Providing Essential Infrastructure in Fragility, Conflict and Violence-Affected States:

A toolkit for enabling SME participation

WORLD BANK GROUP
Governance

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I. INTRODUCTION AND OVERVIEW

A. Purpose and rationale of Toolkit

1. Purpose of Toolkit

The purpose of the Toolkit is to assist policymakers and practitioners in government to create an enabling environment for SMEs to be engaged in private sector participation initiatives (e.g., public-private partnerships (PPPs)) in countries affected by fragility, conflict and violence (FCV), and thereby generate benefits for delivery of essential services, recovery and reconstruction, regional job creation, SME growth and competitiveness, and shared prosperity. This is not as “niche” an issue as it might seem at first glance. It is expected that by 2030 fully half of the world’s poor will live in FCV countries\(^1\) – though the FCV situation is not found only in low-income countries – and PSPs involving SMEs may in some cases be a primary or even the only available source of delivery of essential services and infrastructure. That is particularly the case in the water and energy sectors, where SMEs have been called upon in a number of FCV contexts to engage in the operation essential infrastructure services in those sectors (e.g., through the operation of mini-grids).

SMEs in general, but especially in FCV contexts, face major costs, risks and capacity and financial constraints. Such challenges may be particularly acute in public procurement and related markets when PSP initiatives are being developed and implemented. Creating an enabling environment for SME participation in PSPs in FCV contexts involves building an entire ecosystem. Accordingly, the Toolkit provides an overview of the types of challenges that may be encountered in such scenarios and highlights, based on actual case-studies, possible solutions and conditions that may enable the engagement of SMEs to delivery essential infrastructure services to FCV affected populations through PSPs.

At the same time, the Toolkit is not intended to advocate for the use of any particular strategy for provision of essential infrastructure services. Rather, the toolkit aims to assist policy makers in considering how to deal with various issues that may arise when a PSP type of approach is applied. The Toolkit does not advocate for PSPs over use of traditional public sector approaches. As noted by the OECD with respect to the water sector, “Debate has now moved on from public vs. private ownership, to consider ways in which water services can be provided not only safely but also most efficiently, effectively and sustainably, regardless of ownership”.\(^2\)

\(^1\) http://www.worldbank.org/en/topic/fragilityconflictviolence/overview
Accordingly, the Toolkit employs a broad notion of private-sector participation (PSP) and does not focus solely on PPPs. Traditionally, doing a PPP will be costly and complicated and often the cost of procuring through PPPs will outweigh the potential value-for-money. However, there are lower-barrier forms of private participation including licensing or fostering competitive markets (such as in small-scale power production) that could be much more suitable for FCVs and SMEs. The characteristics of owning the assets and having the direct relationship with consumers may be better secured with these types of arrangements, which, in some sense, may alleviate political risks. The Toolkit, thus, envisages a range of possible transaction models, with differing degrees and types of private sector and public sector involvement (see section I.C, concerning types and chief characteristics of various forms of PSP/PPP).

2. Case studies

The discussion in the Toolkit features a number of actual case-studies of SME participation in provision of essential infrastructure services in FCV contexts. Introductory information about those the case-studies, which display a variety of forms of private sector involvement, is provided below. Specific aspects of those cases are mentioned at various places throughout the Toolkit.

**Box I.1 Introduction of case studies**

**Benin (water)**

The “affermage” model began to be implemented in 2007 in order to connect decentralized municipalities and small-scale private operators (POs). According to a diagnostic carried out by Initiative EAU in 2010, only 16% of PWS were profitable and 27% had sufficient financial resources to renew assets. This was partly due, for some PWS, to high fees and charges paid by the POs to the municipalities (sometimes reaching 35% of the tariff). The World Bank Group-supported Small Scale Piped Water Schemes Inclusive Business Support Project piloted a subsidized concession for groups of PWS (“clusters”) as an alternative to the affermage model previously used, allowing private operators to be responsible for carrying out the investments in the water sector, supplemented with capacity building support for public and private partners, as well as financing support for private operators. That was meant to help overcome a lack of capacity of private operators due to limited technical skills, lack of experience with tendering process, and limited access to finance to carry out required investments. Capacity was also lacking in municipalities (technical, monitoring and financing capacity).

**Somalia (water)**

After the fall of the central government in 1991, the private sector took over the operation and management of public sources. Local committees formed to facilitate and monitor projects funded by NGOs and UN agencies. In the late 1990s-2000s, PPPs formed in urban centers, largely guided by UNICEF, including in Jowhar in 1997, Bossaso in 2000, Galkayo in 2003, Borama in 2005, and in Gardho.

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4 Ibid.

In the EU/UNICEF-supported Making Public-Private Partnership Work for Rural Committees in Somalia project, project components included:

a. Design and establishment of Public-Private Partnerships for rural water supply.

b. Documenting the PPP experiences to allow replication or improvement in other rural areas in Somalia.

c. Improving the water supply infrastructure to make the private sector participation economically reasonable.

Urban utilities were broken into local PPP companies in Puntland and Somaliland. This arrangement resulted in reduced administrative burdens for local company managers enabling their ability to be more responsive to rural user demands and improved confidence in the community. Major challenges included: low capacity of government in running water supply for population in rural districts, partly because of difficulties in accessibility to smaller villages; project locations in Puntland and Somaliland are water scarce; lack of willingness of urban water companies to extend services to rural areas because of anticipated low return to investment; low initial capacity of local private operators; fragile political situation making it difficult to maintain the project’s presence in the field.

Mali (energy) 7

In 2014, the World Bank supported Mali in a project to expand, on the basis of private sector participation, rural access to modern energy services and to increase the share of renewable generation in rural electricity supply, including providing targeted technical assistance and trainings to operators in the hybrid systems. 8

A dual approach was applied (both top-down and bottom-up). The bottom-up component was driven by decisions from local private entrepreneurs/cooperatives to construct and operate small-scale mini-grids in rural areas based on their perception of the local market. Project components included:

a) Creation of an Agency for Rural Electrification as single source of all rural initiatives and peri regulation

b) Establishment of a Fund of a Rural Electrification for finance subprojects ER I RON AER

c) Development of a mechanism of flexible regulation to ensure adequate performance operators

d) Strengthening and scaling up rural electrification through hybrid PV solar/diesel generation in rural mini-grids, including capacity building of rural private operators.

Major challenges included low capacity of private operators and gaps in the legal framework on PSPs.

Cambodia (energy) 9

The World Bank, in partnership with the Asian Development Bank, provided support to Cambodia in 2003 in the power sector, with the objectives to:

a) Improve power sector efficiency and reliability and reduce electricity supply costs

b) Improve standards of living and foster economic growth in rural areas by expanding rural electricity supplies.

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7 WBG. Project concept Note on MALI RURAL ELECTRIFICATION HYBRID SYSTEM PROJECT P131084
8 World Bank Group, Mali P131084 PCN.
9 PPIAF World Bank, Private Solutions for Infrastructure in Cambodia (2002); available at https://openknowledge.worldbank.org/handle/10986/15223
c) Strengthen electricity institutions, regulatory framework, and “enabling environment” for sector commercialization and privatization. Through independent power producers (IPPs), private sector provides generation to state-run utilities. Relevant Project Components include:

a) **Rural Electrification**: this element of the project included supporting the partnership between EDC and the Rural Energy Enterprises and using private sector providers in operation of rural distribution systems. EC would also identify existing enterprises and explore options for private sector participation (e.g., distribution licensing, billing and collection arrangements, management contracts, and leasing arrangements).

b) **Pilot Rural Electrification Fund (REF)**: Implement mini and off-grid electrification program, providing assistance to private sector developers.

c) **Institutional development and sector reform**: consulting and advisory services for Ministry of Industry, Mines and Energy (renewable energy policy, power market analysis, power sector plan), Rural Electrification fund (promote rural income generation options, capacity building), Energy Authority of Cambodia (EAC), and EDC (project implementation, creating independent monitoring agency, capacity building, etc.)

Most PPPs are small-scale and are targeted at the urban sector. POs in rural areas have been supported by donors through targeted subsidy incentives and Design-Build-Lease contracts intended to reduce investment risk. 600-1000 small private power systems operating in Cambodia, serving half a million customers, about 200 householders per business, (as many as the national power company) and provide half of country’s generating capacity (many of whom set up their businesses prior to interim government in mid 1990s). The majority of small operators meter their customers and charge either a flat rate or a single block decreasing tariff. They finance themselves through equity (49%), debt: family borrowing (22%), informal debt (23%), micro-finance (6%).

**Rwanda (water)**

The Law on Public Procurement includes PPP provisions. PPP arrangements are set on an individual contract basis. A PPP Law has been enacted in 2016.

The World Bank Group provided support for a Rural Water Supply and Sanitation Project to the Republic of Rwanda, targeting the rural population in 16 communes selected based on (1) low service coverage rates, (2) little external support for sector investments and (3) high demand for improved services. The project set the following objectives to:

a) Increase availability of water supply and sanitation services in rural areas

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14 https://pppknowledgelab.org/countries/rwanda
b) Strengthen the capacity of communities to pay water supply and sanitation investments and manage water supply and sanitation services, as well as of agencies in charge of water supply services, communes, water users, and private sector.

c) Ensure mobile community support for rehabilitation/expansion of major regional water systems and their operation by the private sector.

**Subprojects Component:** grants to communities provided to finance construction of water and sanitation facilities from community development plans, technical assistance/training/outreach to plan, implement, and operate/maintain water and sanitation facilities sustainability and effectively, and use of a demand response approach.

**Major water supply systems:** decentralized and demand-responsive approach to water supply system rehabilitation and establishment of sustainable management arrangements for those systems tested in Mayaga system and groundwork for Lava Region systems.

**Capacity building** for private sector, NGOs as providers of works, goods, and services, as well as public sector (DEA, communes, CDC) as facilitators of sub-sector development and management process.

During implementation, (local) private operators were sought due to the worsening performance of community management of piped systems. PPPs were supported for the operation of water facilities.

a) Selected on competitive basis based on price of water, fee paid by the operator to the district and quality and reliability of technical proposal

b) Contracts created by each district, rather than using standardized contracts

c) Bidding documents created by inter-district association in September 2005, composed of representatives from four districts served by the system

d) Operating contract was similar to lease contract, where operator expected to be compensated from water sales without external subsidies (with provisions to relook at the economic conditions after a year due to demand uncertainties).

Major challenges included: top-down investment programming; low cost recovery; high per-capita investment costs for system construction in water sector; lack of dedicated PPP legal framework.

2. **Rationale for SME PSPs in FCV contexts**

**Private sector activity in FCV contexts**

The private sector has an indispensable role to play in establishing resilience and sustainable development in FCV contexts. While the difficulties facing private sector activity in FCV circumstances can certainly be formidable, as recognized in a recent *g7plus Briefing Note*, there is a track record of reforms to improve the business environment are as difficult as any other reforms in a fragile political environment; if the classic business climate reforms had been in place, the country most likely would not be facing fragility.  

*--g7plus Briefing Note 3: The Private Sector in Conflict-affected States, p. 1*
of successful private sector investment and other economic activity in FCV zones\textsuperscript{15}.

The phenomenon of SME participation is set against a background of changing composition of actors involved in provision of certain types of infrastructure services. For example, in the water sector, there is a greater diversity of private sector participants than had been the case earlier (including state actors, large private companies, which may be foreign, and which may or may not be concentrated on water-related activities, SPSPs).\textsuperscript{16}

**SMEs have a particularly crucial role to play in FCV zones.** In the first place, many fragile states have “SME economies”. SMEs provide employment, essential supplies and services, can flexibly adapt to prevailing circumstances in FCV zones and take advantage of opportunities other, bigger players may not be able to take, assist community cohesion, instill confidence.\textsuperscript{17} In such ways, SMEs can play an important role in defusing factors contributing to fragility (e.g., by providing youth employment and re-integration of ex-combatants) and thereby help peace-building and demonstrate peace dividends. Conversely, neglect of the SME sector may feed fragility.

> “... compared with larger businesses, SMEs have been appreciated for their ability to accommodate workers in places where larger-scale investment is unlikely to become a more common reality”

Hoffmann and Lange, Growing or Coping?, p. 11 (see note 18)

**Areas of SME activity**

Empirical evidence suggests that SMEs are particularly active in the manufacturing and textile sectors, in addition to traditional activities including trading and agriculture. In sectors such waste, water, and energy, SME participation may be at a lower level, and it is still, as a general rule, more likely that SME participation would be in the form of subcontracting rather in the direct award of PSP contracts. Nevertheless, there is a perception in FCV contexts of a greater need for SME activity in the above-mentioned

\textsuperscript{15} g7plus Briefing Note: The Private Sector in Conflict-affected States, p. 1; available at http://www.g7plus.org/sites/default/files/basic-page-downloads/FFD_side_event_BRIEF_3-private_sector.pdf. This cites the examples of investment in the Democratic Republic of Congo (DRC) and Liberia which have seen significant direct foreign investment.

\textsuperscript{16} OECD, Managing Water for All, supra, note 2, p. 17.

\textsuperscript{17} Anette Hoffmann and Paul Lange, Growing or Coping? Evidence from Small and medium sized enterprises in fragile settings (CRU Report from Clingendael – Netherlands Institute for International Relations), p. 10; available at https://www.clingendael.nl/pub/2016/growing_or_coping/.
utilities sectors, which often are underserved or not served at all, especially in the FCV context.  

Meeting infrastructure needs of underserved populations

The need for critical services in the FCV context is multifaceted. For example, in the water sector, there may be competition among different groups, which may be linked to underlying tensions and conflict. Additionally, there may be competition among various potential uses of the water (e.g., between urban water supply and agriculture). 

PSPs involving SMEs are potentially an important tool for meeting infrastructure and service delivery needs in FCV countries. While the conditions for successful planning and implementation of PSP projects are more likely to be found in stable countries, that does not diminish the fact that in scenarios where the government lacks capacity to provide essential services and infrastructure, where established utilities may not serve the needs of the local population, and where large contractors may not be available or interested to venture, there may be a significant role for PSPs involving SMEs. Such SME involvement may be crucial in filling the infrastructure and service gap, including in FCV contexts where the public sector’s and utilities’ ability to provide essential infrastructure and services may be weakened, and the ability of large contractors to operate may be limited (at the least without some involvement of SMEs). SMEs providing such infrastructure services (in sectors including water, electricity, sanitation, solid waste, transport and broader energy services) are also referred to broadly in some contexts as SPSPs. 

Apart from the possibility that SMEs are in some cases be the only option for providing essential services, they may have some comparative advantages over utilities. 

Box I.2
Small-scale private service providers

Water sector -- services span small handcart vendors, water kiosks standpipes, tankers and private networks

Electricity sector -- services span battery charging stations, solar home systems, isolated mini power grids, resale of electricity bought in bulk

--See Judy Baker, Opportunities and Challenges for Small Scale Private Sector Service Providers in Electricity and Water Supply (see note 21)

18 See report on Survey on SME Participation in Public-Private Partnerships in Annex B.
19 OECD, Managing Water for All, supra, note 2, p. 32.
20 See, for example, Judy L. Baker, Opportunities and Challenges for Small Scale Private Sector Service Providers in Electricity and Water Supply: Evidence from Bangladesh, Cambodia, Kenya, and the Philippines, World Bank and PPIAF (2009), p. 1; it is noted that services operated by SPSPs “range from well-organized networks such as electric mini-grids and small private water networks (SPNs), to mobile distributors of water (tankers), and smaller operations such as battery charging stations, water kiosks, and standpipes”; available at http://documents.worldbank.org/curated/en/346781468047737167/pdf/535040WP0SSPSP10Box345611B01PUBLIC1.pdf.
traditional utilities may offer advantages in terms of size and quality, their services have often not been available in the FCV context and it is SMEs that have stepped in to meet shortfalls and gaps in service. SMEs’ comparative advantages include, in addition to being available and already being in the affected areas, and knowledge of the concerned area, the population and its requirements.

Apart from the job creation and entrepreneurship generated by SME-based PSPs, such activities can also catalyze broader private sector activity and development. For example, such initiatives in the electricity sector may help to address what has been highlighted as the primary constraint encountered by the private sector in the FCV context – lack of electricity.21

The following quadrant shows the relationship between level of fragility and the extent of private sector participation. The fragility level reflects the 2015 Fragile States Index for each case study country, while the extent of private sector participation reflects the predominant PSP/PPP arrangement used in the case study country, drawing from the PPP contract graph (shown below). The range of private sector participation is from 1 (O&M Contracts) to 4 (licenses).

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The y-axis in the above graph is based on the spectrum of different forms of PSP/PPP, with differing degrees of private sector participation, outlined in section [...]; the cases referred to in the above graph employed the following forms: Mozambique, Rwanda (O&M-lease hybrid); Benin (pre-2010 – affermage; post-2010 – subsidized concession introduced in some cases); Somalia (concessions); Mali (concession); Cambodia (license).

As can be seen in the graph above, case study countries with relatively lower levels of fragility may offer lower levels of private sector participation (e.g., Mozambique), or, in some cases, higher levels (Cambodia). Countries with relatively higher levels of fragility may host projects with varying degrees of private sector participation (compare Rwanda and Mali). The limited sample of the case studies does not suggest that the level of fragility is a clear determinant of a country’s PSP/PPP readiness, or the degree of feasible private sector participation, as there are a variety of factors that may play a role (e.g., legal framework, business environment, private sector capacity, access to finance). It does, however, reflect that a relatively higher degree of fragility is not, in and of itself, a bar to PSP/PPP projects.

Critical role of SMEs

PSPs can provide a viable basis for engaging SMEs in the delivery of essential infrastructure and services in the FCV context. As already noted above, in particular in key sectors such as water and sanitation, and energy, SMEs can play a crucial role in the provision of essential services including for the reason that SMEs may be the only viable option in terms of available private sector operators in an FCV zone. With the weakness of the public sector that is prevalent in many FCV scenarios, making available a PSP contracting approach may provide a feasible way in which to ensure delivery of essential infrastructure and services in an FCV context when the public sector is incapable of doing so.

Apart from the scenarios in which only SMEs are involved, there is the possibility, if not the imperative, for a larger company executing a PPP project to engage local SMEs. Such an approach seeks to be mindful of the impact of a large company’s operations on local economies and builds local value chains can help to promote diffusion of tensions and peaceful development, while helping develop a company’s corporate-social-responsibility profile.22 (See III.A.3, concerning SME policies or promotion of SME participation in public procurement markets and in PSP/PPP projects.)

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Enabling humanitarian response and resilient development

Involvement of SMEs in PSPs can help to achieve not only essential humanitarian response objectives, but also promote resilient development. SMEs are important catalysts of growth and sustainability, making up 90% of registered businesses, 25-35% of GDP, and 50% of employment worldwide. SME-based private sector participation projects are an innovative way to promote private sector development and local community participation, as well as to address development challenges, including in fragile and conflict-affected states. Such development challenges may include, for example, elite capture and crowding-out of local businesses, particularly evident in infrastructure projects in the water, energy, and transportation sectors. SME inclusion in PSPs in those sectors, as well as others (e.g. social sector) may overcome these effects. It can do so by enhancing the capacity and competitiveness of SMEs, promoting job creation, and supporting inclusive growth, thereby enhancing the overall positive economic development and resilience effects of PSPs. In the fragile and conflict-affected context, PSPs are particularly fruitful pathways because they facilitate the delivery of services usually provided by the state through private sector participation while maintaining the legitimacy of the government.

SME-based PSPs have the potential to yield a positive-sum result for public and private stakeholders. SMEs benefit from potential long-term contract arrangements with stable income streams (in the case of long-term contracts), greater visibility, and increased access to global value chains. Larger private and public stakeholders benefit from SMEs’ specialized or local knowledge for particular projects. In fragile and conflict-affected states, in particular, SMEs’ understanding of the local context makes them adaptable to volatile political and social situations and therefore able to provide a stable source of supply/services in case of disruptions in the local environment. Furthermore, SME participation promotes sustainability and self-sufficiency in local operations: after the duration of a project, the SMEs may then continue to operate services or facilities (e.g. a power plant) for the community. These benefits have been realized in several infrastructure projects globally, including in Somalia, Chad, Benin, and Vietnam, among others.


26 Mac Sweeney, Naoise. Private Sector Development in Post-Conflict Countries: a Review of Current Literature and Practice, from Donor Committee for Enterprise Development (DCED) and Swiss Agency for Development and Cooperation (SDC); available at https://lra.le.ac.uk/bitstream/2381/27928/4/PostConflict_PSD_EN_rev2.pdf.
Despite the benefits for both SMEs and larger contractors, SME-based PSPs remain limited. Even in developed economies such as in the EU, no SME won a PSP/PPP valued above about 17 Million USD, and 85 percent of participation was at the subcontractor level. Various obstacles stand in the way of SME participation including policy, legal, and administrative burdens, as well as deficiencies in SMEs’ capacity and access to financing in relation to PSPs’ large contract size and requirements particularly in the water, transportation, and energy sectors. Further challenges arise from general barriers to PSPs in the FCV context, such as weak public investment planning preventing the state from efficiently assessing projects requiring private sector investment, as well as donor coordination and state capacity issues.

Given these barriers, the Toolkit seeks to increase the awareness of policymakers and managers in FCV contexts of policies and practices that enhance SME opportunities in PSPs (particularly in water and energy infrastructure services sectors) by creating an enabling environment for such participation.

Public-private sector synergy

PSPs involving SMEs may benefit from synergies that provide more sustainable solutions. A PSP approach may be favored in certain cases as more self-sustaining when it is less likely that public sector management of an infrastructure facility that received donor support would provide adequate maintenance levels. At the same time, the public sector can play the indispensable regulatory role, counter-balancing the for-profit nature of the private sector.

Supporting policies that alleviate tensions

Involvement of SMEs in PPPs can contribute to alleviating some of the sources of tension in FCV contexts. In some cases, by contributing to improved delivery of essential infrastructure and services, as well as promoting inclusive economic development, SME-based PSPs can contribute to alleviating some of the root causes fueling conflict and fragility in a given country, in particular factors stemming from lack of shared prosperity and essential services. That it is not to deny the possibility that in some instances projects might have the effect of exacerbating tensions (e.g., depending upon the nature and context of a conflict, for example, if groups that have had a conflict are artificially brought together under a project (while, by contrast, in another context it may be that not covering all groups under a project may give rise to or exacerbate inter-group tensions). The possibility of such alternative scenarios highlights the importance of “group sensitivity” in selecting, designing and implementing projects.27

SME-based PSPs at the sub-central level can also help to solidify the implementation of decentralization policies and participatory development. As illustrated in the case studies, SME involvement in PSPs providing infrastructure and services often takes place at the local or community level. That may well be coupled with decentralization policies that empower communities to take charge of infrastructure facilities serving the local population and establish approaches that are more responsive to demand levels. In the FCV context, the empowerment of local populations and their closest forms of representative government offered by decentralization strategies are furthered by the involvement of SMEs drawn from those local populations. That in turn fosters participatory and inclusive development, all of which may help to overcome some of the challenges and root causes of fragility and conflict.

B. Scope of Toolkit

The Toolkit has a somewhat specific, limited scope. It is therefore important to note at the outset what subjects this Toolkit covers and what subjects it does not address. The Toolkit is concerned with issues related to the potential role of SMEs in providing essential infrastructure and services on a PSP basis in FCV contexts from the standpoint of how government can help to create an enabling environment for such endeavors. The Toolkit is neither intended to provide a general treatment of PSPs nor to discuss overall policy initiatives to grow the SME sector. Guidance and information resources on PSPs generally are available from other publications and sources. That being said, some information generally relevant to PSPs and the participation of SMEs in public procurement markets is mentioned where necessary to provide sufficient context and also to highlight issues that are relevant to all PSPs, including those involving SMEs.

The focus of this Toolkit is on enabling SMEs as operators of small-scale infrastructure facilities. That of course does not exclude the possibility that, as noted above, SMEs may be engaged in PSP/PPPs as sub-contractors to larger firms, or may be included in a consortium (with larger firms, or with other SMEs).

C. PSP/PPP definitions and terminology

In practice, there is diversity in definitions of the term “public-private partnership” (PPP) as well as in other terms associated with the notions of PPP or PSP. While there is no single, universally agreed definition of the term PPP, the following is an example of

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28 See, for example, the guidance material, samples of legislation, regulations and contracts available at the website of the World Bank’s Public-Private Partnership in Infrastructure Resource Center (PPPIRC) (https://ppp.worldbank.org/public-private-partnership/). A comprehensive overview with various cross-references and links to further details is found in the PPP Reference Guide, a joint product of the World Bank Group, ADB, EBRD, GI Hub, IADB, IsDB, OECD, UNECE, and UNESCAP (version 3.0 having been issued in 2017 (see https://ppp.worldbank.org/public-private-partnership/library/ppp-reference-guide-3-0).
a broad definition that encompasses many sectors, services and types of PPP arrangements (of which there are many): “A long-term contract between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility, and remuneration is linked to performance”.29

Other terms utilized in the PSP/PPP context are also defined variously in practice. It should also be noted that in practice there is diversity and lack of harmonization with respect to various other terms commonly encountered when dealing with PSP/PPP issues, including terms that are used to refer to PPP as a whole as well as to describe particular forms or models of PPP. For example, depending upon the applicable usage, the term “concession” is sometimes used to refer to PPPs generally, and sometimes to refer to particular types of PPP arrangements. Though it is not the aim of this Toolkit to attempt to harmonize or standardize terminology, in this Toolkit the terms PSP and PPP are used in a general and comprehensive sense, while limiting, to the extent possible, the use of terms that may have diverse understandings.

The Toolkit is not limited to any particular form or model of PSP. The broad notion of PSP encompasses a variety of commercial and legal forms, including the different allocations of responsibility, risk and cost as between the public sector and private sector parties. Various types of activities may be performed by the private sector party in a PSP, with the exact mix of activities dependent upon the nature of the transaction and the agreement of the parties that defines the scope of the PSP and the allocation of responsibilities as between the parties. Those possible component activities of a PSP may include: design, building or rehabilitation of an infrastructure facility, operation of the facility and provision of services to end-users, financing, operation and maintenance. In some PSPs, each of those activities may be undertaken by the private sector party. In others, a more limited range of activities may be involved (e.g., operation and maintenance of an existing infrastructure facility). Other aspects of flexibility that are possible through customizing solutions from a menu of options include the ability of local communities to decide on service levels and their possible contribution to a portion of investment costs.

D. FCV context

The Toolkit focuses on SME participation in PSPs in the FCV context. Countries that are categorized as FCV affected are classified as unstable in their political, economic, social and security spheres. As regards the aspect of fragility, the World Bank defines a “fragile” state by reference to criteria including eligibility for assistance from the International Development Association (IDA) (e.g. a grant), involvement of a UN peacekeeping mission

29 Ibid., p. 1.
in the last three years, or assignment of a ‘governance’ score of less than 3.2. Other sources of classification of countries as being fragile include the Fragile States Index compiled annually by the Fund for Peace, which applies a combination of social, economic and political and military indicators, as well as the annual OECD report *States of Fragility*.

**In the post-Millenium Development Goals era, the notion of “fragility” is evolving.** As evidenced in the 2016 edition of the OECD report, the notion of “fragility” is evolving and not necessarily confined to particular countries that may appear on a list of fragile states, but rather is a universal notion that may potentially affect all states to one extent or another. Indicators applied in such a broadened notion of fragility include violence, access to justice, accountable and inclusive institutions, economic inclusion and stability, and capacities to prevent and adapt to social, economic and environmental shocks and disasters (with countries showing vulnerability to more than one of those aspects deemed to be affected by fragility).

**To the extent that fragility is a function of economic instability and exclusion, SME involvement in PSPs may help to remedy that dimension of fragility.** Involvement of SMEs in PSPs to provide infrastructure and services can contribute directly to economic development and inclusion, thus addressing a key dimension of fragility where applicable. Thus, such participation by SMEs can not only fill a void essential service delivery, it also can provide an important engine for promoting economic growth, shared prosperity and resilience. That is in line with the trend in an increasing number of countries to harness public procurement and related types of expenditures to promote the SME sector, thereby contributing to enhanced job creation and economic development.

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**Box I.4 Fragility background in case-study countries**

**Benin (water)**

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30 Based on the Country Performance and Institutional Assessment (CPIA) Index; see https://data.worldbank.org/data-catalog/CPIA

31 http://library.fundforpeace.org/fsi16-report

With the majority of population being rural (57%), the rate of access to piped water in Benin remains low, with only 4% of rural areas having access by 2012, compared to 12% in urban areas. Benin is classified under the “warning” status of the 2015 Fragile States Index, ranked 73rd most fragile out of 178 countries. Major challenges to stability arise from exogenous shocks, such as developments in its neighboring states, Nigeria and Niger (on high alert and alert, respectively, by the 2015 Fragile States Index). In a population of about 10.6 million, 38.4% have access to electricity; 77.9% to an improved water source, and 19.7% to improved sanitation facilities.

Somalia (water)

The fragile political situation in Somalia, classified as a fragile state in the FY15 Harmonized List of Fragile Situations and ranked the second most fragile state (on very high alert), as of the 2015 Fragile States Index, has resulted in fluctuating management of its water sector and difficulties in distributing necessary access to water to its population, the majority of which (61%) live in rural areas. In a population over 10.5 million, 32.7% have access to electricity; the national coverage for safe drinking water stands at 53% with South-Central Region at 51%, Somaliland at 56% and Puntland at 62%, and the coverage by population group stands at 69% for IDPs, 24% for Nomads, 76% for urban, and 37% for rural. The national sanitation coverage stands at 63%, with South-Central Region at 59%, Somaliland at 74%, and Puntland at 65%. The sanitation coverage by population group includes IDPs (75%), nomads (34%), urban (87%) and rural (49%) (JMP/WHO and UNICEF: Progress on drinking water, sanitation and hygiene: 2017 update and SDG baselines, available at http://www.who.int/mediacentre/news/releases/2017/launch-version-report-jmp-water-sanitation-hygiene.pdf).

Mali (energy)

The country suffered from complex crisis on three fronts (conflict and insecurity in the North, institutional and political turmoil in the South, and humanitarian and food insecurity across the country). It is classified as on “alert” on the 2015 Fragile States Index, ranked 30th most fragile out of 178 countries, and is included in harmonized list of fragile situations FY15. In a population of about 17 million, on average, 25.6% of the population have access to electricity; however, while about 50 percent of the population in urban areas has access to electricity, less than 12% do in rural areas, as of 2012 (World Bank Development Indicators).

Cambodia (energy)

Cambodia is classified on “high warning” in the 2015 Fragile States Index, ranking 41 most fragile (out of 178 total countries, 1 being the most fragile). In a population of about 15.3 million, 32.7% have access to electricity, 75.5% to an improved water source, and 42.4% to improved sanitation services. In the electricity sector in particular, only about 17.3% of the population in rural areas has access to electricity, compared to 57.7% in urban areas.

Rwanda (water)

The 1994 genocide and post-war reconstruction resulted in severe challenges on the community level due to high levels of mistrust and water management, prioritizing emergency response over sustainable development. In the aftermath of this conflict, only 44 percent of population had access to a water delivery point. Rwanda is classified as on “alert” in the 2015 Fragile States Index and is ranked 37th most fragile out of 178 countries. In a population of over 11.3 million, 18% have access to electricity, 76.1% have access to improved water sources, and 61.6% have access to improved sanitation facilities. In the water sector in

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33 The Fragile States Index is based on the twelve primary social, economic and political indicators of the CAST methodology, developed by The Fund for Peace. Indicators include demographic pressures, refugees and IDPs, group grievance, human flight and brain drain, uneven economic development, poverty and economic decline, state legitimacy, public services, human rights and rule of law, security apparatus, factionalized elites, external intervention; available at http://fsi.fundforpeace.org/rankings-2015.
34 https://pppknowledgelab.org/countries/benin

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particular, while 89.6% of the urban population have access to improved water sources, only 56.9% of the rural population have access to these water sources. The World Bank had worked with Rwanda in 1987 on a Second Water Supply Project that aimed to ensure community participation and transferring of responsibility of ownership of RWS facilities to communes, which did not succeed partly due to the fragile context such as the 1995 genocide and post-war reconstruction demands.

E. Identification of SMEs

The Toolkit does not purport to establish a universal norm for classifying businesses as SMEs. What is or is not deemed to be an SME will vary from country to country, depending on the prevailing circumstances, including the legal and regulatory regime, and the size of the economy and the composition of the commercial market of a country. Various approaches are used in practice to identify a business as an SME. Possible criteria that are typically applied include number of employees and annual turnover of a business. Other considerations that may be relevant include the independent character of the business (i.e., that it is not a subsidiary of or otherwise controlled by another company).

Purely for the purposes of illustration, below is the matrix of criteria underlying the definition according to the SME development policy in Rwanda. It should be noted that SME size standards are not uniform and vary from country to country, and perhaps also from sector to sector.36

<table>
<thead>
<tr>
<th>Size of the Enterprise</th>
<th>Net capital investments (Million Rwf)</th>
<th>Annual Turnover (Million Rwf)</th>
<th>Number of Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro Enterprises</td>
<td>Less than 0.5</td>
<td>Less than 0.3</td>
<td>1 to 3</td>
</tr>
<tr>
<td>Small Enterprises</td>
<td>0.5 to 15</td>
<td>0.3 to 12</td>
<td>4 to 30</td>
</tr>
<tr>
<td>Medium Enterprises</td>
<td>15 to 75</td>
<td>12 to 50</td>
<td>31 to 100</td>
</tr>
<tr>
<td>Large Enterprises</td>
<td>More than 75</td>
<td>More than 50</td>
<td>More than 100</td>
</tr>
</tbody>
</table>

**Notes on definition**
- Two of the three conditions should be met
- Rwanda Revenue Authority (RRA) has a different definition of SMEs for tax purposes
- Informal companies are defined as those not registered in accordance with the Companies Act or other legislation related to SMEs and cooperatives
- In this policy, SME is used to describe micro as well as small and medium enterprises

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F. Customization of the Toolkit for specific countries

Elements of the Toolkit are meant to be used in relevance to the needs of individual countries. States in the FCV context are “more vulnerable to external shocks (e.g. economic crisis, natural disasters)”37 and therefore are in need of organized strategies (and resources such as the Toolkit) to better their economies. At the same time, the Toolkit does not purport to offer one-size-fits-all solutions that should be applied in a uniform fashion in all contexts. Rather, the Toolkit describes challenges faced by SMEs in the PSP context in FCV environments, elements of an enabling environment for implementation of PSPs operated by SMEs, and a range of PSP techniques that may be selected and customized to fit the applicable conditions.

G. Survey results

For the purposes of preparing this Toolkit, a survey was conducted for country representatives from fragile countries across regions at a global workshop in Beirut. The survey examined five categories of issues: SME enabling environment, regulatory environment, procedural environment, challenges and solutions, and next steps. The survey revealed the willingness of representatives to enhance SMEs’ involvement in PSP projects, particularly in the infrastructure sector, and their realization of the obstacles needed to be overcome in order to do so. Representatives from Bosnia and Herzegovina, Egypt, Republic of Congo, Republic of Djibouti, Morocco, Tunisia, Yemen, Lebanon, Afghanistan, Somalia, and Gambia participated in the survey38. The results of the survey are summarized in Annex B.

II. OPPORTUNITIES AND CHALLENGES FOR SME IN PSPs

A. Trends in private sector participation

In the background of participation of SMEs in PSPs in FCV scenarios, there has been a general trend toward enhanced private sector participation in provision of public infrastructure and related services. As shown in Table 1, below, there is a generally upward trajectory in the role of the private sector in key infrastructure and service delivery sectors, in particular in water and sanitation, transport, energy, and telecommunications (though in recent years that trend has leveled off to some extent (in particular due to low interest rates applicable to public borrowing). Those happen to be sectors in which SMEs may be positioned to fill unmet needs, in particular in the FCV context.

38 The survey was administered to public and private sector officials in dissemination events to ensure that the Toolkit addresses the current concerns of major stakeholders.