INSTITUTE FOR INTEGRATED TRANSITIONS

Entrepreneurs as Peacebuilders in Fragile States

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Introduction

Business entrepreneurs – individuals who take risks, identify unfulfilled needs, start new companies, and innovate through the development of new products, services, ideas, and/or methods of operation – are crucial to raising living standards, creating jobs, and improving the quality and variety of goods.[i]

But they do much more. They upend the existing business order, push to reform institutions, develop new networks, build new skills, and create new sources of wealth. By expanding access to opportunity and opening up the institutions that govern the economy to broader participation, they help to democratise society and widen prosperity. By introducing new technologies and techniques, they not only increase economic dynamism but also change political dynamics. As a consequence, key actors become more likely to focus on developing the economy than political infighting; building bridges and institutions that work across social divides than exacerbating conflict; and building skills that help manage disagreements between parties than working to increase divisions. The net result is a much stronger societal capacity to manage conflict in a constructive manner.

Entrepreneurship is more a mindset – an internally generated mandate – than a product of any particular type of business. It builds on the need, as Harvard Business School's Howard Stevenson writes, for immense creativity in "the pursuit of opportunity without regard to resources currently controlled." It thus contrasts sharply with a managerial or administrative way of thinking and working typical of most organisations. The latter is more defensive – focused on reducing risk, maintaining control, increasing efficiency and creating structure – and oriented towards maintaining the status quo through the preservation of competitive advantages even when seeking growth. The latter can take advantage of existing conditions and methods, but rarely disrupts them.

Although most commonly found in new high-growth-potential business development, entrepreneurship can be found in a wide variety of different business types, including start-ups, small- to medium-sized enterprises (SMEs), diaspora ventures, and neighbouring country companies. "Intrapreneurs" – which have many similarities – can be found in larger companies such as multinational corporations. By contrast, non-entrepreneurial (i.e., administrative or status quo) thinking is more typical and is found in everything from small-scale survival businesses started due to a lack of alternatives (whose founders are sometimes called "necessity entrepreneurs") to large domestic companies with strong ties to an existing regime to multinationals. Multinationals, which receive by far the largest amount of attention from the development field, often play only supplemental roles within fragile contexts: tapping natural resources, developing solitary real estate projects, or exporting from special economic zones in ways that have a limited impact on the rest of a country. They can, however, have an outsized, indirect influence on the success of entrepreneurs – for example, by strengthening the legal regime and infrastructure as well as working directly with them – and signal confidence in an undervalued economy even if they don't lead change on their own.

Fragile contexts – which are plagued by stark social divisions, weak or captured governments, high levels of exclusion and marginalisation, inequitable economic conditions, a dearth of conflict management skills, and oligarchical control over whatever new opportunities emerge – are in dire need of the kind of change entrepreneurs can promote. Medellin, for example, transformed itself from the world's most violent city in the 1980s to the world's most innovative city (according to a 2013 Urban Land Institute competition) partly by launching a slew of initiatives to nurture entrepreneurship. It built a regional innovation system, launched business incubators, created an industrial district, invested substantial sums in infrastructure, established a number of entrepreneurial programs and organisations, and set up a research technology park linked to academic institutions, the private sector, and a network of development centres. All of this was helped by the entrepreneurial culture of the city's inhabitants, one of its most important assets. Cooperation across many stakeholders was crucial to success.[ii]

But whether entrepreneurs (and a new entrepreneurial class) arise and whether they funnel their energies in a constructive manner depends on the ecosystem – regulatory regimes, risk-taking culture, infrastructure, and supporting organisations – in which they operate. The more these promote entrepreneurship, the more likely it will be to appear and contribute to reforming the social and political order – helping build peace in the process. By contrast, if the ecosystem is weak, it will either discourage any risk-taking or encourage the wrong kind – boosting criminality or the economic drivers of conflict instead. As such, improving the entrepreneurial ecosystem is essential if the energies of youth and ambitious people are to be funnelled towards productive activities.

Given the right conditions, entrepreneurship (and the development of new innovative companies) is thus a public good that should be promoted, especially when countries are in transition and have greater scope for promoting change. Through some combination of top-down planning and a bottom-up, demand-driven organic process, the goal should be to create the right conditions for entrepreneurs to thrive and grow in number and become a major driving force pushing reform over time. If enough succeed, a virtuous cycle takes root: social, institutional, and cultural change improves the ecosystem for entrepreneurs, which encourages an ever-greater number of entrepreneurs to emerge and further the whole process of positive change. Over time, an entrepreneurial mind-set and skill-set become more common in the population, with a broad impact on the economy and political landscape. All of this works to counter the many existing vicious cycles and dysfunctional patterns that hold back fragile states.

This publication examines the peacebuilding role of entrepreneurs – broadly defined – in fragile states in transition. It starts by looking at the components of the ecosystem that determine the quantity and quality of entrepreneurs that are likely to appear in any particular context. It then examines the various ways entrepreneurs contribute to peacebuilding – exploring their role in democratising economies, strengthening ties across social divides, reforming institutions, building economic dynamism, forging conflict management skills, and changing political incentives – before turning to a number of case studies. A set of recommendations is provided at the conclusion.

Entrepreneurial Ecosystems

Although entrepreneurs can be found everywhere – even in conflict settings – they are more likely to multiply and promote positive change in an ecosystem that provides a key set of supporting institutions and resources. These institutions and resources constitute what is called an *entrepreneurship ecosystem*.[iii] When the different components of this ecosystem are robust and able to work together in a synergistic manner, they maximise the ability of that environment to nurture the change agents that create new businesses, jobs, and wealth – and, in time, social, institutional, and political reform. Although some people are born risk takers – and others are naturally risk adverse – most can be influenced to play more constructive roles with the right conditions. The ecosystem offers the playing fields, training grounds, youth leagues, coaches, mentors, and so forth where the football players – the potential entrepreneurs – can develop and operate; the better this ecosystem is, the more likely stars will emerge. What is true in sport is true in business alike.

As shown in diagram 1, a robust entrepreneurship ecosystem is made up of a set of components that interact with each other:

- **Government** provides the right regulatory environment (e.g. registration, bankruptcy, taxes, etc.) and ensures that red tape does not hold back new ventures. It also is supportive of the unique needs of entrepreneurs and tolerates failed ventures. In early stage ecosystem development, government may also have to step in to solve various market gaps such as the dearth of financing through grants and guaranteed loans. Longer term, government development and small business support agencies are likewise crucial to tackling various institutional voids and ensuring an ecosystem provides the best support for new company development.

- **Infrastructure** ensures that the necessary energy supplies, road networks, customs offices, broadband internet access, and so forth are available at low cost and risk. Roads are especially important as they are one of the few items that entrepreneurs cannot supplement on their own (e.g., they can buy generators if necessary to overcome lack of electricity).

- **Financial capital**, which comes from informal investor networks, venture capital funds, and banks, must be available to provide early stage financing and then investment capital as companies scale up.

- **Education and research institutions** provide the human resources, training, and knowledge transfer that both start-ups and rapidly growing companies need as they scale up. In some cases, these can also provide basic training for entrepreneurs.

- **Incumbent companies** set standards and provide markets or marketing channels and suppliers or supply networks that are essential to new companies. They also may be an important source of personnel and capital (through investments or merger and acquisition transactions) and in some cases direct assistance in establishing a robust entrepreneurship ecosystem in the sector in which they operate, through their corporate social responsibility or innovation programs.

- **Intermediate organisations**, including law firms, accountancies, credit rating agencies, recruiting firms, and the like provide essential support functions at critical junctures in the development of any new enterprise.

- **Rule of law** – including courts, police, and property rights – plays a crucial role protecting assets, enforcing contracts, and guarding the rights of business owners. If a country's regular courts are unable to provide the service that entrepreneurs require, a country may need to establish commercial courts to facilitate efficient transactions between businesses. If the police are overly corrupt, they alone could be a significant obstacle to new business creation.

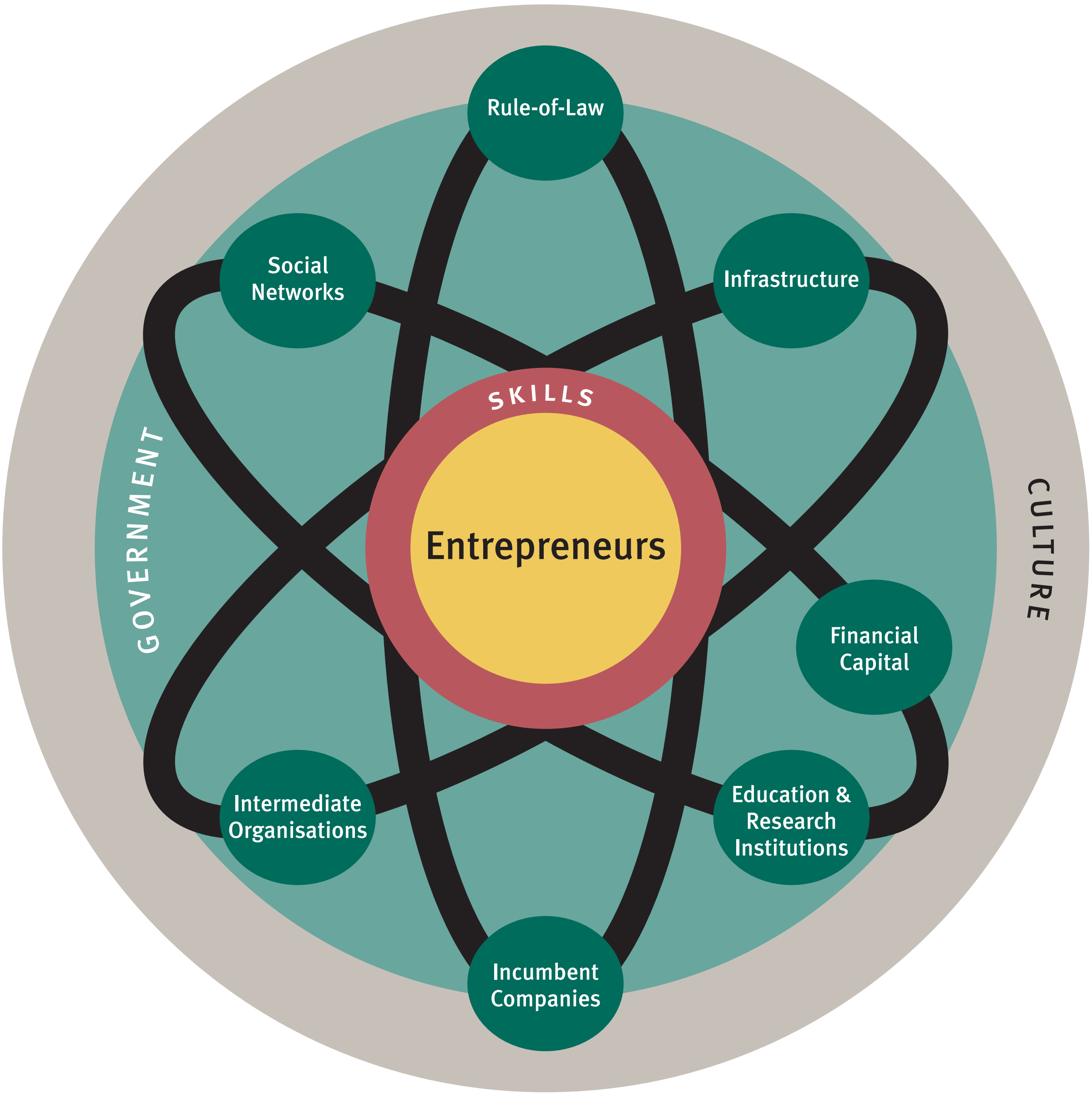
- **Social networks** – based on ethnic, religious, academic, professional, associational, church, union, or personal relationships – spread ideas, contacts, and resources among firms, accelerating the growth of the ecosystem. They also spur various actors to cooperate to improve the ecosystem.

- **Culture** that has few biases against failure and that reveres entrepreneurial success promotes the kind of risk taking at the heart of entrepreneurship. It both encourages members of society to start companies and challenge the status quo, and provides the practical and psychological support necessary for entrepreneurs to thrive and overcome the various challenges they face. The media, professional associations, social organisations, schools, family, and government all play a role in shaping the risk-taking culture.

- **Skills** are also critical for entrepreneurs to get started and grow their businesses. Such skills may include everything from financial management to people evaluation, basic legal knowledge, and an understanding of customer needs. Many of these skills are learned on the job or as a company grows.

Many of the individual components need to be developed simultaneously to be effective because of how they play a role in the development of the other parts. Their interaction creates a *network effect*. For example, the stronger incumbent companies are, the more likely an environment will have numerous service providers and abundant skills. The better education institutions are, the more likely government and courts will work well and entrepreneurs will have the necessary skills. And the more the culture encourages risk taking, the more financial capital

DIAGRAM 1: COMPONENTS OF AN ENTREPRENEURIAL ECOSYSTEM



is likely to be available. On the whole, the more developed each component of the ecosystem is, and the better it coalesces with the other components, the more dynamic the overall ecosystem will be.

As this suggests, strong components alone are not enough: friction between different actors or obstacles that prevent their synergistic interaction can easily impede the development or working of the ecosystem. A lack of trust, ethnic divisions, high levels of corruption, insecurity, and a history of weak cooperation across institutions – all common in fragile settings – can hamper relationships significantly.

In this respect, it is ideal for the state (in the form of dedicated government agencies) to proactively promote the development of and better interaction between the various elements of the ecosystem.[iv] This is what occurred in Israel, where the government played a crucial role building up the entrepreneurial ecosystem – especially parts that were weak, such as financial capital.[v] It now has one of the world's best entrepreneurial ecosystems. Through the Israel Innovation Authority, which is responsible for the country's innovation policy, government continues to play a crucial ongoing role in ensuring the entrepreneurial ecosystem is one of the world's best.[vi] Every country with a mature entrepreneurial ecosystem similarly has strong government support of some sort.

But a state-led approach will not always be possible. In some contexts, the state itself is a major obstacle to the development of a better environment for entrepreneurs. In such locales, outsiders (e.g., international donors), private actors (e.g., a social or economic leader), or entrepreneurs themselves need to play an important role for change to take place. In parts of southern Nigeria, for example, entrepreneurs have helped make dramatic changes in just a generation despite very poor starting conditions when the country democratised in 1999.[vii] A culture that encouraged risk-taking compensated to some extent for weaknesses elsewhere in the ecosystem. Lagos, the business capital of the country, has substantially improved governance since the virtuous cycle of intertwined business and political development took off in the early 2000s. Of course, if the state proactively blocks reform, change will be difficult; but in many places it is more a problem of corruption, misgovernance, or poor leadership.

Each entrepreneurship ecosystem is unique, tailored to its own particular environment and competitive advantages. It is not formed for the benefit of one specific stakeholder, but to facilitate the interaction and meet the needs of various stakeholders: public officials, companies, financial institutions, universities, and entrepreneurs themselves.[viii]

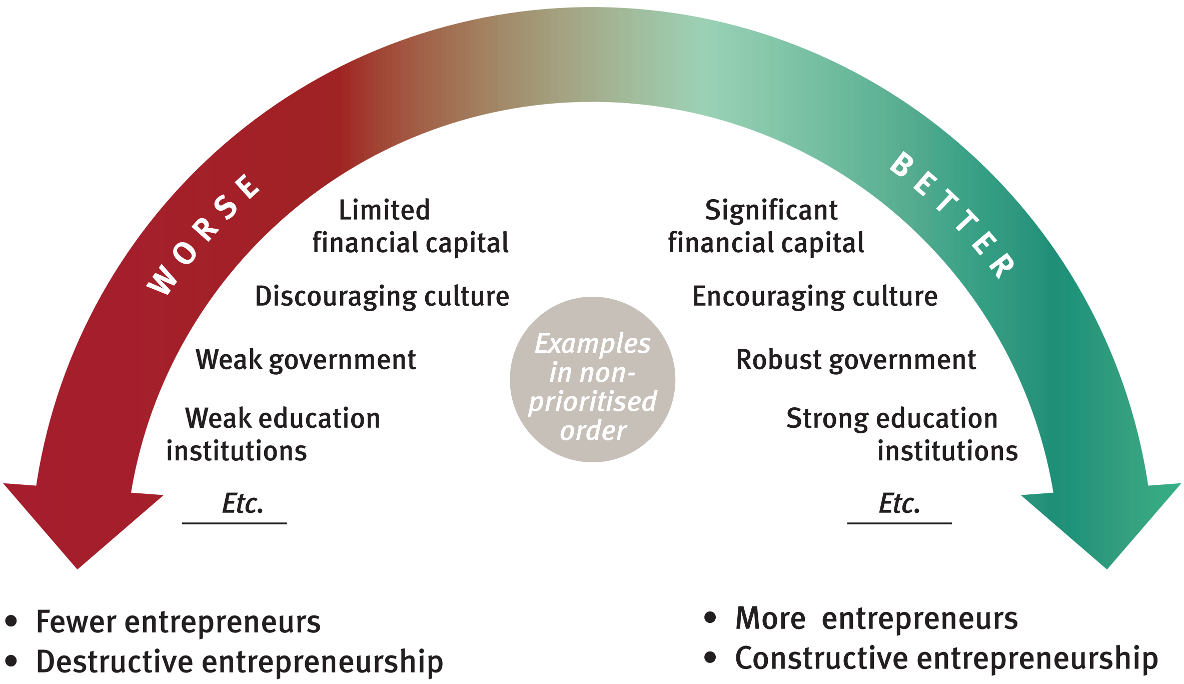
Unsurprisingly, fragile states have a hard time creating many of these components. Indeed, they can be among the least hospitable places in the world for starting and growing a legitimate business – especially one focused on making constructive contributions (e.g., manufacturing jobs, diversified exports) to the country. Corruption increases the costs of doing business and discourages new entrants who lack the necessary contacts to secure their business and bypass bureaucratic processes. Social divides hold back whole segments of the population from entering the formal and informal economy. Access to basic infrastructure (such as energy, roads, and mobile services), finance, human resources, and even courts may be sporadic at best. Institutional voids – lack of training companies, credit suppliers, custom brokers, and so on – leave most companies at a major disadvantage. Economic integration across groups is also blocked by what has been termed the "violence trap", in which the mere threat of violence hinders investment.[ix]

Such contexts either discourage risk taking or create the conditions, as William J. Baumol notes, for activity by the wrong kind of entrepreneurs: destructive ones.[x] These may sell fuel across borders (as they do in Nigeria), pirate ships (as they do in Somalia), or traffic illicit goods or people (as they do in Libya). They may gain from supplying warring sides in a conflict, eliminating competitors, or gaining control of a special import license from a corrupt official. And they may prefer insecure property rights, weak rule of law, and patronage from embattled leaders. In the worse cases, they form militias (as in the Democratic Republic of the Congo), join terrorist groups (as in various parts of the Muslim world), or mount illegal gangs (as in much of Central America). As such, not all entrepreneurs work to reduce fragility. Some may actually benefit from it and act accordingly, thus ending up averse to efforts to improve conditions. Indeed, in some contexts, such entrepreneurs may be ascendant and hard to dislodge.

As Diagram 2 highlights, the better the entrepreneurial ecosystem, the more likely any particular context produces constructive rather than destructive entrepreneurs – or none at all (which may be better or worse depending on circumstances). On the left side, entrepreneurship is more likely to be limited or opportunist. As the ecosystem improves towards the right, the balance shifts towards a greater quality and quantity of constructive entrepreneurship. This requires improving the various components of the ecosystem – governance, skills, culture, infrastructure, social networks, and so forth – as highlighted above.

The risk that destructive (or opportunistic) entrepreneurs will act in ways that strengthen the vicious cycles holding countries back makes the development of a new set of entrepreneurs focused on productive activities a crucial element in any strategy to reduce fragility.[xi] These undermine vested interests by reducing the attractiveness of unproductive activities and rents, changing the calculus of economic and political actors in the process. Without them, the incentives and dynamics that encourage or maintain fragility and conflict are almost certain to continue.

DIAGRAM 2: SPECTRUM OF POSSIBLE ENTREPRENEURIAL ECOSYSTEMS



The Role of Entrepreneurs in Promoting Peace

The more constructive entrepreneurs an eco-system produces, the more likely they can play a productive role promoting peace in fragile settings. This contribution is rarely examined yet potentially of extraordinary importance.

Below, we examine six channels through which entrepreneurs can contribute to the development of peace – and what settings enable them to function most effectively. Given the right conditions, the collective social impact of entrepreneurs competing against and working with each other can combine to advance vital public goods: improve underlying socio-political dynamics, enhance a society's capacity to manage conflict, reduce grievances, improve incentives for politicians and businesspeople, and build bridges across groups.

Increasing Social Cohesion

Entrepreneurs can play a crucial role enhancing social cohesion in fragile contexts by building relationships, trust, and arbitration mechanisms across social cleavages. They do this by necessity: their success depends on their ability to reach new customers, build new markets, introduce new techniques, and bypass dominant actors. This encourages them not only to seek out partners, distributors, suppliers, and buyers irrespective of who they are or where they are located, but also to purposely engage actors that the status quo may marginalise. This can give them an unusual role, as few actors have a natural incentive to work across social divides in ways that strengthen social cohesion – what fragile states most need. In both Colombia and Tunisia, for example, the private sector was directly involved in bringing together groups across key cleavages – in Colombia, it played various supporting roles in peace talks with the FARC, and in Tunisia, it was a member of the Quartet that won the Nobel Peace Prize in 2015 for orchestrating an inclusive national dialogue that proved crucial to the transition and conflict prevention.

Social cohesion – defined as the quality of relationships among groups – determines levels of trust and collaboration between groups and how institutions interact with one another. The more cohesive the society, the greater the likelihood that different groups and institutions will work together and manage conflict constructively. Even if consensus is illusive, in a socially cohesive country the majority understands the importance of working together according to a commonly accepted set of basic rules and values.

Social cohesion is especially important in less politically and economically developed countries because formal institutions are weak and often susceptible to manipulation, corruption, and bias. Unlike their brethren in more developed countries, these states feature formal institutions incapable of neutral mediation, enforcement of laws, and delivery of truly public goods. Elites and officials have much undue discretion to bend the rules and appropriate the resources of the state.

When these conditions are accompanied by stark socio-political cleavages, the countries become structurally fragile – prone to violence and ensnared in an unstable political order that is hard to reform. But as Cox, North, and Weingast argue, "the main way to raise the economic cost of domestic fighting is to promote specialization and integration of economic activity across major political cleavages."[xii]

Entrepreneurs can play an important role in this regard. The ties and trust that they build up across society can both give them – and their partners – the relationships, mechanisms, and incentives to work across divides to manage conflict on an ongoing basis, as well as to cooperate to head off or address crises should they occur. In contrast, political elites, business owners, and ethnic and religious leaders dependent on the existing regime often lack the broader relationships and inherent incentives to compromise across divides or work with others to encourage reforms that might weaken the regime's exclusionary hold on power and wealth. The rise of a new entrepreneurial class may even push some of the regime-dependent sectors of society to change their conduct in order to continue to thrive. Established companies, for instance, may be forced to become more entrepreneurial. Political elites may be forced to open up the political system to stay relevant.

Of course, in some cases, these elites and established companies may try to create new obstacles to prevent the dilution of their power and positions. In that sense, entrepreneurs and new companies will have to guard against such threats to have a realistic chance to succeed.

Conditions that need to be established: High level of security such that primordial identities are not dominant; polarisation between groups limited or non-existent; numerous opportunities for different groups to intermingle (e.g., schools, overseas fellowships); internal migration between different parts of country easy; mechanisms to arbitrate and enforce contracts reasonably functional; existence of decent road connections between different regions; rise of new entrepreneurial class does not so challenge the status quo that it produces violence.

Kenya: Building Cohesion and Strengthening Ecosystem

Kenya's entrepreneurs and broader business community are among the most sophisticated for a state with numerous conditions of fragility. They are well organised, well-connected with other parts of civil society, and in continuous dialogue with the government. This combination proved critical during the country's 2007-8 electoral crisis, which led to violence that killed over 1,000 people and disrupted much activity in the country for nearly two months.

Both the Kenyan Association of Manufacturers (KAM), which consists of more than 900 firms, and the Kenya Private Sector Alliance (KEPSA), which is the umbrella organisation for the whole private sector, played a crucial role in bridging the divide during the crisis and, later, working to ensure it would not repeat. They advocated for a power sharing arrangement between the two main candidates (which was the final result), using briefing and discussion papers, personal relationships, meetings with the protagonists, cooperation with other civil society actors, paid advertisements in the media, and engagement with members of the international community. Almost all of this was organised, yet informal.

Recognising that civil unrest erodes not only profits but also national cohesion, the business community launched a comprehensive campaign to ensure that the subsequent election, in 2013, would be peaceful. The goal was to influence key actors, spread a message of peace across the country, bring together different parts of society, and set standards of conduct (e.g., importance of using courts to settle disputes). The most prominent of the initiatives was launched by KEPSA and other stakeholders under the My Kenya campaign. This consisted of over 200 peace initiatives over 15 months. The goal was to build citizen awareness, celebrate the national identity, recognise the responsibilities each person has to his or her compatriots, and learn better conflict mitigation skills. Throughout, private sector actors contributed approaches, knowledge, skills, capacities, and influence that were not necessarily within the know-how or institutional reach of others.

Dialogue with the government has also produced a number of reforms that have improved the broader ecosystem and led to the introduction of a number of specific policies helping companies of all sizes. For example, KAM has been able to influence the government to reduce duties on industrial raw material, invest in critical infrastructure, introduce a new investment code, shift its trade policy, and enhance its financial sector reform plans.[xiii]

Reforming Institutions

Top-down institutional reforms have mostly failed in fragile contexts because they don't tackle the incentives that encourage political and economic elites to maintain the status quo from which they benefit. Policies, often imported from abroad, are often divorced from underlying socio-political realities, providing little guidance on how to navigate the political terrain and practically rework institutions, procedures, and practices such that governance actually improves. These efforts can be categorised as supply-driven.

Entrepreneurs, in sharp contrast to elites, have ample incentive to press for improvements in property rights, courts, infrastructure, financial institutions, regulatory regimes, education, and the accountability of government to meet their needs. Such petitions are bottom-up and thus demand-driven, both changing the incentives affecting mid-level officials that actually implement reform and ensuring a greater focus on the micro-level obstacles that often block it. In select cases, entrepreneurs even move into government and leverage their experience to personally reform institutions. Olexandr Starodubtsev, for example, left the top of a financial institution to work in civil society before being appointed head of the Public Procurement Regulation Department in Ukraine's Ministry of Economic Development and Trade. This enabled him to forge close cooperation with business and civil society to create and then introduce a new electronic public procurement system called Prozorro. In India, one of the country's most successful technology entrepreneurs, Nandan M. Nilekani, a founder and former head of Infosys Technologies, managed the introduction of the world's largest identification-card project for the central government.

Whereas larger or well-connected companies can depend on their ample resources and close ties to government to get what they want from the state, entrepreneurs need to identify regulatory, institutional, and social obstacles to progress and tenaciously seek to overcome them. They need to obtain licenses less expensively; move goods across long distances more easily; obtain more consistent electricity supply; improve the security of assets; and ensure contracts are better protected. Working to improve each of these items improves not only the effectiveness of government but also the equity of its services – an important step towards reducing fragility. It also helps other newcomers to enter the market, thus creating a cascading effect over time.

In this respect, entrepreneurs play crucial roles in initiating a wide range of demand-driven, micro-level changes that together can combine to produce substantial reform on the macro (political) level over time. This means that they are key to changing not only the incentives that shape societal relationships – improving social cohesion in the process – but also the incentives that shape the society-state relationship. The more active entrepreneurs are, the more likely society and the state will be partners aligned towards common goals.

In demanding reforms of institutions to meet their rising needs, entrepreneurs hold officials accountable in a bottom-up fashion similar to that of democratic processes – except the democracy being exercised is economic not electoral. Improving the institutional environment for new businesses strengthens the rule of law, administrative efficiency, and quality of public services for everyone. China's economic reforms since 1978 match this pattern very nicely: efforts to improve governance for companies has made everything from schools to courts to roads better for the average citizen. The state may not have democratised, but this process has trained citizens to demand more of their government and made government more accountable to citizens. And, looking forward, as Barrington Moore summarised decades of scholarly opinion, "no bourgeoisie, no democracy."[xiv]

Entrepreneurs also build or strengthen the social and state institutions that bridge and manage conflict better than anyone else because they depend on these more than anyone else. Entering new markets and reaching new customers depends on robust mechanisms to enforce contracts with strangers – who are often on the other side of social and political divides. Entrepreneurs will work across these to create the mechanisms – such as commercial courts or some sort of non-state arbitration institution – that ensure their businesses are protected. Over time, these can become buffers for managing larger social and political questions, as happened in the medieval Europe whose "mechanisms of exchange and credit, as well as… enforcement system to guarantee easy and secure transactions over time and space"[xv] lay the ground work for the stronger institutions that were gradually built up. Somaliland, the Horn of Africa statelet that has thrived since the 1990s, owes much of its success to the role of entrepreneurs in building the mechanisms to manage conflict and – as explained below – build a dynamic economy.

Conditions that need to be established: Institutional reform does not threaten elite accommodation (at least in the short term); enough skilled managers working in institutions to actually improve them; access to technical knowledge where necessary; some limit on the fear of or indifference to reform; incentives, such as greater revenue or income, to improve performance; trust and a history of cooperation between private and public sectors (or at least a lack of antagonism).

Lagos: Reforming Governance

Even though it remains a slum-ridden and largely impoverished metropolis, with an exploding population estimated at 21 million, Lagos has been transformed over the past two decades into one of Africa's most dynamic cities. Steady improvements in its governance have enhanced public transportation, cleaned up streets, upgraded the business environment, and bettered the lives of inhabitants. Entrepreneurs such as Bola Tinubu, a former business executive who was State Governor from 1999 until 2007 and initiated the turnaround, have played a crucial role in these changes.

The deep entrepreneurial culture that pervades in Lagos has produced a dynamic business sector in a relatively short period (before 1999 the country's authoritarian rulers limited its potential), a highly networked set of business associations and civil society, and a close relationship with the city's leadership. The city contains most of the country's manufacturing plants, hosts a set of pan-African banks, and has built a thriving music, fashion and film industry that spans the continent. Its high-tech sector is gaining steam in the flourishing start-up scene.

Recognising their importance, the state government has worked hard to meet the needs of entrepreneurs and the broader business community. As former central bank governor Lamido Sanusi says, "Lagos has transformed. In terms of roads, in terms of infrastructure, in terms of governance, in terms of a general investment environment, in terms of security, the government has given people a greater opportunity to thrive." It is now a template for other states in Nigeria.

Many of the reforms that catapulted the city ahead can be traced to a need for it to raise local revenue in the early 2000s. This forced the state government to provide better services to companies in return for more taxes and fees. The dynamic this started – better services, more revenue – created a virtuous circle. Today, most of the city's income comes from local companies (whereas most central government revenue comes from oil). Lagos's improved entrepreneurial ecosystem has combined with a flourishing cultural scene to lure home many diaspora who have invested in the city's growth, adding another chapter to its successful direction.[xvi]

Catalysing Economic Dynamism

As has long been recognised in developed countries, entrepreneurs are the key to a dynamic economy – to the development of the businesses, managers, linkages, and diversification necessary to build a resilient and flexible economy that can thrive in the face of ever-growing competition and rapid changes in the environment. Although the starting point for fragile states is anything but dynamic – as existing companies are likely to maintain the stale status quo – entrepreneurs can transform an economy over time.

Entrepreneurs are both dynamic by nature and, when reaching a critical mass, the mechanism that brings dynamism to the broader economy. They build organisations that can compete better than existing companies; increase exports that can reduce longstanding dependence on commodities; fill institutional voids that hamper business development; strengthen other organisations by demanding better and newer services; build a cadre of managers who may form their own companies later; attract talent that might otherwise leave the country; and so forth. They are problem solvers that directly tackle the challenges of doing business in a difficult environment, seeing obstacles as opportunities in a way that others may not. By scaling up over time, they can radically change the way business is conducted throughout an economy.

In addition, entrepreneurs act as engines that create the productivity gains that boost incomes, the jobs that expand opportunity, and the wealth that enlarges the middle and upper classes, which play a crucial role promoting stability by how they change the incentives shaping society.[xvii] These companies are important to countries at any stage of development, but are indispensable to weak economies struggling to create robust and inclusive growth patterns.

Places that have built dynamic economies through entrepreneurship – such as Taiwan – have not only thrived economically but also built mature political systems and resilient societies that can withstand great difficulties. In contrast, most economies in Latin America, Africa, and the Middle East remain disproportionately dependent on commodities for growth and anything but dynamic. They grow rapidly at times but cycle through bouts of stagnation and instability. Such growth is erratic and does not produce a lot of high-quality jobs. It benefits few people, creating the deep inequality that scars politics and society. Their problems are at least partly due to their long histories of failing to encourage innovation and the development of entrepreneurs.

Conditions that need to be established: Educated workforce; easy access to markets; good infrastructure; constructive regulatory regime and government and low cost of doing business; officials have an incentive (career, electoral, financial) to support growth; entrepreneurial culture; strong macroeconomic fundamentals; technology research and development institutions; competitive advantages in some sectors; connections to international value chains; business-state cooperation.

Tijuana: Boosting Economic Dynamism and Changing Incentives

Tijuana was hard hit by the 2007-08 financial crisis. Tourism declined by 34 percent. 39,000 jobs were lost in export-driven factories alone, as foreign investment dropped by almost two-thirds. On the whole, employment fell by nine percent. Violence reached record levels partly as a result. Kidnappings tripled, violent theft from businesses grew six-fold, and murders increased by four-fifths between 2006 and 2009.

The city used entrepreneurship to address these challenges – seeing it as a way not only to counter the economic woes but also to change the dynamic of rising crime. A local entrepreneur, José Galicot, drove the creation in 2010 of *Tijuana Innovadora* (TI), which started bringing global business and media leaders to the city on a biennial basis. The forum allows local firms to showcase products to investors, customers, and recruiters. Over time, TI evolved into a dynamic NGO spearheading the city's strategic planning. It developed a set of innovation clusters around specific business sectors, which were eventually brought into a public-private partnership organisation, better institutionalising the whole effort. These clusters leveraged the city's unique geographical advantage – it borders southern California and is thus in close proximity to many technology-driven companies – and relatively inexpensive, highly-educated workforce. Cooperation with San Diego, right across the border, grew.

In conjunction with these efforts, local business associations cooperated with federal, state, and local authorities and security forces. The combined effort helped yield a decline in kidnappings by over one-half, violent theft of businesses by over two-thirds, and homicides by one-quarter by the end of 2011. Meanwhile, foreign investment almost doubled, employment grew by 9 percent, and production by one-quarter. TI also contributed to improvements in the quality of life by catalysing innovation in creative arts, fashion, sports, gastronomy, the environment, and other cultural activities.[xviii]

Changing Incentives

When entrepreneurs grow in size and number, they showcase a new mindset and behaviour that revolutionises ambitions – inducing people across society to engage in the types of constructive business activity that develop a country (e.g., invest in factories and farms) instead of becoming gangsters, criminals, militia members, or even terrorists. After all, without jobs or opportunity, the incentives to undertake violent and predatory actions that weaken society and the state are that much greater.[xix]

The new opportunities and role-modelling entrepreneurs provide can change the behaviour of people throughout society – whether they are directly involved in starting a business or not. This is particular true for youth, whose actions can have an outsized impact on the future trajectory of a country. When young people know that starting a legitimate business can chart a path to prosperity, they are less likely to see conflict with competing groups and stealing from public resources as attractive options, and more likely to work across divides and act in ways that strengthen governance. Such changes, in turn, improve an overall sense of confidence, which makes risk taking in general more attractive. The buzz that permeates an opportunity-rich entrepreneurial society (e.g., China in the 1990s and 2000s) contrasts sharply with the cynicism and frustration that permeates an opportunity-poor society.

Even politicians and government officials can change their attitudes and behaviours, as the most important actors now increasingly come from the productive side of the economy – making those using the old ways of working less influential in the process. Whereas previously there was an incentive to ignore social divisions and protect or profit from illicit activities, now there is an incentive to improve governance and bridge social divisions in a way that ensures long-term stability and more growth opportunities – prerequisites for more investment. Officials thus work harder to enhance and cooperate with these businesses and to stay away from actions (e.g., misadministration, corruption) that might antagonise them.

Conditions that need to be established: Strong incentives discouraging criminality, regulatory capture, risk adversity, and so forth; absence of natural resources; government capacity; potential for economic take-off; presence of skilled labour; high levels of security; power and embeddedness of criminal actors.

Democratisation of Economic Empowerment

A growing entrepreneurial sector can expand (in numbers) and broaden (across identity groups) the middle and upper classes. This can reduce the grievances, exclusion, and disenfranchisement that are often catalysts for conflict, and vest ever larger segments of a population in the existing order, increasing resilience in the process. In doing so, the democratisation of economic empowerment transforms societies.

By expanding access to opportunity and the institutions that regulate business activity, entrepreneurs open up an economy, making it easier for everyone to improve their lot, and enabling people who were previously disadvantaged the chance to become upwardly mobile. By decreasing the concentration of wealth – and thus power – this opening up of the economy increases the impetus for improving institutions and the rule of law, which in turn makes a society (and its politics) more open, equal and productive. And by generating new sources of wealth for broader groups of people, entrepreneurs upend existing patterns and methods of making money and running government, challenging existing power dynamics in the process. The net result over time will be a larger middle class, which will likely produce ever more accountable and competitive politics, with greater pressure to reform and perform. As Kim Bettcher writes, "Entrepreneurship brings new entrants into the economy, displaces incumbents, and develops new markets, thereby generating economic pluralism. Economic pluralism, in turn, contributes to political pluralism. A competitive private sector balances the power of the state and fosters a vibrant civil society."[xx]

Expanding access to new opportunities increases competition, leading to 1) better products and services, 2) the introduction of new technologies, products, and ways of operating, and 3) a whole slew of new business and non-business organisations that eases access for subsequent entrepreneurs and strengthens civil society. Whereas once those in power kept a tight leash on registering and expanding new organisations – limiting access to licenses, money, and so on – in order to maintain their hold on economic rents and influence, now it will be much easier to start a company, service provider, association, or NGO – opening access to moneymaking and political influence in the process.[xxi]

There are many avenues to expanding economic empowerment. For example, M-Pesa, a mobile money platform originally developed by Safaricom in Kenya, expanded access to financial services for the majority of the population who lacked access to the formal banking sector. This increased the ability of people to borrow, save, invest, receive remittances, conduct transactions over great distances, manage risk, and start new companies. The result is greater economic dynamism, financial inclusion, and economic empowerment.[xxii]

In neighbouring Somalia, entrepreneurs have built one of Africa's best and cheapest telecommunications infrastructures despite – or even because of – the absence of a central government capable of providing public services. Competition amongst a myriad of private actors lowered costs and led to the introduction of new services, in contrast to countries such as Ethiopia where a stronger government monopolises the sector. This infrastructure has spawned countless other entrepreneurial opportunities, and enabled businesses to operate in spite of the country's deep insecurity.

The democratisation of wealth creation is especially important for marginalised groups. Women entrepreneurs, for example, are healthier, less vulnerable to violence, and more influential in household decisions. Lower caste or minority groups get greater sway over a whole slew of areas. The Nadars, one of India's lower castes, have become remarkably successful entrepreneurs by cooperating to build up the group's skills, financial resources, dignity, and self-reliance. "We are supposed to be a backward community but we don't think of ourselves that way," says Nadar businessmen C. Manickavel, who went to one of the country's best engineering schools and now runs a million-dollar-a-year business designing e-books for big American publishers.[xxiii] India's SEWA (the Self-Employed Women's Association) has helped its one million members organise over one hundred cooperatives to turn their collective efforts into enhanced economic security. Programmes give members access to markets, create alternative employment opportunities, and establish institutions to provide services such as health care and insurance. Various types of training and capacity-building develop leadership abilities, self-confidence, and life skills.[xxiv]

Conditions that need to be established: Solid and inclusive education system; universities that recruit disadvantaged groups; inclusive angel investors, banks, and financial system; infrastructure that reaches disadvantaged regions and groups; a regulatory regime that does not overburden new entrants; easy access to large market; bridging social networks across groups; constructive attitudes towards women and youth; little or no personal discrimination based on ethnic or religious group; culture that does not penalise failure.

Building Skills

Entrepreneurs develop skills that are in short supply in fragile states and that can subsequently be used to bridge social divides or improve governance. These skills can be broadly divided into two types: 1) hard ones that are essential to running any organisation and are typically taught in business schools, including accounting, finance, and operations management; and 2) soft ones that are typically learned only through practice and that may be uniquely useful for managing the types of conflicts that are common in fragile contexts. The latter include the ability to:

- Manage conflict and disagreement with a wide range of different people and organisations;
- Negotiate agreements;
- Offer an optimistic vision for the future;
- Lead people towards a goal;
- Build a useful social network that helps achieve goals;
- Develop persuasive capacity;
- Develop a wide range of relevant social networks;
- Select appropriate partners – including suppliers, clients, service providers, and state agencies;
- Work with government as a partner and not as an ideological enemy, source of patronage, or target of predation;
- Strategically use the law to achieve particular goals;
- Think strategically about the future;
- Take calculated risks and effectively manage uncertainty;
- Locate, hire, and motivate salespeople, technicians, managers, and so on;
- Develop systematic methods for organising and rationalising business processes; and
- Save and invest financial and social capital.

The elevation of a class of people whose success depends on their results orientation, negotiation prowess, ability to find creative solutions to difficult problems, skill in cooperating with a wide range of different actors, and knowledge about international norms, sets new standards for society at large and empowers a group whose conflict-resolution skills may be useful if a broader conflict over resources or power threatens. In the early 1990s, for example, a few senior activist business executives leveraged their unique skills to play a crucial role in South Africa's transition to majority rule. They created the Consultative Business Movement, a sizeable organisation, which combined with religious leaders to catalyse civil society action to promote peace, provided institutional support and active encouragement during negotiations, and managed potential spoilers who threatened to disrupt elections and the broader transition afterwards.[xxv]

Indeed, unlike most politicians, factional leaders, or crony capitalists, entrepreneurs are likely to have succeeded because of their ability to manage conflict productively and to work with a broad set of actors from across the political spectrum. The combination makes them (and those influenced by the culture they establish) exceptionally well positioned to contribute to reducing the societal and institutional drivers that plague fragile states.

Conditions that need to be established: A large and increasingly influential entrepreneurial sector; large business associations supporting skills development; ample opportunity to learn entrepreneurial skills in school and as an adult; media that actively promotes business ideas; ample mentoring opportunities.

* * *

Countries such as the United Kingdom and United States in the 19th century and Indonesia and Taiwan in the late 20th century show evidence of these dynamics. As the number and influence of entrepreneurs and new businesses grew in these places, the closed systems were forced to open up to greater participation. Yet, because of the high stakes and interrelationships among major actors, reform proceeded peacefully for the most part.

Of course, entrepreneurship can also increase inequality, exacerbate the divisions between groups or regions, empower a minority at the expense of the general population, weaken the state, and produce a backlash from elites who feel threatened by the changes – all of which may increase rather than diminish the chance of violence. Upper castes in South Asia, for example, may use their greater access to resources and government to monopolise the gains from new business development at the expense of lower castes at times. In Southeast Asia, Chinese entrepreneurship has often angered indigenous populations even while enriching countries. In Nigeria, entrepreneurship has expanded the divide between the southern and northern parts of the country. The key is to anticipate such potential downsides in order to minimise the chance that they will occur.

Building the Entrepreneurial Society Bottom-Up

If those are the expected peace dividends of a thriving entrepreneurial sector, how can the right ecosystem be built for them to emerge and develop?

Historically, attempts at developing an economy have emphasised the macro level, with government as the main actor. This has led to an unnecessarily narrow focus on issues such as macroeconomic stability, regulatory reform, incentives for foreign direct investment, tax reform, privatisation, and property rights. This way of thinking is exemplified by the Washington Consensus of the past, and the World Bank's annual *Doing Business* reports of today.

The results have been decidedly mixed – not necessarily because these international policies are wrong, but because they overemphasise one area and mostly disregard other highly relevant approaches. Indeed, there are many countries across Africa, Latin America, the Middle East, and elsewhere that put into place the policies that this top-down model recommends without producing the kind of economic take-off that it predicts because the technical fixes that distant policymakers emphasise ignore issues that are arguably as or even more important. These include the nature of institutions, robustness of social networks, access to financing, risk-taking culture, and other components of a vibrant entrepreneurial ecosystem. There is, for example, insufficient consideration of the many micro-level obstacles entrepreneurs actually face – such as developing relationships with officials, learning how to satisfy local and overseas customers, gaining access to capital, ensuring contracts are kept, and locating key human resources.

As such, there is a need to develop a complementary bottom-up approach that emphasises the need to proactively develop an entrepreneurial society and ecosystem. There are broadly three interventions that comprise this bottom-up approach.

The **first** builds up the various components of the ecosystem itself, including the basic infrastructure, financing mechanisms, policy framework, and culture. While a government body (e.g., presidents' office, economic development board) should ideally take the lead, there often is none able or willing to do so in fragile contexts. As such, some combination of international actors (e.g., multilateral bank, donor agency) and local non-state actors (e.g., university, bank) may be the only option for kick-starting the process.

The **second** intervention involves replication of what the better business incubators achieve in more developed countries. Working at the firm level, these carefully screen companies and then directly mentor the entrepreneurs in a wide range of areas, such as management; marketing; accounting/financial management; gaining access to banks and investors; networking; training; business etiquette; regulatory compliance; strategic partnerships; technology commercialisation; and intellectual property management. The goal is to support the entrepreneur financially and practically so that he or she will be able to establish and grow a new company. This can be done by a private local or international incubator located in a university, chamber of commerce, or even an angel investor network.

The **third** intervention requires working directly with entrepreneurs to improve how key institutions actually function, enhancing the ecosystem through a series of micro interventions. Many obstacles to entrepreneurship are, in fact, non-regulatory in nature, and only identifiable through direct experience at the micro level. In this regard, public-private dialogue with the goal of creating feedback mechanisms to improve policy design and implementation and reduce corruption and state capture are essential. Many infrastructural and institutional problems (e.g., institutional voids) are not apparent except from first-hand experience or particular to small companies that lack the type of influence and resources that larger corporations have. In fragile states, regulatory bottlenecks typically affect different businesses differently, depending on the socioeconomic class or ethnic background of the owner. Access to financing and financial services may differ by the size of company and location or ethnic background. Social networks may be highly exclusive, preventing many ambitious people from ever accessing the type of opportunities that elites have. When the state is unable to play a constructive role, it is once again a leading nonstate actor (e.g., university), foreign entity (multilateral bank), or entrepreneurial association that may have to lead such reform efforts.

Of course, in the most fragile contexts, none of the usual suspects may be positioned to steer the change process. Governments may be too weak, other local institutions may be too impotent, and international actors may be limited in their capacity to play a constructive role. In such cases, only local entrepreneurs can lead the effort in building an ecosystem for these actors. They will need to proactively build companies while playing constructive roles in society and politics, as happened in Lagos, Nigeria. Of course, progress will be faster if there is some government good will (or at least ambivalence); in repressive contexts, however, even this may not be forthcoming.

Nevertheless, if enough change can be produced at the micro level in the short term, then substantive change at the meso and macro levels will be evident in the medium term as many small changes accumulate, reshaping the socio-political dynamics and the context for peace such that:

- On the micro level, many organisations and people that interact directly with entrepreneurs change their behaviour. New technology is adopted, new methods of working are spread, and new skills are learned. Innovation becomes more common.

- At the meso levels, the accumulation of the micro-level effects creates a cascade as more and more organisations and individuals adapt. Changes go well beyond the initial interaction with entrepreneurs to reach components of the ecosystem, including parts of the government.

- At the macro level, ever greater piecemeal change filters throughout society, multiplying its impact over time. The entrepreneurial ecosystem improves, begetting ever more change agents. A better socioeconomic and socio-political landscape produces more sustained and broad-based demands on government. A virtuous cycle may begin.

The goal of these three levels of intervention is to create a virtuous cycle of entrepreneurship that leads to ecosystem reform and then more

DIAGRAM 3: THREE-TIER EFFECT OF ENTREPRENEURIALISM

EXTERNALITIES **Micro Level**	SOCIAL SHIFTS **Meso Level**	GENERAL EQUILIBRIUM **Macro Level**	FINAL PICTURE
Knowledge dissemination Increased rate of innovation Network effect Spillovers	Increase in human capital Increase in social capital Shift in social norms Incremental improvement in ecosystem	Reduction of barriers to entry Increase in value-added products Increase in employment Increase in demands on government Larger-scale improvement in ecosystem	Shifts in equilibria Self-sustaining virtuous cycle Improvements in incentives More dynamic economy Greater inclusiveness Reduced fragility

Mechanisms: Cumulative causation, feedback effects/multiplier effects, social reciprocity, competions

entrepreneurship. The more influential entrepreneurs become, the better the environment and support system will be for newcomers, further increasing their influence over time as their numbers grow. The development of an entrepreneurial cluster eventually lowers risks and costs for all companies, leading to a multiplier effect on a whole region or country.

Conclusions and Recommendations

As has been widely recognised, fragility threatens a number of important international goals, including those related to terrorism, security, migration, poverty reduction, and economic growth. Yet, despite decades of effort and billions of dollars of investment, progress on addressing fragility has been thin. And the problems fragility poses are likely to worsen in the years ahead as various international forces – including climate change (which can worsen economic conditions), proliferation of weapons (which can empower non-state actors), growing importance of new communications technology (which can augment polarisation), and rising international divisions (which often exacerbate internal divisions) – work to increase the stress on weak states.

Entrepreneurship thus offers what is widely needed – a new focus that offers much promise if properly applied. Just as social and political entrepreneurs can drive change, so can business entrepreneurs. But whereas the former two groups are often constrained by the lack of revenue to grow (and hire), places in the public square to operate, and personal profit to earn, business entrepreneurs have none of these limits. If they can succeed, they will be self-financing, have ample scope to grow and expand, and create returns that provide ample incentives.

They can thus expand and multiply their influence in a way that other change agents cannot, offering a unique mechanism to assist in reconfiguring a society. In fact, the social and political spill-over effects of investing in entrepreneurship and the entrepreneurial ecosystem can be so great as to make such investments worthwhile regardless of the economic implications.

The goal should be to create an entrepreneurial culture that nurtures change agents who will look to promote reform in every direction. The more the entrepreneurial ecosystem dynamically nurtures such agents, the more likely they will appear and multiply. And the more these change agents are empowered and linked up, the more likely the constellation of forces throughout a society promoting reform will gain strength.

Of course, such a process takes a sustained commitment over a long time horizon. But that only reinforces the importance of focusing on local entrepreneurs who, more than any international, have a significant stake in the endeavour and thus are likely to have such staying power.

This is why it is especially important for international actors to listen to entrepreneurs, as a World Bank book on firms coping with crime and violence concludes. "Their knowledge, ingenuity, urgency, and flexibility show how individual firms adapt their operations and markets… The challenge is to capture this information in the context of its environment and institutions; prioritise 'best fit' interventions; and tailor a process that would help strengthen the private sector ecosystem."[xxvi]

Ecosystem reform represents a huge opportunity, but as the effect shows itself most clearly in the long term, it is often rhetorically supported and then set aside – by both local leaders and international donors – in favour of short term, political necessities. Reform will thus likely be more successful if a few quick wins can highlight what ecosystem reform looks like. This builds momentum and sustains actors through the inevitable setbacks that will appear from time to time. Elite buy-in can help – but may be hard to achieve in some contexts.

The more entrepreneurs (and business people in general) and politicians and policymakers can learn to speak the same language, the more likely cooperation across the sectors will flourish and a social consensus around change will develop. Too often, they speak past each other, with negative consequences. This points to the need for smart communications strategies for entrepreneurs, for the platforms that bring them together, and for any outside actor seeking to assist. Good communications can mobilise consensus, as well as help shape the image of a place as entrepreneurial where it previously was not – both to locals as well as others.

With all of this in mind, a synthesis of the various data and analyses yields the following ten recommendations:

1. **Assess** the ecosystem to identify components in need of improvement, bottlenecks holding back entrepreneurs, and any incentives discouraging the necessary changes. But use a tool (or develop one) that is adapted to work in poor, fragile contexts, as most existing tools are for use in developed contexts. Then create a national "entrepreneurial ecosystem" action plan that incorporates the results.

2. Build up the **capacity of government** to design and implement public policy, especially as it relates to entrepreneurship. Create feedback mechanisms that can translate insights from entrepreneurs directly into public policy design and implementation. Create **islands of excellence** – mini ecosystems that can nurture and showcase entrepreneurship – where contexts are especially difficult.

3. Find a **leadership champion** who can steer change. The person – who can come from either the public or private sector – needs to be capable and senior enough to mobilise different actors across government, the private sector, and academia to be effective. In some cases, a strong government agency or private organisation (such as the Chamber of Commerce) can play a similar role.

4. Introduce **entrepreneurial training** and a culture of creative thinking, risk management, and acceptance of failure into universities, high schools, and even primary **schools** in order to develop as many agents of change in a society as possible. Extend the use of entrepreneurial training, mentoring, and practice to as wide an audience as possible; these can produce important behavioural changes and are correlated with the various positive spill-over effects outlined above.

5. **Support new venture formation and development** by establishing business incubators, entrepreneurial training programmes, opportunities for mentoring, mechanisms to increase access to financial capital, tax and other incentives (especially for violent or formerly violent areas), and regional development agencies.

6. Attract **pioneering investment** in strategically-chosen sectors that can create ample spillover effects, as Bangladesh did with textiles and China has done in a wide variety of sectors. Use devices like tax incentives, special infrastructure investments, and economic zones, as necessary.

7. Build **platforms** that bring together constructive entrepreneurs so that their ability to act collectively is enhanced. These platforms can pool resources, develop value chains, fill institutional voids, mentor and practically assist entrepreneurs to overcome the various problems they face as they grow (e.g., accounting, human resources, contracts), and push for broader systemic change. Public-private forums – PPFs – can work with governments to reform regulatory requirements or work with security forces to reduce violence, which is especially important when incentives encourage destructive entrepreneurs.

8. **Promote a culture of entrepreneurship** by publicising the achievements of successful entrepreneurs in the media, schools, and various organisations so that they become known as heroes. As a complement, lionise some entrepreneurial failures and proactively help those who have failed to get back on their feet so as to make risk taking more culturally acceptable.

9. Invest in **women and youth** entrepreneurs, as these have a multiplier effect across families and generations and are often the most underutilised creative force in less developed countries, which can be dominated by older men. For example, develop schemes that promote women and youth entrepreneurship (business plan competitions, meetings with investors, public lectures, small business funding windows, etc.). Where possible, encourage women and youth input into broader decision-making.

10. Leverage **international actors** when necessary: multinationals can be required to build infrastructure, invest in universities, buy from local businesses, and take various other steps that helps strengthen the ecosystem. The United Nations and other international organisations – which are often major players in post-conflict or fragile settings – can be required to use local banks and contractors whenever possible. In addition, membership of or affiliation with a regional or multilateral organisation can be used as an anchor to set standards, arbitrate disagreements, and hold governments accountable for commitments.

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ENDNOTES

i These are “innovative entrepreneurs,” not “necessity entrepreneurs”. The latter start a business due to a lack of economic opportunity (e.g., street vendors, small-time goods traders) and never employ anyone beyond their family.

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