Challenges, learning and coping strategies of firms in FCS

Introduction

This chapter explores how companies take decisions about their activities in FCS. It examines the factors which companies take into account in decisions about whether or not to invest in specific conflict-affected locations, and in the subsequent management of those operations over time. We find that companies differ by sector in the conflict-related issues which affect them, and also that the realities are different depending on a company's size and where it is domiciled. Large international companies have different options for example from smaller firms indigenous to fragile states.

However, despite these differences this chapter observes that there are nonetheless some clear commonalities between companies in the issues that affect their operations in FCS. Although different companies are affected in different ways, all have to consider issues such as physical security, inadequate legal and regulatory structures, weaknesses in government capabilities, and challenges relating to infrastructure. Similarly, although the specifics processes differ from company-to-company, the coping strategies used to deal with these potential threats also present clear commonalities. Companies all need to develop integrated decision-making processes that take into account issues relating to conflict issues alongside more 'normal' technical considerations. Attention to detail is also crucial within which detailed insights into the conflict dynamics in different territories are seen as vital. Underpinning these systems is the need to identify staff able to operate with integrity and resilience in fragile locations.

However, this chapter also observes that many of the issues that face companies in their operations in FCS are not wholly within the capability of companies to manage effectively on their own. The challenges companies face relate significantly to the conflict environment, and therefore effective management of these issues requires collaboration between companies and other actors including the international community, the host government and civil society. This chapter concludes with some observations on the challenges of making such action work effectively.

This chapter is based both on the existing literature, and on a series of interviews conducted with a range of companies operating in FCS locations. The companies interviewed operate in a range of sectors including banking, healthcare, investment, food production and mineral extraction. The companies also varied in their size: those interviewed included global corporations; 'regional multinationals' – that is companies operating in several countries within a specific geography such as West Africa or the Middle East; and smaller, local firms indigenous to FCS states.

This chapter first explores the context for an examination of companies' decision-making processes in FCS and briefly examines some of the relevant background literature and the issues arising from this. The next section sets out the evidence from the interviews undertaken for this study, and the conclusions that might be drawn. The final section focusses on challenges to collective action in addressing the issues facing businesses in FCS.

1: Corporate strategy and management in FCS: the context

'Good' companies, and bad ones

The aim of this chapter is to identify good practice amongst companies in managing their operations in FCS in ways which both ensure business continuity and profitability AND that the company's activities at least do not exacerbate conflict tensions, and where possible contribute to peace-building. In doing so, the conclusions of this chapter can hopefully provide a model on which other companies might build in their operations in FCS.

However, it is by no means a given that corporate behaviours and management systems will necessarily tend towards companies having positive and beneficial impacts on conflict dynamics. The corporate sector has often been strongly criticised for its adverse impacts in such locations. Wenger and Moeckli argue that "corporations have long been accused of causing or exacerbating conflict through their business operations"[1]. Haufler agrees: "foreign investors have been linked to the emergence or exacerbation of conflict around the world for centuries."[2] So adverse can this impact be, she argues, that "some observers have argued that all major extractive industry development in fragile states, including those just emerging from war, run the risk of abetting corruption, conflict and criminality; they should not be undertaken at all"[3]

As was pointed out in an article in the *Journal of Conflict Resolution*, 'universal ''goodness'' of entrepreneurship is not implicit and activities can certainly exert questionable or undesirable effects.'[4] Entrepreneurs do not necessarily consider the externalities or societal effects of their activities[5], and companies will tend towards activities ''with the highest private returns, which need not have the highest social returns.''[6] Thus the private sector cannot therefore be presumed to be *a priori* a positive force in conflict-affected areas. Indeed one clear category of companies actually benefit from conflict, and therefore whose management processes are unlikely to have much to teach others. The past decades have seen a sharp increase in the number of Private Military Companies (PMCs) whose business is war[7], and which have taken on a number of roles that the armies of the first world would have previously undertaken."[8] The range of activities undertaken by such firms is extensive. As well

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[1] Wenger, A. & D Moeckli. *Conflict Prevention: The untapped potential of the business sector*. Lynne Renner, London. 2003 p5

[2] Haufler, V. 'Is there a Role for Business in Conflict Management?'. In Crocker, C A *Turbulent Peace: The Challenges of Managing International Conflict* United States Institute of Peace Press, Washington DC

[3] Haufler, V. 'The Private Sector and Governance in Post-Conflict Societies'. In Brinkerhoff, D W. Governance in Post-Conflict Societies. Routledge, London. 2007,

[4] Desai S, Z J Acs & U Weitzel. 'A Model of Destructive Entrepreneurship: Insight for Conflict and Postconflict Recovery'. In *Journal of Conflict Resolution* 2012 57(1) 20-40

[5] Baumol, Wi. ''Entrepreneurship: Productive, Unproductive and Destructive.'' In *Journal of Political Economy* 98 1990 pp893–921.

[6] Murphy K, A Shleifer & R Vishny. 'Why is Rent-Seeking So Costly to Growth?' In *The American Economic Review* 83 1993 pp409–14.

[7] O'Brien, K. 'Military-Advisory groups and African Security: Privatised Peacekeeping'. In *International Peacekeeping* Vol 5 No 3 Autumn 1998, p78

[8] Kinsey. C. 'Regulation and Control of Private Military Companies'. In *Contemporary Security Policy* Vol 26 No 1 April 2005, p85

those companies which "projected lethal force in combat operations"[9] others are engaged in other functions such as close protection or providing security.

Developing thinking on corporate strategy in fragile states

Companies have operated in FCS locations for a long time. For example, BP's first major operation was established in Persia (now Iran) in 1908[10], Shell's operations in Nigeria date from 1937 and in South Africa from 1902[11]; and Nestle has operated in Africa and Asia since the beginning of the 20th Century[12]. However, even if corporate engagement in such countries is not new, a focus on how those operations are managed is more novel. As Timothy Fort observes, before 1999, "there was very little on what business can do to promote peace and security."[13] In Haufler's view, the development of interest in this topic since then was sparked by the issue of so-called 'blood diamonds', the sale of which provided the revenues for the prosecution of the civil wars in Africa in the 1990s.[14]

As Josselin and Wallace say, there is an 'ambivalence about transnational economic actors,'[15] Part of which stems from the belief that companies do not have the right skills to operate effectively in fragile states – 'commercial actors are generally ill-suited for such tasks…'[16] This is compounded by the belief that companies respond primarily to short-term shareholder needs, rather than to longer-term broader considerations: according to Gerson and Colletta 'in part the…reluctance to fully engage with the private sector is due to a lingering lack of confidence in the private sector's willingness to sustain commitments in any one area…'[17]

The first systematic assessment of the decision-making processes of multinational companies in conflict-affected countries was published in 2000. *Boardrooms and Bombs: Strategies of Multinational Companies in conflict Areas*[18] was based on interviews with 25 companies operating in regions of armed conflict. This paper concluded that the corporate attitude to conflict was driven by five key factors. First was the perceived geographic extent of a conflict: if it is geographically limited, companies were more likely to maintain their operations. Second was the severity of the conflict: terrorism seemed widely to be tolerated, whereas very few MNCs were prepared to maintain operations in countries where opposition groups control large areas of the country. The third factor was the attitude of the government: if it provided an otherwise-stable investment climate (as it was the case, for example, in Northern Ireland during its conflict) then investors are prepared to look past

[9] Kinsey. C *Corporate soldiers and international security : the rise of private military companies*. Routledge, London. 2006

[10] BP *Our History* http://www.bp.com/en/global/corporate/about-bp/our-history.html (accessed 06/12/16)

[11] Shell. *Shell at a glance* *http://www.shell.co.za/about-us/who-we-are.html* (accessed 06/12/16)

[12] Nestle *The Nestle company history.* http://www.nestle.com/aboutus/history/nestle-company-history#tab-1905 (accessed 06/12/16)

[13] Fort, T. 'The Corporate Contribution to One Planet Living in Global Peace and Security: An Introduction'. In *The Journal of Corporate Citizenship* Issue 26, June 2007

[14] Haufler *Op cit*

[15] Josselin, D. & W Wallace. 'Non-state actors in world politics: a framework'. In Josselin, D. and Wallace, W. (eds.). *Non-state actors in world politics*. Palgrave, London. 2001

[16]Wenger and Moekli p37

[17] Gerson, A. and Colletta, N. *Privatising peace: From conflict to security.* Transnational publishers, Ardsley, NY. 2002 p25

[18] Berman J. 'Boardrooms and Bombs: Strategies of Multinational Companies in conflict Areas'. In *Harvard International Review.* 22(3) Fall 2000

the risks associated with the conflict. The fourth factor was the sector in which a company operates: those who feel themselves to be essential to the economy felt less risk from armed conflict. However, extractive companies are more likely to tolerate conflict risk simply because they want access to, for example, oil reserves. Finally, companies would alter the financial structures of their operations, for example by using subsidiaries as the investment vehicle, in order to protect themselves as far as possible from the risks of conflict.

2: Challenges to business in FCS

Both the interviews conducted for this study, and the body of existing literature point to the existence of a number of challenges which are faced by companies of all types and in all sectors, albeit to different degrees and in different ways.

Security

Physical security was cited by almost all those interviewed as a key challenge to operations in conflict-affected countries. In particular, companies wanted to be sure that they could protect their people in such environments – physical 'stuff' is regarded as being replaceable, whereas highly-skilled staff are not. 'For us, the black and white issue is the safety of our people: if there's a significant risk to our people that we can't manage, we won't do the project,' was the comment of a representative of an oil services firm. This reality is borne out also in the literature, for example, as the background paper to the 2011 World Development Report observed, 'in the absence of basic security …businesses are reluctant to make the long-term investments that spur economic growth and generate the jobs so desperately needed in these challenging contexts.'[19]

In assessing security risks in countries where they operate or are scoping out, international companies do make use of security advisory firms. However, a number of those interviewed said the value of such advice was limited. The preferred option is to rely on their own staff to get on the ground and assess the situation for themselves. 'There's no real substitute for being on the ground and finding out for yourself how things actually work, and what's really going on', observed a senior manager from an agribusiness company. Local staff are also seen as a valuable asset given their likely greater insights into local conflict and security dynamics.

Geographic impact

Berman's 2000 paper found that 'the perceived geographic reach of a conflict is by far the most important factor in determining whether an MNC will operate in a conflict-affected country.'[20] It is clear that the specific geographic location of a proposed investment remains a significant factor in companies' decision-making processes. It is clearly a key factor in company's decision-making to understand where in a conflict-affected country they will be operating, and whether that geographic location in any way insulates them from violence elsewhere. Rarely is an entire country swallowed up by conflict – even in present-day Iraq, some areas of the country remain viable as places to do business. For example, a Beirut-based bank explained that operations in Baghdad remained viable even if activities in areas of the country controlled by ISIS were off-limits.

Legal and regulatory environment

Visibility and predictability of the regulatory environment

At the most basic level, companies want to be sure that their investment in a country is secure, and that at the very least they will be able to recoup that investment. According to the World Bank, 'rule of law is essential to economic development and poor enforcement of business contracts is damaging

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[19] Peshka M P. *The role of the private sector in fragile and conflict-affected states*. World Bank 2011

[20] Berman J. *Op cit*

for countries rebuilding from conflict.'[21] Evidence shows that developing economies with better business regulations achieve faster annual economic growth rates, particularly because predictable enforcement of contracts encourages foreign investment.[22]

The example of First Quantum Resources in DRC demonstrates the potential risk in this regard. Having spent an estimated £460m in developing the Kolwezi and Frontier mines, the company was 'stripped systematically of all its assets'[23] by the Kinhasa government in 2010. The case of Zimbabwe's indigenisation laws also demonstrates how adverse legal structures can deter investment. The Indigenization and Economic Empowerment Bill was introduced in 2007 and required companies to hand majority ownership (51%) to indigenous Zimbabweans, who were defined in the Law as being 'any person who before the 18th of April 1980 was disadvantaged by unfair discrimination on the grounds of his or her race, and any descendant of such person.' Potential investors, both international and domestic have been put off by an apparent requirement to hand effective control, and 51% of their capital investment, at a cost to be determined sometime in the future, over to a company owned by the Zimbabwean Government: a considerable disincentive to both foreign and local investors. However, the situation was further complicated not just by what the Law said, but what it did not say. As an *Economist* article observed at the time 'the law contains a lot of ambiguity, and gives a lot of loosely-defined discretion to the government. It is unclear whether the transfer would apply only to future mergers, demergers, restructurings and transfers, or to all existing companies.'[24] This lack of clarity, and the competing interpretations from different ministers as to exactly how the policy was to be implemented have further damaged investor confidence and willingness to invest.

Even where laws are in place, companies frequently cite concerns about whether these will be enforced in practice. Issues such as corruption in courts or different interpretations of regulation in different parts of a country are seen as being of particular concern. One bank interviewed, for example, explained that although it provided finance to projects in fragile states, it accepted collateral for these loans only in jurisdictions (for example in Europe) where legal structures were predictable.

Ethics and corporate governance

However it is not just in matters of commercial law that companies face challenges in fragile states. Also of considerable concern is the need to operate to international standards of ethics, anti-corruption, human rights and labour conditions. The desire to avoid corruption is driven by a number of factors. The first is that legislation in companies' home markets has become much tougher over the past two decades. The Foreign Corrupt Practices Act and the Dodd-Frank Act in the US, , and the UK's 2010 Bribery Act all provide a considerable disincentive to engage in corruption. However, there also seems to be a realization that whilst paying bribes may facilitate entry into a new market, it brings with it higher long-term costs as the company will have to keep paying bribes. A number of those interviewed said that they had faced situations where paying a bribe would have sorted out a problem in the short term, but then it would be impossible to avoid paying bribes in the future – 'in the short term, if you have competitors prepared to pay bribes when you don't, then you have a problem. But

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[21] Samuels K, *Rule of Law Reform in Post-Conflict Countries: Operational Initiatives and Lessons Learnt*. World Bank Working Paper No. 37. World Bank, Washington DC. October 2006

[22] Djankov S, C McLiesh, & R Ramalho, 'Regulation and Growth.' In *Economic Letters*, vol. 92, no 3. 2006

[23] MacNamara W & C Thompson. 'Congo seizes First Quantum Minerals' assets'. *Financial Times* 31/08/10

[24] The Economist. *Blackening the economy.* 13th Sept 2007.

in the longer term, it will come back to haunt them'. Thirdly, companies are concerned at the risk of contagion: that a reputation for corruption in one location will adversely affect their reputation and so undermine their ability to do business in other places. As one DRC-based company put it: 'if you want to become an international company, then you have to obey the international rules'.

On analogous issues too, such as human rights and labour conditions, companies believe that they need to operate to international standards, no matter what the local regulations might be. The result is that many companies adopt standards of behaviour in these areas even if this is well above local legal requirements. International companies will often adopt standards such as the Equator Principles even if they do not require bank funding, for the simple reason that operating to such standards ensures that they will be operating to acceptable standards of behaviour . This 'regulation in a suitcase' means that companies feel they are reducing their reputational risk, and operating in ways which will stand up to scrutiny by the media and others. The World Bank has recently introduced a new *Environmental and Social Framework*, which is intended to apply to all Bank investment projects, and to provide clear standards in relation to issues such as 'transparency, non-discrimination, social inclusion, public participation, and accountability – including expanded roles for grievance redress mechanisms.'[25] This framework is likely to be adopted even by companies who are not co-investing with the World Bank, as it will be seen as a clear set of principles against which to operate.

Constraints in host government capacity

A further challenge facing companies in fragile states relates to a lack of capacity in the governmental structures of those states. Whatever the regulatory framework may be, in many cases the structures through which those regulations are implemented lacks capability and capacity. Civil servants are, reportedly, sometimes unaware of their proper role, and lack the necessary skills to do the job for which they are in principle employed. Or there may simply be a lack of properly-qualified people. In Rwanda for example, the effects of the Genocide are still being faced in that those people who might now have been middle- to senior-ranking civil servants are absent because they were killed back in 1994. Companies operating in Rwanda report that whilst the top ranks of ministers and officials are very capable, this is a thin veneer and more junior officials lack capability. Collier and Duponchel agree that conflict has long-lasting impacts on governmental (and firm) capabilities: what they term 'forgetting by not doing'.[26]

The case of Jordan also illustrates the challenges of governmental capacity. Doubts about whether Jordanian ministerial officials have the capability effectively to implement policy (even were the political will there to do so), is borne out by a study of Jordan's economic reforms and attempts to kick-start the private sector. One study concluded that the state's capability is 'limited by budget shortages and by a lack of bureaucratic capacity.'[27] The assessment provides a clear warning for potential investors in a country where reform efforts 'suffer from being embedded in Jordan's general bureaucratic environment. Staffing is difficult, and programmes may find themselves the target of jealousy and obstruction from other bureaucratic bodies.' The capability of Jordan's government and ministries to operate effectively is also undermined by high levels of nepotism. Many in government

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[25] World Bank. *World Bank Board Approves New Environmental and Social Framework.* Press release, 04/08/16
[26] Collier P & M Duponchel. 'The Economic Legacy of Civil War: Firm-level Evidence from Sierra Leone.' In J*ournal of Conflict Resolution* 57(1) 65-88 2012
[27] Carroll K B. *Business as usual? Economic reform in Jordan.* Lexington Books, Oxford 2003. p252

– from those at most senior levels, right down to administrators and drivers – are in post because they used their connections to secure their position, not because they necessarily have the requisite skills, education and aptitude for their job. The prevalence of nepotism is borne out by a report by Transparency International (TI), which found the practice endemic, with the result that 'the integrity of the country's… regulations are considered to be extremely weak.'[28]

This situation is further complicated by the fact that in many conflict-affected countries the host government's capability to provide service to investors may be inhibited by the direct effects of war. For example even the ability of a government to provide information on even basic issues such as demographics may be compromised because relevant offices and data records may have been destroyed in fighting; or because it may be unsafe for officials to go into the field to gather data. These short-comings make doing business in fragile states a slow and cumbersome process. Companies report that they often find themselves in the position that they have to work with government officials to help those people understand what their proper role is, in order that they are able then to provide the service (for example, signing a contract or other official document) which the company requires. The companies express concern about the appropriateness of their doing this: likewise studies of this issue 'question the role of MNCs and whether they should be a substitute for service provision of the state (be it temporary or permanently).'[29]

Physical infrastructure

Whilst not an issue for all companies, the state of a country's physical infrastructure can be a substantial challenge for some. Oil, gas and other extractive companies will construct their own infrastructure, and this is normally in a reasonably confined geographic location. However, companies such as those in consumer good sectors rely on the existence of a road and rail infrastructure to be able to move their goods around the country, and of functioning ports to get their goods into the country in the first place. If this infrastructure is not in place, then there is a significant impediment to their operations.

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[28] Johnson E & M Martini. *Corruption Trends in the Middle East and North Africa 2007-2011.* Transparency International, Berlin 2012.

[29] Datzberger S & M Denison. *Private Sector Development in Fragile States.* EPS Peaks/ DFID. 2013

3: Coping mechanisms

In the same way as there is a commonality in the challenges that companies face in fragile states, so there is in the mechanisms and approaches companies are using to respond to these challenges – 'responsible businesses are taking measures to understand conflict dynamics and design policies that better integrate conflict-sensitivity in such operating environments.'[30] A number of key themes have emerged:

Hire the right people

Many of those interviewed spoke of the central importance of having the right people to be able to operate effectively in fragile states. It is clear that those who are taking decisions about what to do in such locations need to be able to rely completely on a group of others whom they can trust implicitly, and whom they believe have the right skills and approach to feedback reliable information and insights. Key skills include:

Integrity

As was observed in the previous section companies operating in fragile states generally wish to avoid corruption and abuses in areas such as human rights. Therefore it is most important to have staff who can operate with integrity and who can be trusted to go about their work in a fashion that the company as a whole can have confidence in. One bank interviewed, for example, explained that any new daughter operations in unstable locations were established by highly trusted staff from the mother company. Locals are hired, but initially only at junior levels. Only when local staff have won the trust of those at headquarters are they promoted to positions where their decisions might affect the reputation of the bank. Equally, staff believed to be acting improperly need to be sanctioned. A representative of a company operating in a number of countries in Sub-Saharan Africa made clear that 'our policy is to respect the law, and if there is any suspicion of corruption, then the person concerned will be disciplined.'

Persistence and patience

Fragile states are challenging locations and therefore things will often happen in unexpected ways. Avenues which appear to have potential will sometimes close down for no apparent reason, and so other ways need to be found to get things done. Persistence, patience, and a willingness to keep pushing and identifying different ways forward is therefore a key skill for staff operating in fragile states.

Societal and political awareness

Many also stressed that a key skill required in staff operating in fragile states is that they have the facility to understand and be aware of the societal and political dynamics where they are working. Technical expertise in the activities of the company are not sufficient. Staff need to be able to understand what is going on locally, and be able to take a view about how this might affect different aspects of the business. They need to be able to anticipate events, not simply respond to them. In this

[30] Moody-Stuart M. 'Foreword' In *Responsible business advancing peace*. UN Global Compact, New York 2013

regard, it is clear that local staff can add particular value since they are likely to have a more detailed and innate understanding of the socio-political dynamics.

Integrated systems

Companies operating in fragile states need to ensure that decisions are informed not just by 'normal', 'technical' issues, but also by the 'non-technical' issues of political risk and conflict dynamics. Companies therefore operate management processes which integrate both of these sets of factors. A representative of a large agribusiness firm said that, 'the investment proposal for any new project needs to include an environmental, societal and political assessment before it before it goes to the board. So any conflict-related issues are issues are part of the process of how that project will be managed from the very start.'

Some companies have developed sophisticated management procedures to analyse non-technical issues and ensure that these as well as other, technical considerations inform decision-making. An example of this is Anglo American's Socio-Economic Assessment Toolkit (SEAT). Although not specifically aimed at fragile states, the SEAT process enables operations to take a more strategic view of their interactions in relation to, for example, conflict dynamics, societal dynamics and tensions, reducing the exclusion of disadvantaged groups, training, procurement and community social investment. Anglo American states the objective of a SEAT process as being[31]:

- To identify the key social and economic impacts and issues to be managed.
- To assess existing initiatives, provide feedback on their success and suitability, and identify where improvements might be made.
- To be a useful resource in developing a community engagement plan
- To provide an analytical framework to assist operations to assess their overall sustainability, especially in balancing the extraction of natural resources with an enhancement of social and human capital.
- To ensure that "best practice" is captured and shared within Anglo.
- To provide a planning tool for managing an operation or plant's social and economic impacts, including social investment and mine closure.
- To gather and collate data for corporate social reporting purposes, as well as development of indicators that are relevant to local conditions.

SEAT has been used extensively throughout Anglo's operations since 2003 and forms the basis of understanding and responding to local community needs and expectations. It thereby helps to ensure that the company's impacts are as developmentally positive as possible. The campaign group*, Business for Social Responsibility* has stated that, 'the toolkit represents one of the most significant corporate investments we know of to equip personnel to better understand, plan, implement and account for the social and economic performance at the local operations level.'[32]

[31] Anglo American. *Socio-Economic Assessment Toolbox.* Anglo American, London 2003

[32] Business for Social Responsibility. *Anglo American SEAT Evaluation Public Report*. BSR, San Francisco. 2007

Attention to detail

Many of those interviewed stressed the importance of attention to detail in their operations in fragile states. Management systems need to be detailed and deliberate and focus on the detail. For example, a Moroccan company investing in West Africa said that new subsidiaries would in their early life be subject to random and frequent audits to ensure that corrupt practices could not take hold, and any irregularities could be addressed immediately.

Risk management techniques

Within these broader management structures, companies also use a range of approaches which enable them to manage the risks and challenges they face in FCS.

Staged investments

The sequencing of investment is an approach that seems to be widely used as a way of 'testing the water' in fragile environments, in particular as a way of developing a better understanding of the tax and regulatory environment. According to one private investor, 'with a new market we would make a single small investment to begin with as a way of testing the legal structures. Depending on how that goes, we will develop from there.' Another company with diverse investments in SSA explained how an initial investment in South Sudan had enabled them to learn about the situation there, and to develop a good network of contacts. By being present in the country meant that new investment opportunities were brought to them, and their growing understanding of the local dynamics enabled them to sensibly evaluate these properly.

An existing presence in a country appears to make it more likely that a company will stay in a country, even if violence does re-emerge, than if they were looking at a prospective investment. One oil service company representative used the example of the deterioration of the situation in Iraq from 2005: 'We went in early, in 2003, and stayed during the insurgency. Had we not been there anyway, it's unlikely that we'd have undertaken a fresh investment there at that stage.'

Flexibility

It is clear that companies operating in fragile contexts need to be flexible, and to respond quickly and imaginatively to changes in circumstances. The examples of how two local companies in Yemen have dealt with the resurgence of violence there are highly instructive in this regard[33].

Yemen Soft is one of Yemen's leading IT companies. As a result of the conflict Yemen Soft saw a sharp decline in demand for their services since many customers were no longer prioritising IT services. As a result of these challenges the company was obliged to reduce workers' hours and salaries by 50%, and some were given the opportunity to work abroad. In the longer term, a possible impact of the current conflict is that some of these skilled staff may not return to Yemen. To generate business the company also gave discounts to its customers. The company is also exploring expanding its business into Kenya, Turkey and India.

[33] Examples are drawn from the work of a GiZ project on business resilience training for SMEs in Yemen.

Al Thaour is a distributor of agricultural machinery, working mostly with government customers. However, as the conflict worsened, most of the provinces that they were working in became untenable, and they were forced to close all offices in the south, with consequent significant losses. Given the effective cessation of their usual business, the company decided to open new business lines responding to market demands. For example, due to the absence of the electricity there was a demand for cold water, and so the company opened 3 cold storage refrigerators to sell cold water. The company is now considering opening bottled water factory outside Yemen, as well as a facility to package nuts.

Community programmes

Far from being philanthropic, it is clear that for many companies in fragile environments, their social responsibility and social investment programmes are a key element in a risk-management strategy. There seem to be a number of strands to this. Firstly, engagement with local communities provides an invaluable source of intelligence about the local situation. Working directly with local people is seen as an excellent way to understand local concerns and tensions.

Secondly, strong community engagement programme can develop good local links and make an investing firm a more important element in the local community. For example, in Zambia, Konkola Mines support the national premier football league as a way of demonstrating their importance as a local citizen and in South Sudan a significant supplier of clean water in Juba is the brewer SABMiller, who is also the country's largest supplier of bottled water.

Finally, community programmes can provide political support in difficult circumstances, since they can demonstrate that a company's presence in a country is beneficial. A good example of this is the relationship between oil service companies, Petrofac and the NGO BRAC in Sudan, which helped the company to resist pressure to divest from the country. In 2008, the Sudan Divestment Task Force commended the company for its 'readiness to develop policies at the group level to respond to the unique concerns associated with its operations in Sudan'[34].

Decision-making in fragile states

Even though it is the case that there is no pre-defined management system for companies operating in fragile states, there are manifestly considerable commonalities between the approaches taken by many of the companies interviewed, and those discussed in the literature. A study similar to the present one was undertaken in 2012, which derived the decision tree shown in Fig 1. The key stages of this decision making process are as follows:

- **Commercial analysis:** Is there an opportunity to do business which is consonant with a company's business strategy? This may not necessarily imply one which is immediately profitable, for example a Lebanese bank operating in Iraq said they were losing money at the moment, but felt it was important for long-term business development to have a presence in Iraq.

[34] Petrofac. *Sudan Divestment Task Force removes divestment recommendation on Petrofac*. Press release, 12th May 2008

- **Security assessment**: What risks are there in terms of physical security, and can these be managed effectively? Factors such as a company's geographic location are important. For example Al Fakry Trading, a leading Yemeni consumer goods supplier, established a strategic stock of their main products in Aden in 2011 as this was less conflict-affected than the company's main site in Sana'a[35].
- **Political and societal analysis**: This phase includes analysis of the legal and regulatory frameworks, and the risks that this poses in terms of reputation. Companies will also seek to understand the conflict dynamics, and how these differ across a country and factor these issues into their management decisions. As noted elsewhere, companies express the importance of decision-making structures which take account both of technical and non-technical risks .
- **Risk minimisation:** Even given careful decision-making, companies still face considerable risk in conflict-affected locations. Typically they will use key staff and other sources to ensure that they are aware of how a situation is developing. They may also use a number of approaches to minimise and mitigate risks. A company may, for example, undertake a staged investment – starting small and then expanding gradually over time as they better understand the situation. They may diversify into other geographic locations or business lines to spread their risk. Or they may use local content to improve connections to local communities.

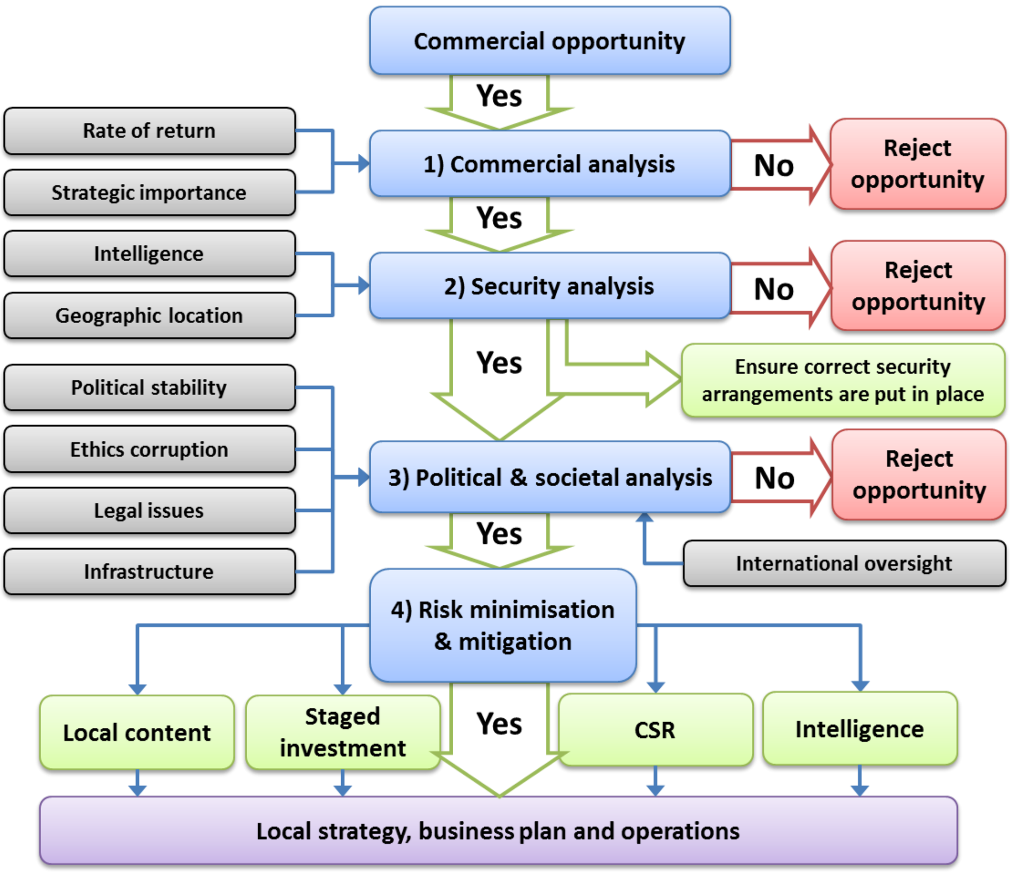

Fig 1: Generic management decision tree for companies operating in FCS[36]

[35] Data from interviews undertaken by GiZ, Yemen and SMEPS, Yemen.

[36] Davis P. *Boardrooms and Bombs II: Strategies of multinational companies in conflict areas*. PeaceNexus Foundation, Geneva. 2012

4: The 'ecosystem' of impacts

Although there is a great degree of commonality both in the issues that companies face, and in the processes they use to address these adequately, it is nevertheless the case that companies experience the challenges in different ways, and the options available to them to address these challenges are also different. As Tillman Brück, Naudé and [37]put it, 'the impacts of conflict are geographically varied and the impact of violent conflict on entrepreneurs and firms will differ across a country or region.' Although the decision tree set out above is true in the general, there are specifics which impact on different companies. There are three dimensions to this:

1. **Exposure:** How exposed is a company to different risks and threats? How do factors such as its country of domicile, the nature of its business, and the geographic location of its operations impact on a company's exposure to conflict-related risks?
2. **Options:** What options are open to a company on how it can address these risks? Are there factors which mean that a company can avoid or mitigate conflict-associated challenges that it faces?
3. **Intelligence:** How readily can the company obtain information that enables it to take informed decisions about its conflict risks and possible mitigations strategies? What sources of information does a company have, and how reliable are these?

Companies by origin

Companies experience the impacts of conflict differently depending on where they are domiciled, and whether they operate at international, regional or local level.

International companies

This category encompasses large-scale multinational companies who operate in multiple territories throughout the world. These companies are impacted by conflict issues in the following ways:

Exposure

International companies are very highly exposed for a number of reasons. First of all, they are in the spotlight of media and NGO attention, and therefore any transgressions these companies might be guilty of will be picked up on and magnified. Also, poor behaviour risks legal sanction in their home market through, for example anti-corruption legislation.

Options

Although international companies are more in the public eye, the also have options about where they operate. They are in a position where they may consider a number of countries as potential locations for investment. If a fragile state appears to be too risky, they can go elsewhere.

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[37] Brück T, Naudé W & P Verwimp. 'Business under Fire: Entrepreneurship and Violent Conflict in Developing Countries'. In *Journal of Conflict Resolution* 57(1) 3-19 2012

Intelligence

Multinational companies have access to very high quality advisory services. Moreover, some of them may have been investing in fragile states for years, if not decades. On the other hand, they may lack granularity of understanding of the situation on the ground because they lack a local network of contacts.

Regional multinationals

There are a range of companies which are not known internationally, but which invest in countries in their 'back yard'. This category includes, for example, companies from Beirut investing in other countries in the middle east; and companies from Morocco and Nigeria expanding into other places in West Africa. These companies are impacted in the following ways:

Exposure

Although regional companies may not be known outside their immediate region, they nonetheless face a risk of contagion if their actions in one country are alleged to be implicated in corruption or other abuses. Furthermore a bad decision in a fragile state may have financial implications across a company's scope of activity.

Options

Although they may not have a wide-a choice of investment markets, they nonetheless have some flexibility, and can up-weight or down-weight activities in a range of countries depending on the particular circumstances from time-to-time. They may also have options to leverage assets in stable countries to facilitate business in fragile states, for example a bank may use collateral in Western Europe to secure a loan in somewhere like Iraq.

Intelligence

'Regional multinationals' leverage the fact that they are 'local' in a particular area of the world. For example, Nigerian companies expand into West Africa; Lebanese trading firms expand operations into countries where there is a significant diaspora; and banks from Lebanon extend their operations into other countries in the middle east. The reason for this careful expansion is that in al cases these companies believe they have sufficient affinity with their target markets because of their similarity with their home market.

Local companies

These are firms which are based in, and emanate from fragile states. As such they have low international profile yet consequently have fewer opportunities to avoid the impacts of conflict in their home, operating market.

Exposure

Local companies have no choice but to accept and work around the issues where they work because their home territory is a fragile state. These companies therefore find themselves exposed to the full fury of conflict, and its impacts on their ability to do business. Even in the aftermath of conflict, these companies still have to live with the on-going impacts of war on people and infrastructure.

Options

Local firms have fewer options about coping with the impact of fragility and conflict. However, interviews suggest that companies domiciled in fragile states will look for opportunities in other countries to diversify and so reduce their risk. There is also evidence that these companies adopt other coping strategies such as moving into other business areas which might actually grow as a result of conflict. The example of Yemen's Al Thaour Group is illustrative of this, expanding into supplying bottled water when their agricultural machinery business was badly affected by the renewed conflict.

Intelligence

Where local firms have an advantage is in their access to intelligence. Because they are local the understand the social and political issues better, and therefore can take more informed views about what risks really are, and how best to manage them. They can therefore be more nimble in avoiding the worst risks. They can also use local contacts and connections to develop effective coping mechanisms.

A good example of the implications of conflict for local firms is demonstrated by the example of The Majed Assilmi Dental Centre in Sana'a,[38] a well-known medical facility which found itself having to manage a range of issues in order to protect its business from the impacts of the conflict.

In 2011 when the conflict began, an immediate impact was a shortage of fuel. The centre began to stockpile fuel so that if the situation worsened again (as it did in 2015) then there would be reserves of fuel to rely on. However, to manage the use of fuel, the Centre reduced its working hours to reduce fuel consumption and thus operating costs. They worked closely with their patients to ensure that their, and the Centre's schedules were accommodated. The Centre also worked with others to press the Ministry of Health to allocate fuel to medical facilities.

In 2014, shortages in anaesthetics began to emerge. Again, the Centre began to stockpile reserves when it had access to them, but also re-worked its operating procedures to reduce demand. The Centre also worked hard to reduce its internal costs for laboratory and other fees to reduce costs to clients and so maintain its client base. The Centre also began a social media campaign to attract and inform new targeted customers about their revised prices and services.

The Assilmi clinic also offered other dental colleagues who have been affected by the current situation and have had their practices closed down either due to location and security reasons or financial reasons an opportunity to work at the clinic with no engagement or lease, and implementing a commission based agreement that helped maintain the clinic's revenue.

Companies by sector

Companies also differ by sector in the way in which the challenges impact on their operations. Examples of these differences include the following:

[38] Data from interviews conducted by GIZ, Yemen and SMEPS (Small and Micro Enterprise Promotion Services)

Extractive industries

Oil and gas companies, and those in mining and other extractive sectors are often some of the most high-profile investors in fragile states. At the same time however, many of these companies have been operating in these countries for a considerable time. Their profile in such locations might be typified as follows:

Exposure

Extractive firms have no choice about where the resources they wish to mine are located. Thus if deposits are located under fragile states, they have no choice but to operate in such jurisdictions. Moreover large extractive firms are frequently in the spotlight of the media and campaign groups.

Options

International extractive firms can choose not to exploit resources in fragile states, but in a competitive market this is not necessarily and attractive option. However these companies do have other options to limit their risk, for example by operating off-shore, as if often the case with oil and gas extraction. Alternatively, if a resource is on-shore it may be possible to set up a defensive compound or in other ways to limit risk by providing strong physical security for people and assets.

Intelligence

Many extractive firms have operated in fragile states for years, if not decades. As a result many of them have well-developed intelligence-gathering and risk-management processes. They are also aware of the need to anticipate problems: 'our payback period on an investment may be 25 years,' said an executive of an oil firm, ' but the whole lot could get blown up in a morning if we call a civil war wrongly.'

Agribusiness

Companies operating in production of crops and other agricultural goods often find themselves operating in fragile states. Their risk profile can be categorised in the following way:

Exposure

Agribusiness companies are particularly exposed because they often operate large-scale plantations which are highly vulnerable to attack or predation by factions in a conflict. Like extractive firms, those in agribusiness sometimes find themselves the target of attacks because of perceived adverse impacts of so-called 'land grabs': "the expansion of corporate farming is exacerbating tenure insecurity, displacing local producers, undermining the ecological sustainability of local land and water resources, with profound and long-term implications for the economic and social structures of rural societies."[39]

[39] Da Via. E. 'The Politics of "Win-Win" Narratives: Land Grabs as a Development Opportunity'. Paper presented to *International Conference on Land Grabbing* IDS 6-8 April 2011 p4

Options

Companies in this sector have relatively few options to mitigate risk. Plantations are often large and, unlike extractive facilities, very hard to protect. As a result many in this sector are extremely circumspect about which countries to invest in, and which to avoid. There also appears to be a good deal of collaboration between companies in this sector, and between the agribusiness companies and the brand companies (such as Nestle) who buy their products.

Intelligence

These companies work hard to develop sources of intelligence and collaboration provides further insights that allow them to take informed decisions. These companies also develop highly-skilled, dedicated teams capable of operating in a number of locations who are trusted to gather and analyse relevant intelligence.

Banking

Many banks will choose to avoid entirely any activities in fragile states. Others, however recognise that there are opportunities available:

Exposure

Banks differ from other sectors in that their exposure is indirect rather than direct. A bank's own footprint in a fragile state may be confined to a small office. However, the exposure lies in funding other companies and projects which themselves are vulnerable to the impacts of conflict. Moreover, the often-problematic legal framework in these countries pose challenges in terms of security of collateral, and in terms of the processes of banking oversight and regulation.

Options

Those banks interviewed for this process made it clear that the key to successful operations in fragile states is highly detailed risk management. These companies will seek to operate to international standards of transparency and practice, even where this is significantly above the local legal requirements. Others reported that they secured loans in fragile states on assets based in countries with stable legal systems, for example in Europe. Banks operating in fragile states also stated that they reviewed local financial processes extremely regularly.

Intelligence

Some banks reported that they only did business with individuals and companies which they either knew personally from other places, or who could be vouched for by trusted sources. One Lebanese bank operating in a number of countries in the Middle East and north Africa said it only did business with Lebanese companies and individuals in these countries. It is notable that there are a relatively large number of 'regional multinational' banks operating in places such as north and west Africa – for example Access Bank from Nigeria. These companies believe that being 'local' gives them an advantage over international rivals in understanding the risks in these places.

5: Coping strategies, where next?

It is clear from the previous section that companies are developing systems and processes to enable them to operate effectively in conflict-affected locations. However, what is also clear is that there are limitations to what internal structures are able to achieve. There are a number of issues that have emerged which companies' own systems cannot deal with effectively, and where collaboration with other actors is needed.

Firstly, what happens when appropriateness and expediency collide: when companies find themselves, for practical reasons, taking on roles which may not be appropriate? For example, as was noted earlier, a key challenge in fragile states can often be that host government officials lack capacity to do their jobs effectively – they may not be properly aware of their proper function and may in any case lack the skills to fulfil that role in any case. Several of the companies interviewed said that they had found themselves educating host government officials in what those officials ought to be doing. The rationale was that doing this was necessary to secure the relevant approvals and other paperwork necessary to proceed with a proposed investment, and skills building was not going to happen if the company had not stepped in. However all expressed reservations that they were engaged in work which ought more appropriately undertaken by international agencies, not by companies, and that they were laying themselves (and the officials) open to allegations of conflict of interest. What are appropriate roles for companies? And what are companies meant to do when they find themselves contemplating roles which may inappropriate, be are necessary for their work?

Secondly, companies find a challenge in negotiating the difference between international expectations on issues such as human rights and the realities they face on the ground in conflict-affected states. It is not realistic, many of those interviewed said, for Western commentators to expect human rights to be the same in places like South Sudan and DRC as in Germany or the UK. Ought not companies to be judged on whether their activities are producing 'net positive outcomes' – that their presence is leading to an improvement in human rights standards, even if from a low base? How are companies to decide how much change is enough, and over what timeframe; and who will adjudicate if that calculation is correct?

Thirdly, many companies pointed to financial structures which would help them sustain and increase their investments in conflict-affected states. Institutions such as MIGA exist, but may often be unavailable for fragile states; yet for companies operating in such places, insurance cover to limit liability might be critical in persuading sceptical colleagues at headquarters to maintain or increase investment in a fragile location. First loss investment by development finance institutions such as CDC or IFC might also serve a similar purpose.

In all these cases what is apparent is that there are issues for which companies cannot unilaterally develop coping strategies: addressing them effectively requires collaboration with other actors. This reflects the fact that many of the challenges in FCS emanate from the conflict dynamics of the host state. As such they require joint action by companies, governmental agencies (both domestic and international) and civil society organisations. Companies' coping strategies therefore need to form part of larger processes of joint action: 'co-ordination between…actors'[40] is vital. Such processes are, however, complicated and challenging to sustain.

Joined-up action in development of local capacity

The complexity of such joint action was demonstrated by an IFC project run from 2013-14 which focused on one particular business challenge for international companies operating in fragile states: local content[41]. As far back as 2003, an UNCTAD report observed that, 'while more and more countries welcome inward FDI, increased attention is being given to policies that can enhance the development benefits of such investments.'[42] The logic behind such an approach is self-evident: to ensure that the maximum benefit from a foreign investment accrues to the local economy and to local people. Specific regulations on local content requirements are therefore becoming more prevalent. In Nigeria, for example, the Government introduced a Local Content Act in 2010. In Mozambique too, the Government is exploring policy options and strategies for the development of Local Content – in their case advised by USAID – which may 'have potential to boost economic multiplier effects of the oil, gas and mining industries into the local economy.'[43] Specific proposals were presented in August 2013.

The aim of the IFC project was to develop a collaborative process for the development of indigenous value chains for large-scale 'anchor' investors which would leverage the different capabilities and skills of different actors. To that end the project team identified the different tasks that would be necessary for the successful and sustainable development of local supply chains. The project team identified seven key areas to be addressed:

1. **Working with the procurement team of the anchor investor**
   The anchor investor will need to amend its procurement processes to enable it to work with a larger number of smaller suppliers, and sometimes to accept that there will be issues of timeliness and quality of delivery. There will also be a need to flex payment terms to support that cash-flow of smaller-scale suppliers.

2. **Public-private dialogue and stakeholder engagement**
   It is important to develop a joined-up approach between different actors to develop inclusive supply chains around anchor investors. PPD, and continued stakeholder engagement are key tools for achieving this, as is a process of engaging key stakeholders over time. The overarching aim is to create a collaborative approach to addressing key issues.

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[40] De Vries H & L Specker. *Early economic recovery in fragile states*. Clingendael Institute, 2009

[41] The project was run by a Working Group made up of a number of organizations with interests in fragile states. A number of units from the IFC were involved, namely Sustainable Business Advisory; the Fragile and Conflict-Affected Situations Coordination Unit; and Investment Climate Advisory Services. Other partners were Royal Dutch Shell; *Spark*, a Dutch NGO specializing in provision of business development services to catalyze youth employment in fragile states; the Clingendael Conflict Research Unit; and the *Let's Work Global Partnership* which focuses on creating more and better private sector jobs

[42] UNCTAD. *Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries*. UN Geneva & New York. 2003 p13

[43] USAID. *Policy Options for Local Content in Mozambique* 15th Oct 2013

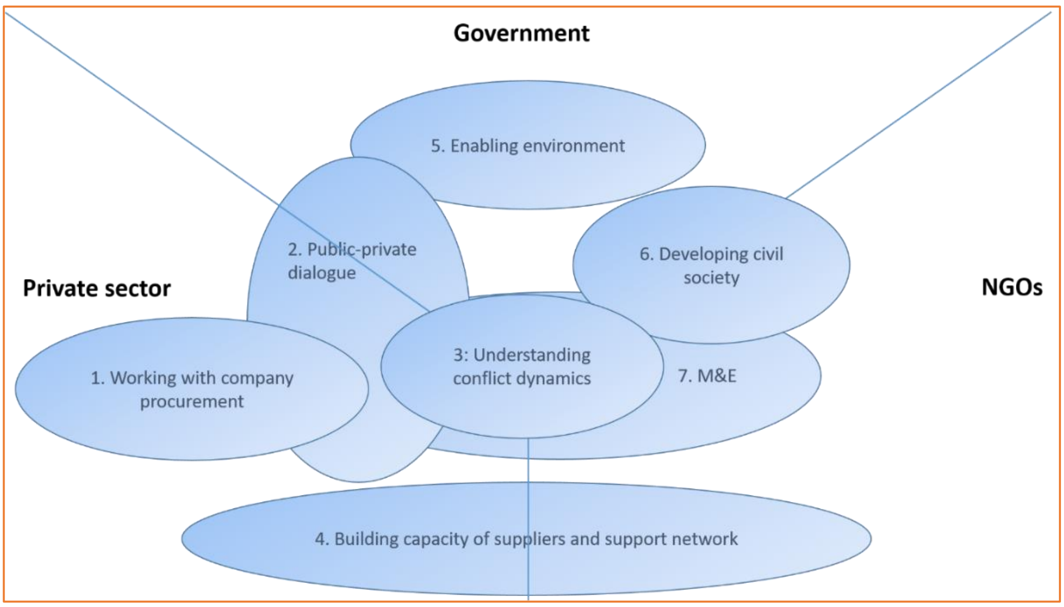
3. **Understanding the conflict dynamics**
   In any location, there is a need to develop a clear and shared understanding of the dynamics of the conflict. What are the major drivers of it, and how do these interact; what are the key strategies for peacebuilding and development of peace and stability; and what is the interactions of those dynamics with the company's proposed value chains.

4. **Building the capacity of suppliers and their support network**
   Efforts need to be made to develop local suppliers to enable them to provide acceptable levels of service to the anchor investor. To avoid dependency there also needs to be a process of developing other customers for these local firms, and a network of support institutions to achieve this.

5. **Building an enabling environment and ensuring fair competition**
   The regulatory environment is crucial in allowing new firms to emerge and invest, and to form sustained trading relationships between the anchor investor and suppliers. There is a need to address those aspects of the business environment which will hinder these issues, and to ensure both that changes in regulation occur, and that these are implemented in practice.

6. **Working with civil society & local communities**
   It is important that local communities feel the benefits of foreign investment. Also the local community will provide the investor with access to community institutions such as colleges which will be instrumental in addressing gaps in the capabilities of local suppliers. Therefore, engagement with local communities is of key importance.

7. **Measuring results and obtaining feedback**
   There needs to be a transparent measurement process that can demonstrate progress in three areas: that the company is able to access effective local suppliers; that local suppliers are developing effectively as organisations and therefore able to expand; and that the whole process influences the local conflict dynamics in a positive fashion.



As is evident from Fig 2, few of these tasks can be undertaken by one actor alone; and the overall goal (in this case of developing local supply chains for anchor investors) requires co-ordinated and collaborative work between different groups of actors. Therefore, in the longer run, there is a limit to what can be achieved by the coping strategies developed by companies themselves. Many of the issues facing companies in conflict-affected states derive from the political economy and conflict dynamics of the host country. Whilst companies might develop strategies to get by, there is a need for them to work with donors, governments and NGOs to develop long-term approaches to addressing these issues.

Business in conflict-affected states: where next?

This chapter has examined the processes that companies have developed to date to cope with the challenges of operating in fragile states. These approaches have, for the most part, been developed as a response to the realities that companies themselves are facing: they have established through trial and error what works, and what doesn't work. Moreover, these approaches have been designed to work within, and as part of, each company's management processes and decision-making structures.

However, it is clear that these 'bespoke', company-specific approaches are limited in what they can achieve. They can – to as high a degree as possible – keep a company out of harm's way. However, they cannot deal with these risk issues in an holistic and durable way. The issues are societally-based, and so even a large company's systems can only go so far in addressing them. What is needed is a more collaborative, joined-up approach involving companies, government agencies, development actors and NGOs. Even though it is the case that 'policies aimed at assisting entrepreneurs in countries racked by civil war need to be geographically differentiated and focused'[44], it is possible to define some ways of working which could be used in different locations.

Ideally, entities such as IFC should play a co-ordinating function, as in the project to develop local supply chains. IFC (and indeed World Bank, and UN agencies) have political credibility and convening power, and therefore are well-placed to bring different partners together and to find joined-up ways of dealing with at least some of the challenges companies face in operating in fragile states. A 2013 paper by the Center for Strategic and International Studies[45] made a strong case for international development actors to facilitate private sector investment in fragile states, for example by acting as a co-financer or by acting as a shared hub of knowledge on which a number of companies can draw. However, co-ordinated action of this type is hard to get started in the first place, and then to maintain over time. In which case, there is a still a need in helping companies to develop faster their own internal structures and systems. Many of the companies interviewed for this study had gone through similar learning curves: if IFC or others could provide a repository of knowledge and expertise, this might enable more companies to develop more quickly viable businesses in conflict-affected locations. As a *Council on Foreign Relations* paper, looking at business development in fragile states concluded: 'Partnerships among governments, non-profits, and corporations are critical. Long time frames are also important because sustainable SME growth is a long-term process that requires capacity building

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[44] Brück *et al. Op cit*
[45] Cusack J & Tilleard. *Investment facilitation in transitional and fragile states*. CSIS 2013

and the development of local business environments. There should also be greater information sharing of lessons learned and efforts to scale solutions that have been successful…'[46]

There is a clear need for greater collaboration between the private sector and development actors. Both sides have much to gain from the perspective of their own interests[47]. However, developing co-ordinated and collaborative actions will also have the effect of making fragile states more stable and durable, and less likely to return to conflict over time.

[46] Lemmon G T. *Entrepreneurship in Postconflict Zones*. Council on Foreign Relations, Washington DC 2012
[47] Avis W R. *Private sector engagement in fragile and conflict-affected settings*. GSDRC 2016