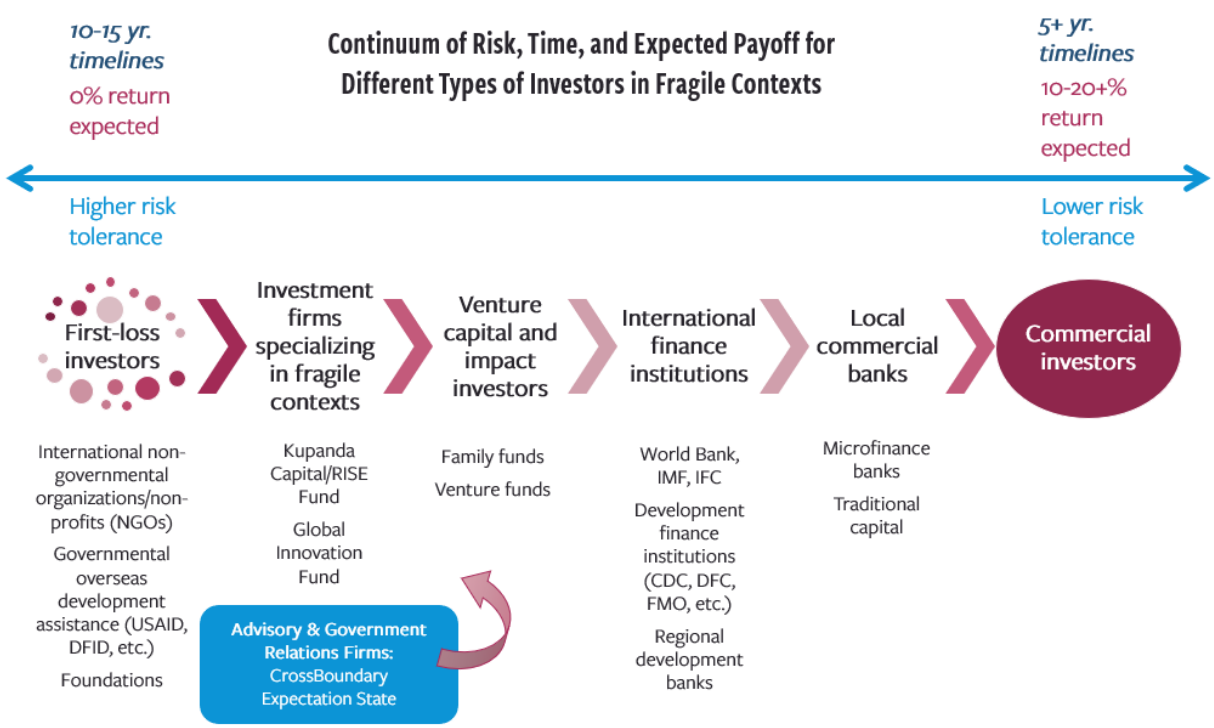

Figure 1: Continuum of Risk, Time, and Expected Payoff for Investors in Fragile Contexts

There are several key indications within the public and the private sectors that signal when a fragile context is beginning to mature as a market. The country's government and elite institutions should demonstrate a commitment to rule of law and inclusive growth through 1) the consistent and credible application of business regulations, 2) development policies that are realistic for investors, 3) the creation or existence of legislation that is conducive to international investment, including repatriation opportunities and infrastructure (converting foreign currency into local currency), 4) right-sized tax rates and structures for domestic resource mobilization, and 5) enforcement mechanisms for business regulations. The country's private sector signals readiness through 1) a sufficient level of formalization, 2) presence of sectors that have a high likelihood of generating commercial returns, and 3) business opportunities for investment from both international and local actors.

Companies that are first to invest can also generate a demonstration effect that proves to other firms that are watching that "it can be done." Through their example, first movers drive down market-entry costs for firms that follow, such as was the case when Coca Cola invested in Somaliland. However, these firms often face barriers in the form of diligence and transaction costs that can make it unprofitable for these firms to invest. Therefore, it can be worth it for public and philanthropic actors to subsidize these costs to remove barriers for first movers. A successful example of this has been the funding of transaction costs by USAID under Power Africa.

THE PRIVATE AND THE PUBLIC: BUSINESS AND GOVERNANCE REINFORCING ONE ANOTHER IN FRAGILE CONTEXTS

It is typically the role of the government to ensure sound development policies that regulate investments in ways that create inclusive growth. The challenge in fragile contexts is that government officials are either disincentivized to do so as a result of long-standing patronage networks that favor some segments of the population and exclude others to the benefit of those in power. In other cases, the governments do not necessarily know how to regulate business in a way that equitably distributes resources. International actors have a role to play in convincing and pushing governments to work this way. They can both ensure that companies help generate goods and services for customers who are socially, economically, and politically marginalized.

The private sector has the potential to generate and support good governance, analogous to the ways that armed actors and elites can potentially generate bad governance. The crux of fragility lies in elite capture of state resources coupled with the state or non-state security forces that protect them in the name of patronage. Companies in these environments can create formal and informal institutions in ways that allow elites to see it in their own personal interest to "play fair." For example, one firm worked with a Ministry of Finance to convince the ministry that having consistent land ownership policies that did not discriminate along ethnic lines is good for business. Under certain circumstances, firms may find that supporting inclusive growth through their business practices can also help them meet their bottom line, such as through equitable hiring practices, supply chain management that includes formerly excluded segments of the population, or creation of products and services that uniquely address the needs of customers neglected by both the government and the broader private sector.

Increasing and improving investment in fragile states will require taking a sub-national look at fragility and opportunity. In terms of geographic differences, business can have a positive impact on national governance even when working at the sub-national level. This requires overcoming the "tyranny of the country lens" and looking at sub-national dynamics and opportunities. Where violent extremism may negatively impact the tourism industry in one locale of a country, for example, those types of attacks might not be prevalent elsewhere, creating a window of opportunity. Moreover, in many fragile "states" there is no state or a very weak state, making regional economic linkages as strong or stronger than intra-country linkages, creating opportunities that cross boundaries, such as in the eastern DRC or western Afghanistan.

Unlike traditional models that focus exclusively on economic growth as a driver of stability, "escaping the fragility trap" and preventing backsliding involves supporting investments that can help locales manage shocks and stress. The fragility agenda, in part, seeks to prevent conflict both in places that have yet to experience violent conflict, as well as places that are emerging from crisis and are at-risk of backsliding. While there is a high correlation between extreme poverty and poor governance, suggesting that economic growth is critical to strengthening governance, the relationship between the two is more complicated than this. Most fragile states in history emerged from tumult by effectively managing crises and shocks, which in turn promoted longer-term economic growth. As such, investment actors should be cognizant of how they exacerbate or mitigate crises, particularly those catalyzed by patronage networks. Most of the international finance institutions (IFIs), including the African Development Bank, World Bank, and some UN agencies, are rewriting their policies on risk and resilience to account for this.

There is a need to help firms and governments address corruption without destabilizing elite bargains. For example, from the 1940s-1990s, Pakistan was making great progress, even exceeding levels of growth across other Southeast Asian countries. From 1990-2018, however, the country's governance has been in demise, yet the private sector has continued to grow. As a result of bad governance, corruption took root. This led to the advent and growth of the informal economy, which has now grown to be equal or even larger than formal economy. New investment firms in fragile environments must strike a hard balance: creating a demonstration effect through their investments without attracting clientelism, as medium to high levels of corruption equate to about a 20% tax. The opportunity cost of not addressing corruption is not typically considered. Particularly in extractives, firms must be held accountable for human rights abuses as one aspect of addressing corruption. This could be done by divesting from state-owned enterprises (SOEs). While not considered a fragile state, South Africa's Commission on State Capture offers an interesting model of how to address widespread corruption and how it can destabilize the elites in a country, even in more overall stable countries.

QUESTIONS FOR FUTURE DISCUSSION

- Is there a way to screen out investments that are likely to contribute to unequal growth?
- When are we crowding in private resources as opposed to crowding out?
- How do we avoid investing in companies with little return, and instead make investments that generate public goods with higher demand curves, lower unit costs, and shared comparative advantages?

BARRIERS TO ENTRY AND SCALE

Sourcing opportunities for investment is a key challenge for firms in fragile contexts. Many times, the lack of local knowledge and trusted counterparts prevent investors from entering a geography; this is especially true when contract enforcement is weak. This creates a need for firms and organizations that can play that intermediary, deal-sourcing role. Sponsoring the creation or market entrance of a trusted intermediary can significantly alleviate this problem and serves as a quasi-public good for all investors interested in entering the market, helping to source and conduct due diligence on existing investment opportunities.

Weak contract enforcement is also a major impediment for firms that stand to lose. Due to the lack of rule of law in most fragile contexts, there is a risk that certain transactions and contracts are not upheld as they would be in places with stronger contract enforcement. There is a need for greater support to firms that risk entering into such contracts. Blended finance (blending philanthropic capital with commercial capital) is a powerful solution to help share these risks appropriately between philanthropic and commercial capital sources. Relatedly, fragile contexts often lack the legal infrastructure needed for a vibrant business environment. This can result in too much regulation and taxation of business thereby squeezing business out, or too little regulation, allowing criminality to control the business environment. This requires policy- and enforcement-level changes.

International corporations and businesses already working in fragile environments face challenges around human capital – in terms of availability of employees with specialized skillsets and local knowledge, and staff safety, security, and health. In terms of human capital, one firm currently has 300 employees working across Africa with a $10 billion operating budget. Their main challenge is ensuring their workforce has the capacity to do the work that needs to be done. Health challenges are also prevalent (i.e. malaria among staff). There is both a need to increase exposure for young, mid-career, and senior-level private sector professionals to the issues prevalent in fragile contexts, as well as to support firms that are already developing a workforce locally in those places.

Devaluation of investments made in local currency due to changes in the exchange rate remain a serious challenge to attracting investment in fragile states and has a significant impact on where the money flows in such contexts. Foreign exchange (FX) risks exist for investors whenever they make investments in foreign currencies. These risks emerge from a vicious circle wherein bad governance leads to fragility, which then instigates economic instability, eventually devaluing local currency. Governments then step in with contractionary monetary policies to contain current account and fiscal deficits, which slows down growth. In traditional markets, there are established and efficient hedging tools available to allow investors to manage these risks. When investing in fragile states, however, such markets either do not exist, or are very expensive or unreliable. Existing technical solutions such as TCX are expensive and often not available in the most fragile contexts. They are also inadequate for equity capital. If fixed in fragile markets, this would greatly incentivize more firms to invest. A solution requires both technical and political approaches. There is potential for overseas development assistance (ODA) or IFIs to step in to provide some level of hedging to investors in these markets to greatly reduce investor risk and improve the expected returns for investing in fragile states. Proxy hedges, for example, have been proposed and are showing promise in hedging currency volatility for equity investors. Political solutions include taking preemptive measures to avoid running down this downward spiral rather than a reactive one. The support system for this issue will need to work with central banks and ministries of finance of the respective countries to be most effective.

In order to scale investments, replicate. An alternative to scaling a single project or growing an NGO-led effort is to increase investment firms' abilities to capture a greater portion of the attainable market by using recurrent investment and expanding investments that are already there. This would happen by repeating and contextualizing already tried and tested investments in more locations. Replication is not happening as much as it should because investment firms still do not have the right kind of consulting services that can shepherd them through. Large consulting firms do not prioritize work in these markets given the cost of entering these markets and the limited amount of profitable project. At the same time, government contractors who are present in these situations have structures that are optimized for servicing government contracts rather than working with investors. Finally, boutique firms are still the primary actors doing this work, though are often limited in the breadth of services they provide and geographies they cover given the limited deal flow available in these areas.

Currently fragile states suffer from a perception of risk that is larger than the actual risk experienced in these geographies. Many investors are affected by perceived risk that is generated by news media or their peers, disincentivizing them to invest in places that might otherwise have great business opportunities that outweigh the real levels of risk. As one possible solution, if the Global Emerging Markets (GEMs) Risk Database – a database set up for Development Finance Institutions (DFIs) to share pools of data on credit default rates – were made public, it would go a long way to overcoming this perception bias and would help investors appropriately price their investments.

Despite lack of information as a major barrier to scaling, there is tension between making measurement data transparent or monetizing it for business development. In general, more data is needed to encourage investment, but there are on-going debates between sectors about the right degree of transparency, given different norms between for-profit and non-profit actors on open data. NGOs tend to support open data, though they are in the minority when compared to the number of private sector actors that keep data as proprietary information. NGOs have an immense amount of sub-national data that they do not typically know how to make sense of. Some platforms exist to share information, such as NGO Aid Map maintained by InterAction, which is a repository of 18,410 overseas projects implemented by 9,971 organizations. Moreover, few people are making money from data, but it does support their business development, and as a result, companies are not inclined to share even if it would collectively reduce overall costs of due diligence and pipeline development. There are also questions around privacy and responsible use of data that remain unsolved.

QUESTIONS FOR FUTURE DISCUSSION

- Would replicating as a scaling strategy overwhelm country governments, as donors have done before?
- How can the time inconsistency problem of investors losing money due to currency devaluation in fragile states be overcome? How can IFIs, NGOs, and ODA help with this issue?

A MULTISECTOR, NETWORKED APPROACH: COMPARATIVE ADVANTAGES OF DIFFERENT ACTORS

NGOs' comparative advantage is in providing bottom-up, in-country connections and knowledge. Donors' primary role could be in providing "patient capital." Heifer International ran a randomized control trial (RCT) that demonstrated that NGO presence at the local level helped link people to larger markets. NGO presence could be an asset to firms looking for investment opportunities as part of their pipeline development, overall operations, or exit strategies. Likewise, NGOs are best placed to provide an understanding of local markets and relationship-building that then links with investment firms specializing in working in those kinds of contexts. The donors that support NGOs are well-placed to provide first-loss and early stage capital through grants over long time periods ranging well beyond available investment tenors. The traditional donor model for NGOs suggests that donors are expecting a 100% loss, or 0% return on investment, as a result of what they provide, given that they see other social, political, or environmental changes take place. This suggests that donors that typically support NGOs are also ripe to provide concessional capital for early stage investment that may not succeed, provided that adequate measurements of the positive social dividends are established.

Humanitarian actors widely acknowledge that markets in fragile contexts are inherently unequal, favoring some and disadvantaging others in stark ways. Inequality is a primary driver of violent conflict which is a leading cause of humanitarian crises and unprecedented levels of forced displacement worldwide. Investors have the potential to both reduce inequality in their daily operations and engage and partner with humanitarian organizations responding to crises where opportunities for shared value exist. With the scale of global humanitarian needs far outpacing available funding, there is a need to examine how private sector engagement in countries in the midst or at risk of crisis both helps and hinders economic equality in places historically ravaged by inequality. These considerations should be evaluated through the lens of "do no harm," conflict sensitivity, and the humanitarian principles, as well as what is financially prudent for firms themselves; there will be areas where collaboration between humanitarian actors and the private sector is not the right choice, though exploring these ideas could yield some ground-breaking and mutually-beneficial solutions.

Development aid agencies' comparative advantage could be to strengthen value chains and markets, or attract private capital by reducing risk; however, this raises issues of the appropriate use of taxpayer funds. Overseas development aid from donor countries could go toward connecting producers to market demand, supporting the development of investable companies or projects, connecting those investors to companies and projects, expanding markets, and providing initial first-loss and project preparation capital on large-scale projects. The challenge is that some stakeholders and taxpayers may disdain the use of public funds for activities that eventually become profitable for private investment firms. However, the only way to get more private investment firms interested is if there is an expected financial payoff for them. Exploring acceptable models of risk sharing via public-private partnerships could create alternatives. There is also a risk that if the investment is unsuccessful, money from governments of donors might be drawn down.

QUESTIONS FOR FUTURE DISCUSSION

- Can different actors produce outcomes at different levels on this issue?
- Private sector actors are largely not involved in life-saving humanitarian goods and service provision. Should they be?
- Which organizations, institutions, or platforms should be responsible for identifying first-order and second-order risks in fragile contexts when it comes to deciding on investment?
- How should we think about financial and development additionality in this context?

IMPROVING THE CASE FOR INVESTMENT

Given the multisectoral nature of the solution set, different industries need bespoke arguments to be convinced to act. Fragility, as an issue, seems to be slipping down the priority list of U.S. national security interests. Extremism, even, is no longer perceived to be as much of an existential threat to the U.S. government as it was recently. This is not the case in Europe where the refugee crisis has spurred action. More work is needed to continue to make the case to the U.S. Congress. Meanwhile, private sector actors are not compelled by national security arguments. As such, there is a need for new language to make the case for action for addressing fragility, as well as motivating the private sector to get more involved in fragile contexts based on expectations of positive returns and a reasonable investment environment.

There is an inherent tension between what is often considered “market” investment and “impact” investment in that few impact investments have yielded the kind of scalable returns that commercial investors are looking for, yet impact investors are not interested in standard activities. Mainstream investments that appear to benefit only the private sector are criticized by some INGOs that feel that those investments are not addressing as much social need as they possibly could; in contrast, “impact” investing is viewed among some investors seeking commercial returns as insignificant. These differing viewpoints suggest the need for greater understanding across sectors and the two areas of investment. As such, there is always an indirect advantage to the economy even if the more direct and larger proportion of the benefit is accruing to the private sector. Creation of jobs and improvement in standards of living and quality of life are all rewards of expanding the market. Likewise, in places that struggle with extreme poverty and instability, there is a need for investible opportunities that are both socially impactful and commercially sustainable.

Increasing the private sector’s level buy-in for inclusive growth through government policy is key to ensuring investments improve sustainable development and avoid exacerbating fragility. There is a need for governments and other relevant actors to determine and shape whether firms are inclusive in their business practices. Efforts should be aimed at incentivizing large corporate firms to take more risk, rather than taking their current risk posture as immoveable – risk that must be properly managed to avoid negative market distortions and perverse incentives. At the regional level, growth that only benefits a few exacerbates fragility. As an example, the ADB predicted the Arab Uprising by showing how inclusive economic growth flatlined in the five years prior to 2011. If inclusive growth is not a priority, the private sector will be part of the problem. This suggests that having large multinational corporations move in will not automatically turn exclusive growth into inclusive growth, nor will it address fragility.

QUESTIONS FOR FUTURE DISCUSSION

- What does it take for different types of investors to take more risk?
- What would effective advocacy toward corporate actors with purely profit-driven interests, especially in extractives, look like?
- Should the coalition of the willing push the risk profile of big corporates or "meet them where they're at"?

CASE EXAMPLES

MARKET FAILURES AS MISSED OPPORTUNITIES IN FRAGILE CONTEXTS

- **Katanga Province, Southern Democratic Republic of the Congo (DRC):** In a resource-rich country where a significant amount of the food is imported from China and Europe, market failures are relatively common. In Katanga Province, an international mining company has moved in and built roads that could partially support nearby businesses to get their goods to market. However, banana farmers would have to travel 100km taking time away from farming to bring their goods northwards where the markets are. Their produce might go bad due to lack of refrigeration. There is an unpaved section of road that deters most farmers from linking to larger markets and selling their crop all at once. For a firm to capitalize on the arbitrage opportunity between the banana farmers and the distant market, investment by a private or public donor in a road would be needed to first complete the value chain.

- **Haiti:** Despite a massive market for all varieties of Haitian mangos in the United States, exports do not happen. Even with short value chains, sometimes markets originating in fragile contexts fail because they cannot meet bio-sanitation and must contend with poorly constructed roads or no roads at all.

- **Mozambique:** A large MDB wanted to set up a private equity fund in Mozambique. After selecting the fund manager to administer the fund, that group went through the registration process in order to get a license for their fund. The government took two years to finish their diligence on the fund, in which the government asked for a list of every equity investment the MDB had made. At the end of the two years, the fund received the license, but it was only a banking license that did not pertain to the type of equity investment they hoped to make. Rather than go through the process again, the fund manager walked away from the project.

- **Pakistan:** The Government of Pakistan has an agency that is intended to support SMSEs, called the Small and Medium Enterprise Development Authority (SMEDA); however, SMEDA does not have a standard definition of what constitutes an "SME," which allows them to withhold any investment yet benefit from the appearance of having such an institution. Similarly, SMEs and other private businesses lose out because different parts of the same government bureaucracy do not communicate or coordinate: about 40% of food in Pakistan is wasted because there are no proper storage and holding mechanisms for excess food and crops. There are no procedures for farmers to be able to get financing against their produce. As a result, they are vastly exploited by intermediaries. There is an immense need for the private sector to "crowd into" this sector to avoid food insecurity and resource waste.

SHARPENING DOMESTIC RESOURCE MOBILIZATION AND BRODER POLICY VIS-À-VIS PRIVATE INVESTMENT IN FRAGILE CONTEXTS

- **Eastern DRC:** A foundation was supporting coffee production in a region that borders Rwanda; coffee is one of the only revenue-generating activities in that part of the DRC. However, the central government of DRC began taxing this industry at about 70%, which caused the coffee production companies to cross the border into Rwanda and sell there instead where the tax rate was only 15%. This is an opportunity to advise the government on taxation regimes, and how despite needing to mobilize domestic resources, they need to be cognizant of how their fiscal policies affect the market, and in turn, the state's own revenue generation since they lost in the end.

- **DRC:** FINCA bank was experiencing offline data collection challenges which caused their banking customers to have to come into branches to access banking services. This caused a reduction in their number of customers, so they instituted an "agent banking" service that allowed people to designate someone to bank on their behalf to save them travel and waiting time. This change was associated with an increase in average customers from 7K to 18K. The Central Bank of DRC used this as an opportunity to test out new regulations and policies to regulate and tax agent banking, though it took the Central Bank 7 years to determine how to tax it.

- **Gulu, Uganda:** Rice farmers in Northern Nigeria were underproducing for the land acreage they owned by 90%. An ODA-private sector partnership between USAID and ABA Trust provided agricultural locals, grants that would cover farmers' losses due to crop disease, technical assistance, and shaped policies in Uganda. By addressing the full value chain, they were able to grow all the farmers' production. This suggests that there are often an array of financial products and services that are needed to stimulate production and value chains, not just money.

- **Mali:** In partnership with USAID, CrossBoundary catalyzed over $50 million of investment into the WASH and agriculture sectors by working with investors and companies to overcome the barriers to investing in Mali such as perceived risk, high transaction costs, information asymmetry, lack of pipeline, difficulty to effectively conduct due diligence on an investment opportunity, among other challenges.

- **Mali:** In Mali, the conversations that Kupanda Capital would have in the north where ISIS is present are very different from the activity they would engage in in the west where the biggest threat is criminal activity, not violent extremism. In the north, the firm provides pre-investment support in the name of Corporate Social Responsibility (CSR). In the west, the firm is determining how to invest $2 billion over 10 years. In both cases, Kupanda Capital works with the government.

- **Babban Gona, Northern Nigeria:** Relying on its due diligence process and flexible financial instruments, Global Innovation Fund significantly de-risked an investment in an end-to-end agricultural franchise service for small holder farmers in Northern Nigeria. GIF provided a local currency loan to the organization that helped to crowd-in senior-level, dollar-denominated debt from other investors, including DFIs such as OPIC, CDC, and FMO. GIF's involvement addressed the challenge that some investors want a higher rate of return to account for losses they will likely incur when investments are done in local currencies.

- **DRC:** The Japanese government attempted to invest in workforce development in the DRC; despite good job training programs, there were no jobs. The firm then turned to FINCA bank to help them encourage young people to build their own businesses. FINCA bank provided two different financial products – one for men and one for women – and as a result nearly all of the youth were successful in starting their own businesses.

- **Afghanistan:** In the Basic Package of Health Services in Afghanistan, the Ministry of Health, international implementing partners, villages, and urban centers all worked together on a single platform. Since the Taliban was controlling the national government, the Ministry of Health opted to work at the village level with great success. Given investment from international partners, this example also suggests how IFIs can be involved in scaling outcomes.

- **Rajasthan, India:** In Rajasthan, India, the Global Innovation Fund supported the India Education Initiative to allow an educational software company called Mind Spark to expand via state procurement. To bridge this "pioneer gap," GIF advised the government on how to run a procurement process for software, which was uncommon at the time, and provided a grant to Mind Spark. This $2 million investment resulted in the software being adopted in four Indian states – a major win. This stood in stark contrast to the challenge fund model that often left entrepreneurs who were looking to scale at a loss because the fund did not enable them to be investment ready for larger firms. Lessons coming out of this suggest that companies should not try to scale so fast that they do not wait for much-needed evidence that it works. In addition, investors need to be flexible, patient, and ensure that concessionary funding does not distort markets. There is also a need to utilize metrics beyond job creation and social return on investment.

- **46 different countries:** One successful example of scaling is CARE's Village Savings and Loans Associations which has increased social capital, resilience, and women's economic activity. See the 2017 VSLA Report.

- **Multiple countries:** Habitat for Humanity scaled by entering the mortgage market, then bringing in Standard Modern Bank and OPIC.

QUESTIONS FOR FUTURE DISCUSSION

- Why do some markets in fragile states work while others do not?
- What are the market characteristics that make an investment “work”?
- What is the difference, for example, between market failures in DRC for bananas, and successes in Uganda for rice?
- What is the role of gender in finance in fragile contexts?

DATA-DRIVEN DECISION-MAKING FOR INVESTING

- **Burkina Faso:** Using Accolade Data and ADB poverty maps, Kupanda Capital was able to make decisions about where to invest in mining in Burkina Faso. They made very different choices at the sub-national level than they would have at the national level.

- **Bihar, India:** CARE initially supported the Bihar Health Intervention. By having open data, they invited others into the process to help them scale it.

QUESTIONS FOR FUTURE DISCUSSION

- How can better measurement, knowledge management, and information-sharing allow for the brokering of capital and projects?

PREDATORY PRIVATE INVESTMENT

Private Chinese investment firms and public Chinese development finance institutions are burdening fragile states with unprecedented levels of debt and an inability to reform regulatory structures, thereby exacerbating risks of financial and political instability. Both private firms and public institutions from Chinese counterparts operating in fragile, often resource-rich countries oftentimes exchange mineral rights and little regulation for investment in local infrastructure and other public goods. This hampers fragile states’ abilities to apply new regulations on any Chinese investment as well as collect taxes from their own extractives. Moreover, the Chinese Development Bank (CDB) is now a major competitor to the African Development Bank and other multi-lateral development banks (MDBs) on the African continent. The CDB is borrowing many lessons learned from the MDBs, but often saddles countries with unsustainable debt loads, calling into question the true developmental potential of such investments. Examples of this include:

- **Pakistan:** In an underdeveloped area of Pakistan, private Chinese firms came with a full $3 billion package for mining and power generation through extracted coal. In addition to providing their own machinery and equipment for doing the work, the firm also insured their debt.

- **South Sudan:** China has invested extensively in South Sudan, though when they attempted to leave due to worsening security, the Chinese government and elites did not allow them to leave.

QUESTIONS FOR FUTURE DISCUSSION

- What will future competition between U.S.- and Chinese-owned firms look like in fragile environments?

EMERGING PRINCIPLES FOR INVESTING IN FRAGILE CONTEXTS

Build on the Bellagio Consensus on Fragile States and the U.S. Fragility Commission findings to create a movement in favor of increased investment in fragile states.

In fragile states: 1) Keep politics at the center, 2) Emphasize local leadership, 3) Ensure robust conflict analysis, 4) Commit to collective action. U.S. government engagement in fragile states should be ″strategic, systematic, selective, and sustained.″

Do not let ″perfect″ governance be the enemy of ″good″ governance. At the same time, be very weary of the creation of possible perverse incentives.

In the same way that encouraging elections will not immediately create democratic institutions and may even be harmful, investing in fragile contexts with entrenched patronage systems should be concessionary. We should not impose a "gold standard" on the local private sector in fragile contexts, and rather, meet them ″where they're at.″ This must be coupled with a keen awareness of when international non-profit or for-profit involvement is generating harmful incentives.

Pushing for inclusive national development plans and related laws in fragile contexts is critical to making economic growth more inclusive.

Investment-driven economic growth will not automatically translate into broad benefits for people living in fragile contexts due to ineffectual and corrupt public administration. Generating inclusive growth is primarily the work of governments. Other donor governments and advisory firms should continue to work to incentivize those governments to build inclusive growth into their national development plans and investment laws.

Focus on the investors who are already involved and invested in fragile contexts.

We are often so focused on addressing skeptics and what is ″new″ that we neglect friendly investors that are already involved in fragile contexts. Focus instead on the landscape of firms that are in adjacent geographic regions or sectors, and ask, ″What is stopping you from working in a nearby area or sector?″

Disrupt the traditional coordination model toward move to a multisectoral, networked approach.

Traditional coordination models that emphasize information-sharing based on good will have not worked. A networked approach that cuts across multiple sectors and that takes into account incentives will be more likely to take action because stakeholders' incentives, while not the same, are at least aligned.

It is not always about the money.

Fragile contexts do need investment, but the way that investment is delivered should also include advisory services, reforms, ideas, and other supports that are not necessarily pure capital.

Prioritize investment in natural resource-rich countries.

Natural resource-rich countries, particularly those with oil and gas, will end up with stranded assets if the globe continues to shift toward renewable energy. As a result, we need to be proactive about our investment approaches to these countries.

Be patient.

Building markets that you are selling into takes time. Supporting the private sector in such contexts is best done through evergreen vehicles, rather than closed end funds that may seek exit on timelines that force firms to move up market or otherwise pivot away from social value creation.

To avoid crowding out private investment, we must target investments where social returns exceed financial returns.

To do this, be on the constant look out for market failures. There is often a missing market due to high costs of market discovery. Innovating in new markets means a long process of iterating on the right product-market fit and discovering the right cost structure. The firm's ability to capture the returns of that investment can be limited.

Measure social impact.

If actors are providing concessional finance – whether because they are taking a subordinate position, providing technical assistance, or using a low discount rate – it is important to be held accountable for social value. We must go beyond measuring "lives touched" or "jobs created," and get closer to social return on investment or welfare gains for people living on low income levels.

Be transparent.

Financial terms and estimates of social value should be available for others to see. Firms may resist this, but to understand market creation, it is important to explore.

ACTIONABLE IDEAS & RECOMMENDATIONS

A COALITION OF THE WILLING CAN:

- Create a multisectoral platform or joint venture between NGOs and investment firms that bridges the "pioneer gap," shares risk, matches capital to deals in fragile contexts, reduces start-up and transaction costs for public-private partnerships (PPPs) on the front end, and on the back end, helps with different scaling strategies, particularly replication ("crowding in"); Such a platform could also influence regulatory regimes, engage at different levels, and advise companies in fragile contexts to improve their ability to navigate patronage networks such that they can diagnose whether there is an elite bargain in place that they need to address in order to enter a certain market. The platform could be a place where existing NGO and other financial resources are applied for collective impact, as well as a forum through which countries could compete for funds.

- Draft a set of investment vehicles, finalized principles, and approaches/investment products and structures that apply specifically to fragile states (e.g. subsidies, first-loss investment, advisory services for blended finance, offshoring) and refines the existing innovative finance for development toolkit, paying particular attention to market forces and unintended consequences

- Generate evidence and information exchange to support an index for investor to learn about business opportunities for sustainable development in fragile contexts

- Create an engagement or advocacy strategy for each type of actor: governments, NGOs, and commercial investors

- Engage with relevant USG agencies to shape USAID's Private Sector Engagement Strategy, BUILD Act implementation, Global Fragility and Violence Reduction Act, and USIP Task Force on Extremism in Fragile States using retreat findings, with a focus on country selection for pilots; include advisory firms that work in fragile contexts in these discussions

- Draft and socialize guidelines for fragile state governments that want to better attract private investment, to help them make internal decisions that prioritize the growth of markets rather than squashing it, or to incentivize the use of public funds to support small and medium-sized enterprises (SMEs), such as guidelines for conflict-sensitive domestic resource mobilization and governmental policies to create a supportive environment for investment

- Provide streamlined venture support for businesses through a shared-services model that offers functions such as banking, compliance, procurement, and advocacy support in one place, thereby reducing transaction costs and accelerating replication

- Exchange programs for both mid-level and high-level professionals in corporations to spend time in fragile environments to increase their understanding of the issues and tradeoffs

- Improve the business case and policy arguments for why private sector actors and government (U.S. Congress) should want to invest in fragile contexts; these arguments will be different depending on the audience, since most are not organically inclined to do so.

- Create standards for and a vetted list of business opportunities in fragile contexts

- Map key actors and their activities in the investment landscape in fragile contexts

- Organize and collect data from investments in one fragile location to tailor and test the approach in a context with similar characteristics

- Make use of the multitude of data available within NGOs and donor agencies; pool it to effectively use it for supporting the case for investing in fragile states

- Continue bilateral engagement between NGOs and investment firms

THE EXECUTIVE AND LEGISLATIVE BRANCHES OF THE U.S. GOVERNMENT CAN:

- Ensure USAID's Private Sector Engagement Strategy includes aspects of investing in fragile contexts

- Reform procurement processes to help smaller firms navigate the USG contracting process

- Ensure that the new U.S. Development Finance Corporation effectively implements work in fragile contexts

- Utilize upcoming pilots in the Global Fragility and Violence Reduction Act or the USIP-convened Task Force on Violent Extremism in Fragile States to apply the principles and approaches identified in the retreat, with a focus on resource-rich countries

INTERNATIONAL FINANCE INSTITUTIONS AND DONORS CAN:

- Provide backing to firms that invest in countries with high currency volatility to safeguard against losses; begin this conversation by convening the heads of Central Banks and IFIs to look at the effects of foreign exchange (FX) exposure

- Examine localized opportunities for investment in fragile contexts at the sub-national level

ABOUT INTERACTION

InterAction is a convener, thought leader, and voice for nearly 200 NGOs working to eliminate extreme poverty, strengthen human rights and citizen participation, safeguard a sustainable planet, promote peace, and ensure dignity for all people.

ABOUT THE ANNENBERG FOUNDATION TRUST AT SUNNYLANDS

For more than 40 years, Ambassadors Walter and Leonore Annenberg welcomed political, business, educational, and entertainment leaders to Sunnylands, their 200-acre winter home in Rancho Mirage, California. In 2001, the couple established The Annenberg Foundation Trust at Sunnylands to preserve the estate as a place where world leaders could meet to discuss issues of national and international importance.