

## 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)”<sup>37</sup> 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 survey<sup>38</sup>. 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.

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<sup>37</sup> Woolcock, Michael. “Engaging with Fragile and Conflict-Affected States” (2014), p. 3; available at <https://research.hks.harvard.edu/publications/getFile.aspx?id=1091>

<sup>38</sup> 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.

Figure II.1

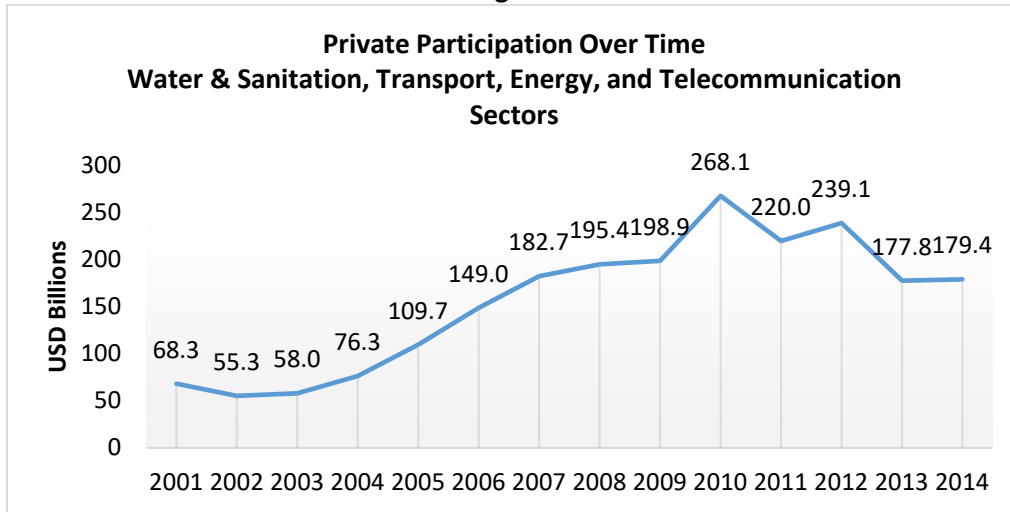


Figure 1 Source: World Bank Development Indicators, as of May 2016

The volume of private sector participation varies from region to region. As shown in Tables 2 and 3, there are significant differences among the various regions as regards the level of private investment in some of those sectors.

Figure II.2

Investment in Projects By Region (USD Millions)<sup>39</sup>  
Water and Sanitation

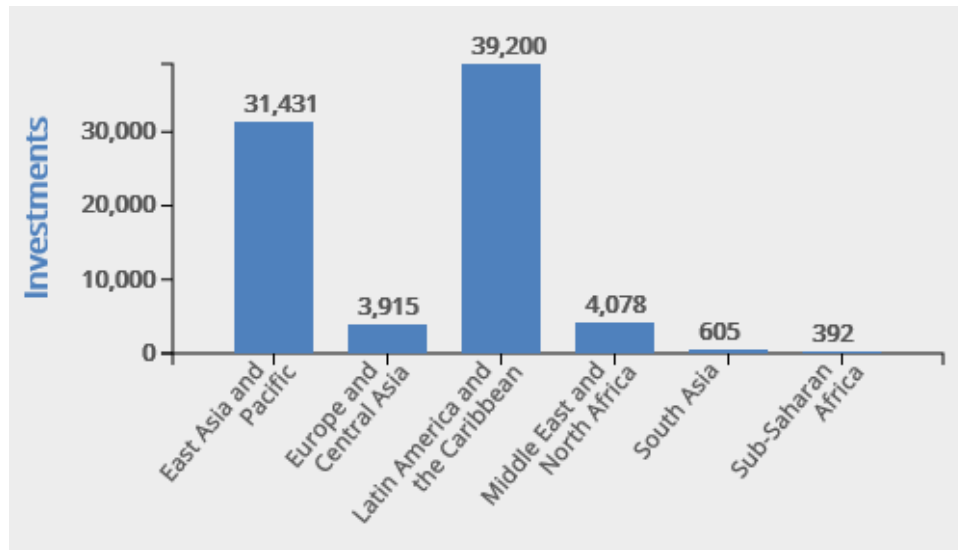


Table 2 Source: Private Participation in Infrastructure (PPI) Database, May 2016. It should be noted that PPI database only tracks a certain size of project and does not indicate the extent to which projects, if any, have been sponsored by an SME.

<sup>39</sup> <http://ppi.worldbank.org/snapshots/sector>

Figure II.3 – Electricity

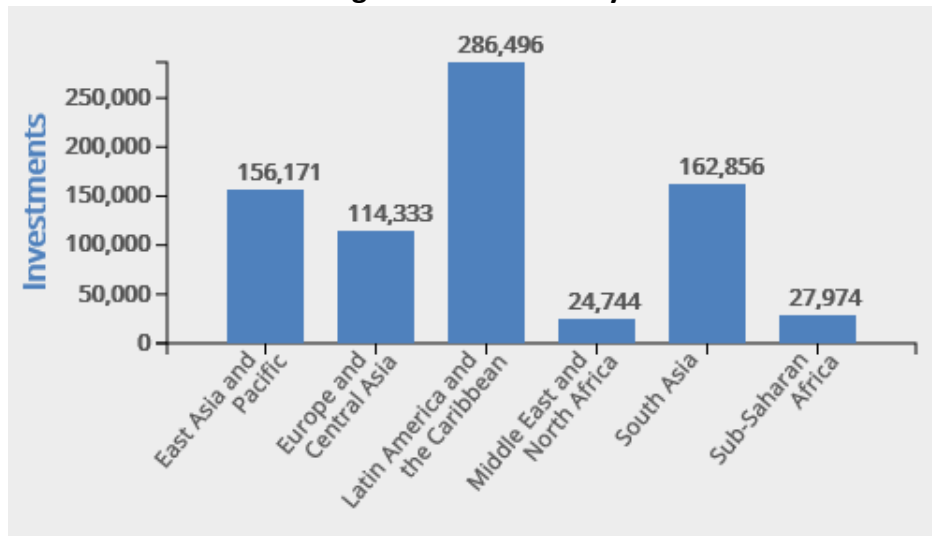


Figure 3 Source: Private Participation in Infrastructure (PPI) Database, May 2016

## B. Possible challenges confronting PSPs and SME participation

**Various obstacles may complicate access of SMEs to participation in PSPs.** Outlined below are obstacles typically found in the way of SME participation in PSPs. To one extent or another, those obstacles may be encountered in any context, but they are likely to be particularly exacerbated in an FCV environment.

**In considering a possible PSP transaction involving SME participation, it should be recalled that various of the possible challenges to be met are not necessarily specific to SMEs, but related to private sector participation generally.** However, for SMEs, those challenges, even if they are not unique to SMEs, may be more acute for SMEs. One must also consider SMEs' capital and resources and therefore the likely types of PSPs in which they are able to be involved and what public sector support may be needed to enable SME participation. Thus, one can easily see SMEs involved in user-pay O&M (where government is an unreliable counterparty) but they might not necessarily be able to provide expansion or rehabilitation of systems, and other forms of participation requiring investment.

### Box II.1 Challenges for SME participation: Example from Cambodia

- **Lack of standardized approach to procurement** in PPPs, which is conducted on a “reactive, unsolicited and negotiated basis.”<sup>40</sup>
- **Asymmetrical focus on urban areas**, compared to rural areas that house 80% of the population.
- **Financing challenges for private operators:** lack of credit or medium-term financing available in Cambodia. SPSPs must largely fund themselves.

<sup>40</sup> <https://pppknowledge.org/countries/cambodia>

- **Low capacity of public sector** in terms of technical skills and funds to prepare, tender, and manage PPP projects—rely on the private sector to conduct functions on an unsolicited and noncompetitive basis.<sup>41</sup>

## 1. Challenges in the FCV context

**Private sector activity is particularly challenging in the FCV context.** The World Bank’s *Doing Business* database and other studies cite various features of fragile environments that make them particularly challenging for conducting business activities, including<sup>42</sup>. Those include in particular weakness in formal institutions and rule of law, existence of parallel structures of authority (state and non-state) and habituation to practices of the informal sector, a glut in labor supply that may depress already low wages (due, for example, to the appearance of ex-combatants in the labor market, or by virtue of the fact that in communities with increased numbers of skilled workers among displaced or refugee populations, there is bound to be a glut in labor supply), political instability and physical insecurity, both of which have direct impacts on business activity and may make it difficult to maintain a project’s presence in the field<sup>43</sup>, low degrees of community unity, corruption, for which the FCV context provides a breeding ground (e.g., selective enforcement of law and of customs duties and taxes), loss of business assets, which complicates restoration and resumption of business activity, infrastructure issues including access to electricity.

### Box II.2 Legacy of war risks that may hinder entrepreneurship

- Possibility of conflict reigniting, which tends to push the private sector to focus on short-term perspectives and plans
- Stratification of resources and power among groups resulting in income inequality
- Steering, monopolization or oligopolization of opportunities and resources on the basis of rent-seeking behavior and regulatory capture

-- Wim Naudé, *Peace, Prosperity, and Pro-Growth Entrepreneurship*, pp. 11-13 ([see note 63](#))

It is hardly surprising that, in such circumstances, the economies at the bottom of the *Doing Business* rankings are heavily dominated by fragile States. Such difficulties tend to persist, beyond the actual conclusion of the conflict.

<sup>41</sup> <http://www.adb.org/sites/default/files/publication/29921/assessment-ppp-cambodia.pdf>, xii.

<sup>42</sup> Mary Porter Peschka, *The Role of the Private Sector in Fragile and Conflict-Affected*, World Bank Development Report 2011 Background Paper (July 2010 (updated April 2011), pp. 10-11; available at [http://web.worldbank.org/archive/website01306/web/pdf/wdr\\_background\\_paper\\_peschka\\_0.pdf](http://web.worldbank.org/archive/website01306/web/pdf/wdr_background_paper_peschka_0.pdf)

<sup>43</sup> This has been a challenge encountered, for example, in the Somalia case study.

### **Box II.3 Risks of low community unity: Example from Somalia case study**

For example, the PPP concept was not as easily accepted in Lowya'ad in the context of low community unity, inhibiting the creation of PPP companies. In this situation, a formal tender process may be available way to ensure the legitimacy of the company.

**The FCV context may well exacerbate challenges typically faced by PSP programs.** Implementation aspects prone to be more complicated in the FCV context include infrastructure planning (which should be rationalized rather than opportunistic), donor coordination, and capacity<sup>44</sup>. Challenges typically faced by SMEs in accessing public procurement markets and PSP arrangements are also likely to be exacerbated in FCV contexts, including in particular accessing finance as well as access to the site (which may be difficult even without FCV conditions, for example if remote areas are involved and the road network is not nearby). FCV environments may well compound such difficulties with political instability, security risks and prevalence of corrupt practices.

## **2. Inadequate or non-existent policy framework**

**A policy framework for PSPs is an important element, the absence of which may complicate efforts to engage SMEs on a PSP basis.** Without an adequate policy framework for PSPs, there is a significant probability of uncertainty as to the rationale and nature of PSPs and the availability of PSP mechanisms in any given case. Uncertainty may surround the question of which sectors if any are open to use of PSPs, lack of awareness as to the potential benefits that use of a PSP arrangement may provide, and uncertainty and opaqueness as to the process of identifying and implementing PSP projects. The lack of a policy framework, or uncertainty as to the commitment of the government to PSP strategies intended to involve SMEs (e.g., in operating mini-grids), may hamper the mobilization of private sector resources and impact in particular on the possibilities of utilizing SMEs through PSP arrangements.

**Weakness in the policy framework for SMEs may hamper SME participation on a PSP basis.** It appears that a significant percentage of FCV countries do not have a formal definition of the term "SME". Another common weakness of particular note is the lack of data collection mechanisms for monitoring activities of SMEs, including monitoring of SME participation on a PSP basis.<sup>45</sup>

**In some cases, however, the lack of a developed policy framework, rather than constituting a constraint, may present opportunities.** That might be the effect to the extent that underdeveloped policy frameworks mean that barriers to entry are lower than they otherwise might be. Yet, the lack of a policy framework might also be symptomatic of situations in which it may be difficult to muster political support for projects.

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<sup>44</sup> Andrew Jones, *Making PPPs work in fragile situations*, World Bank Public-Private Partnership Blog, available at <http://blogs.worldbank.org/ppps/making-ppps-work-fragile-situations>

<sup>45</sup> Based on findings of the Survey on SME participation in PPPs (see Annex B).

### 3. Weakness in infrastructure planning

**Inadequacy in infrastructure planning is likely to be encountered in FCV contexts.** As a result, governments and donors engage in ad hoc, opportunistic infrastructure, rather than efficient, systematic planning. Identifying opportunities for PSP projects, including those involving SMEs, may entail a broader assessment of the landscape for potential public sector investment than would otherwise be the case.<sup>46</sup>

### 4. Inadequate or non-existent legal framework

**The legal system may well be one of the primary components of societal and governance structures that is weakened in the FCV context.** Instability in law and inconsistency between formal rules and actual practice may be a primary effect of conflict.<sup>47</sup> For example, war can decimate not only the perceived legitimacy of the judiciary, but also decimate the physical infrastructure of the court system, as well as destroying records and weakening the human resources that operate the court system. That feeds into what is a common effect of fragility and conflict -- weakness in enforcement of contracts and unreliability of property protections, which inhibit reconstruction and development.

#### **Box II. 4 Stages and steps in restoring rule of law in FCV contexts<sup>48</sup>**

##### **Early recovery efforts**

Identifying entry points that will limit/end violence & violations  
Empowering communities especially women, youth and displaced populations  
Partnering with humanitarian actors  
Engaging international police and peacekeepers

##### **Post-conflict recovery – rule of law in peacebuilding**

Long-term commitment from international partners  
Access to justice and security at the community level  
Transitional justice  
Security and justice sector reform to support rule of law  
Rule of law for economic recovery (e.g., housing, land, water, property, labor law aspects)<sup>49</sup>

<sup>46</sup> This phenomenon has been observed, for example, in Afghanistan and in Palestine; see Andrew Jones, *supra*, note 45.

<sup>47</sup> See Mary Porter Peschka, *supra*, note 43, pp. 12-13.

<sup>48</sup> *The Rule of Law in Fragile and Post-Conflict Situations*, UNDP Bureau for Crisis Prevention and Recovery (UNDP/BCPR 17 July 2009), pp. 3-6; available at [http://siteresources.worldbank.org/EXTLICUS/Resources/511777-1224016350914/5474500-1257528293370/HS\\_July\\_21\\_Paper\\_by\\_Jordan\\_Ryan\\_UNPD.pdf](http://siteresources.worldbank.org/EXTLICUS/Resources/511777-1224016350914/5474500-1257528293370/HS_July_21_Paper_by_Jordan_Ryan_UNPD.pdf)

<sup>49</sup> *Strengthening the rule of law in crisis-affected and fragile situations: A UNDP global programme for justice and security (Phase II)*, p. 7; available at

**Additionally, lack of an adequate legal framework for implementing PSPs is likely to result in uncertainty and lack of confidence on the part of potential private sector parties as well as potential public sector parties.** Without an adequate legal framework, doubts may arise in particular as to the permissibility of procurement on a PSP basis, the procedures to be applied for gaining the necessary approval of such projects, and the procedures to be applied in procurement on a PSP basis.

**Weakness in land law and insufficient clarity in title to real property is another potential area of challenge for private sector activity in the FCV context.** That impacts on a wide spectrum of private sector activity and investment, including in contemplating whether there is sufficient legal security to engage in PSP projects.<sup>50</sup>

**Weaknesses at the level of contractual instruments may be another challenge.** Inadequacies in the quality of contractual instruments that are utilized in implementing PSPs with SMEs which might not contain all the provisions essential to ensuring that there is clarity as to the rights and obligations of the parties, and to establishing accountability. Even in legal systems which rely less on contracts and more on legislative codes for definition of the rights and obligations of the parties, gaps and uncertainties may arise to the extent that PSP-specific issues are not defined in the legislative code or in the contractual instruments with sufficient precision.

#### 5. Low capacity of SMEs

**A significant obstacle facing many SMEs seeking to participate in public procurement markets is the lack of capacity.** Such capacity shortfalls may be particularly exacerbated in the PSP context, and even more so in the FCV environment. Capacity challenges may concern technological capacity for managing and building infrastructure and availability of skilled personnel (e.g., shortage of engineers which may be particularly acute in situations of humanitarian crisis), in addition to access to debt finance and equity investment.

#### 6. Low regard for SMEs

**Reliance by SMEs on subsidization may perpetuate a stereotype, held by some, that SMEs are dependent on such assistance.** That in turn may feed the impression that

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<http://www.undp.org/content/dam/undp/library/crisis%20prevention/Global%20Programme%20Phase%20II%20-%20FINAL.pdf>

<sup>50</sup> As catalogued in *Land & Conflict: A Toolkit for Intervention*, prepared by the USAID Office of Conflict Management and Mitigation, land issues in conflict affected States, the resolution of which is important for stabilization efforts as well as for private sector activity, include: land tenure (rights of access and use of land) failures and insecurity; competing land claims and uses; land-holding inequities; displacement and return of populations; post-conflict land issues; available at [http://pdf.usaid.gov/pdf\\_docs/Pnadb335.pdf](http://pdf.usaid.gov/pdf_docs/Pnadb335.pdf)

subsidized projects are therefore somehow less worthy of being considered to have a demonstration effect. This has been referred to as a “paradoxical demonstrative effect”<sup>51</sup>.

## 7. Inadequate market development

**Implementing PSPs on the basis of SME involvement may be hindered to the extent that the level of competition in awarding contracts for such arrangement is inadequate.** The lack of market development may mean that the contracting authority’s options may be limited when inadequate performance issues arise during implementation and there may be a shortage of replacement operators to tap. That may be the case in particular in rural areas, and especially in the FCV context.<sup>52</sup>

## 8. Capacity shortfalls on the public sector side

**It is not only the private sector (SME) side that faces capacity challenges.** Capacity shortfalls on the public sector side may include not only inadequate understanding of how to engage SMEs in PSPs, but, more fundamentally, in experience with PSPs and inadequate ability to identify and assess potential PSP projects, weaknesses in the process and capacity of developing, implementing and monitoring such projects (which may be on top of overall weakness in the project cycle, from preparation to approval), risk-sharing mechanisms that leave the public sector shouldering a share of risks beyond its capacity, and low implementation capacity, in particular regarding procurement, negotiation and supervision of PSP arrangements. Furthermore, there may be a lack of effective communications with stakeholders, including the public and private sectors, and civil society.<sup>53</sup> Such capacity shortfalls on the public sector side are particularly likely to be encountered at the local government level, with which SMEs are more likely to interact in the delivery of infrastructure and services. Moreover, capacity shortfalls on the public sector side may be exacerbated in the FCV context by institutional changes and departures of key staff.<sup>54</sup>

**Access to finance may be another capacity challenge for the public sector.** To the extent that a project is not able to cover costs and sustain itself on the basis of tariffs (“full cost

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<sup>51</sup> Haselip, James Arthur; Desdain, Denis DR; Mackenzie, Gordon A., *Energy SMEs in sub-Saharan Africa: Outcomes, barriers and prospects in Ghana, Senegal, Tanzania and Zambia* (2013), p. xi; available at [http://orbit.dtu.dk/files/56433833/Energy\\_SMEsin\\_Sub\\_Saharan\\_Africa\\_full\\_report\\_May\\_2013.pdf](http://orbit.dtu.dk/files/56433833/Energy_SMEsin_Sub_Saharan_Africa_full_report_May_2013.pdf)

<sup>52</sup> See Somalia Final Evaluation report, p. 37.

<sup>53</sup> See Adiat A Abiodun, “The Challenges and Solutions of PPPs in Fragile Countries and Conflict Affected Areas”, in *International Affairs Forum*, available at <http://www.ia-forum.org/Content/ViewInternalDocument.cfm?ContentID=8369>

<sup>54</sup> That is what occurred, for example, in the case of AMADER in Mali; see Output-Based Aid in Mali Rural Electrification Hybrid System Project, in OBA [Output-Based Aid] Approaches, June 2015, Note No. 45; available at <https://www.gpoba.org/sites/gpoba/files/OBA45%20Mali%20Electrification.pdf>.



recovery” approach), necessary supplemental funding may come from taxes or other sources such as development funding institutions.<sup>55</sup>

## 9. Weakness in institutional structures

**Inadequacies in the institutional and regulatory framework may present an additional set of serious challenges.** To one extent or another, capacity issues in the public sector may be linked to weakness in the institutional arrangements related to planning and implementation. Reduced authority and poor capacity and performance of governmental institutions hampers bringing about needed change, providing security and delivering essential services, as well as possibly bureaucratic obstacles and weaknesses in permit issuance, contract enforcement and regulatory structures in particular sectors in which SME participation in PSPs may be considered. Such weaknesses tend to be more pronounced at the local and community levels.

**In the absence of, or weakness or mistrust in, state institutions, informal institutions may acquire greater influence.** Relying on informal institutions may be a part of the “coping strategy” of SMEs in the FCV context as they struggle to maintain operations, obtain supplies for production, and reach the market<sup>56</sup>.

## 10. Deficiencies in quality control

One of the main difficulties impacting on the possibilities of SMEs as providers on a PSP basis concerns the control of quality of services provided on such a basis. Any lack of, or deficiencies in, quality control, in particular in a field such as water supply and sanitation services, can pose a significant public health risk (e.g., due to water being distributed without disinfection).<sup>57</sup>

## 11. Diminished access to finance

“As in most fragile and conflict-affected economies, the lack of access to credit remains a key challenge to enterprise development in Liberia.”

- *World Development Report 2017*, p. 54

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<sup>55</sup> Possible funding sources in the water sector have been referred to as the “3Ts” – tariffs, taxes and transfers (including official development assistance grants) (see *OECD, Managing Water for All, supra*, note 2, p. 15).

<sup>56</sup> Regarding the possible role of informal institutions and related practices such as payment of protection money, hiring on the basis of social background, as such coping practices may relate to SMEs in fragile states, see Hoffman and Lange, *Growing or Coping, supra*, note 18, p. 4

<sup>57</sup> See, for example, *Evaluation of Small-scale Providers of Water Supply and Sanitation Services in Peru*, p. 5; available at <https://openknowledge.worldbank.org/handle/10986/17261?show=full>.

**FCV situations can have a particularly devastating impact on the financial sector.** The spectrum of possible impacts include looting of banks and destructions of records, shutdown or impairment of banking operations and services, vulnerability of banks to being caught up in the struggle of factions to secure financing, and a weakened capital base for surviving banks.<sup>58</sup> While micro-financing may be available for micro-enterprises, and bank financing for large companies, SMEs may be left without access to bank financing.<sup>59</sup> As a result, it may be that financing is obtained through social ties or diaspora investors, or from public sources. That is in addition to business activity that may result from migrant entrepreneurship.<sup>60</sup>

**Moreover, difficulty in accessing financing is an obstacle commonly faced by SMEs in penetrating public procurement markets, and one that is not necessarily resolved by the restoration of commercial banking services.** That difficulty may be particularly important in the context of PSP projects that entail some investment on the part of the project company, and exacerbated in the FCV environment.

**Box II.5 Financing challenges of private operators**

**Benin (water):** A 2010 diagnostic study found that only 27% of private operators in Benin had sufficient financial resources to renew assets, at least partly due to high fees and charges paid to municipalities

**Accessing finance may also be an obstacle to the public sector side in the FCV context.**

Such financial obstacles may make it difficult for a potential public sector sponsor of a PSP to contemplate systematically and thoroughly all the possible implications of establishing PSP arrangements with SMEs for delivery of infrastructure and services. That may be the case when the public sector side has to incur financial responsibilities for subsidization, or even if access to finance is needed only for the purposes of preparation of projects, conducting capacity building of targeted communities and the private sector, and exercising regulatory responsibilities.

**Box II.6 Financial issues for municipalities: example from Benin (water)**

Municipalities lacked sufficient funds to carry out major rehabilitations. The profitability of each PWS varied greatly, including within municipalities: this was due to variable asset conditions, the presence of alternative water sources and varying population densities.

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<sup>58</sup> See Mary Porter Peschka, *supra*, note 43, p. 16.

<sup>59</sup> *Ibid.*, pp. 10-11.

<sup>60</sup> See summary of presentations by Bogdan and Roxanna Romanica, “Doing Business: A Social Affair”, at the IGNITE! 2015 Conference, Doing Business in Fragile States, as well as, at the same event, the presentation on “Inclusive finance for entrepreneurs”, by a panel of Mirwais Momand, René Kim, Nicola Armacost, Ben White, moderated by Aissatou Ba (AfDB); “Entrepreneurship and Migration”, panel of Roelof van Laar, Robert Kloosterman, Raheil Aziz and Michael Newson, moderated by Khaalid Hassan; available at [www.spark-online.org/wp-content/uploads/2015/10/IGNITE-2015-report.pdf](http://www.spark-online.org/wp-content/uploads/2015/10/IGNITE-2015-report.pdf).

## 12. Low-levels of awareness

**Low levels of familiarity with PSPs present another potential challenge to introducing PSPs operated by SMEs.** In the public and private sectors, including SMEs, and other stakeholders, including civil society, there may be a lack of awareness of the nature and potential applications of PSP to meet infrastructure and service needs.

### III. ENABLING SME PARTICIPATION

**While there are considerable obstacles and risks in FCV contexts, the private sector typically continues to be active.** There is an established track record of private sector investment in fragile countries.<sup>61</sup> Private sector activity, including that of SMEs, can play a key role in securing peaceful conditions and establishing the basis for a recovery and reconstruction process. The private sector can do so in particular through job creation for the unemployed, for example, former combatants, and for those that are being resettled.

**To deal with the various challenges in an FCV context, SMEs may adopt a “coping strategy” aimed at survival rather than focusing on a growth strategy.** Included in such a coping strategy may be, for example, relying on personal and social networks<sup>62</sup>, and dealing with traditional or informal institutions, or parallel authority structures<sup>63</sup>.

**Below is an outline of key elements in an enabling environment for SME participation in infrastructure PSPs in FCV contexts.** Creating an enabling environment includes, in addition to the positive development of systemic aspects (e.g., policy framework), addressing systemic obstacles as well as improving capacity building and other types of technical support to empower SME activity. All the while it is important to bear in mind that, depending upon the context, support strategies for SMEs need to be “conflict sensitive”. It may also be useful to consider the elements of an enabling environment for

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<sup>61</sup> For examples of private sector business activity and investment in fragile contexts, and supporting and facilitating initiatives, see IFC, *Rebuilding for Tomorrow: Private Sector Development in Fragile and Conflict-Affected Situations in Africa* (2015); available at [http://www.ifc.org/wps/wcm/connect/7440fe80485e6a868cacfd299ede9589/IFC\\_CASA\\_SmartLessons\\_Booklet.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/7440fe80485e6a868cacfd299ede9589/IFC_CASA_SmartLessons_Booklet.pdf?MOD=AJPERES)

<sup>62</sup> The post-Apartheid experience of South Africa demonstrates how private sector networks can, in the context of diminished public sector capacity, provide public goods and infrastructure, including roads, water, energy, education and health; see Wim Naudé, *Peace, Prosperity, and Pro-Growth Entrepreneurship*, United Nations University UNU-WIDER Discussion Paper No. 2007/02, p. 8; available at <https://www.wider.unu.edu/publication/peace-prosperity-and-pro-growth-entrepreneurship>. An example of network role would be when reputational implications play an ascendant role in enforcement of obligations in the context of weak or lacking judicial enforcement mechanisms.

<sup>63</sup> Annette Hoffman and Paul Lange, *Growing or Coping, supra*, note 18.