

Roadmap for DFI Investment in Somalia

Report
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Authors: Hodan Osman, Ayan Osman and Dozie Ibekwe
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Executive Summary



Context

- The goal of the study was to **develop a roadmap to increase investment in Somalia from development finance institutions (DFIs)**
- The **concept was launched by the EU Delegation in 2019** and builds on the EU External Investment Plan (EIP)
- At the EIP Outreach Event for Somalia, **investors discussed challenges in Somalia such as regulation, infrastructure and security**
- **There is work in progress to address structural issues**, for example, through regulatory reform and successful early movers in investing in Somalia such as Gargaara, a PPP lending program



Case for change

- **Fragile states need DFIs for patient capital**, technical assistance and signaling effect
- **The early investment successes** such as Shuraako, an SME financing program, **make a case to increase engagement in Somalia**, as well as actions taken by government to improve the investment climate
- DFIs have articulated interest in investing in Somalia **but need support to navigate constraints**



What we did

- Over eight weeks, **we conducted over 30 interviews with different stakeholders**, including representatives from the Somali government, the Somali private sector, DFIs and development partners
- We **focused on understanding the obstacles and constraints to DFI engagement** in Somalia, and developing potential solutions
- Per findings from our interviews, we **designed a roadmap and collaborated with key stakeholders** to refine the approach



Findings and recommendations

- **Key challenges to DFI investment in Somalia include:** limited access to market information; misalignment between DFI risk profile and fragile markets; weak and unstable financial services; lack of trust in business environment; and limited market capacity and size
- The roadmap was designed to be **coordinated, adaptable and multisectoral in approach**
- Some specific recommendations include: **adoption of separate strategy for fragile states**; shared resources and pooled funds; and targeted early support for private sector readiness

Introduction

This study is a high-level exercise to capture views of key stakeholders and serve as a step towards a coordinated response with practical solutions

This study is ...

- A snapshot **of views and perspectives of the key stakeholders** interviewed
- A **basis for better understanding the nature of the challenges** and barriers through the lens of DFIs
- Focused on the **most binding constraints in the initial stages** of DFI engagement
- A **practical approach to prioritizing actions** that can be taken immediately
- A first draft for designing a more **coordinated and integrated view of a shared roadmap**
- A view of the **roles and activities for different stakeholders**

... but is not ...

- A **comprehensive, empirically validated study** of all the challenges
- An extensive and exhaustive **root cause analysis of all the barriers** facing DFIs
- An **analysis of macro level structural challenges** such as nascent financial sector, limited regulatory and legal framework and enforcement, lack of payment infrastructure, etc.
- **A comprehensive assessment of the private sector and financial sector**; rather the focus is on the DFI engagement in these sectors
- **Exhaustive list of recommendations**; in particular macro level recommendations are not addressed

Note: Although this study touched on unemployment and SME growth, these issues are mainly out of scope, including coverage of underrepresented groups such as women and youth. These findings require further investigation and are not to be generalized.

Macro picture of Somalia challenges should not deter DFIs from early engagement

Though vibrant, Somalia's economy continues to be fragile and underdeveloped

- **Much progress has been made in Somalia across all fronts** – political, economic, social and security. There is need for the external **narrative to catch up and accurately reflect this progress.**
- **Work continues to address structural challenges** relating to nascent public institutions with varying degrees of capacity
- Political environment is more stable in some areas in the country than others and further consistency and cohesion is needed. **Similarly, insecurity is more rampant in certain parts of the country.**
- **Financial sector requires further regulatory oversight** and needs to be fully aligned to international standards and systems, such as AML/CFT
- **Financial intermediation remains weak** and there is lack of payment systems to facilitate transparent flow of funds
- **Highly informal private sector** operating under opaque conditions
- **Broader macro structural challenges need to be addressed** including limited infrastructure, inconsistent coverage of legal frameworks, human capital underutilization, lack of access to finance, high cost of energy, etc.



DFI engagement is key to development

- **These challenges should not deter DFIs** but encourage early engagement as part of the reform process
- **Waiting for a perfect investment environment** or for mature private sector reforms **decelerates the development** of fragile states
- DFIs should be **proactive in identifying opportunities** and creative in seeking ways to mitigate risk
- By working with one another and with other stakeholders, **DFIs can broaden their options for early engagement**
- For example, DFIs may **engage early by sharing knowledge and building capacity**, with a multiplier effect

Findings

Somalia faces multiple constraints to growth and they have been exacerbated by COVID-19

High level growth diagnostic indicates that Somalia is facing multiple constraints to growth*



However much progress has been made and reforms are currently underway to address these constraints

Social & Environmental Constraints	Government Constraints	Market Constraints	Financial Constraints
+ Poor infrastructure (e.g., road, ports, etc.) + Low utilization of human capital + High cost and limited supply of energy + Gaps in meeting skilled labor needs	+ Weak regulatory oversight and enforcement + High political & security risk + Monetary & fiscal instability + High micro risks relating to cost of doing business e.g., property rights, contracts	+ Under-developed industries + Lack of growth/new entrants to market + Weak competition + Coordination failure + Asymmetric information	+ Limited access to external finance + High cost of local financing (high rate, short duration) + Weak financial intermediaries + Low investments & savings

- **At a macro level**, the government has made progress on **meeting the structural benchmarks under the IMF Staff Monitoring program** and Somalia is in the process of accessing concessional financing
- **Legal and regulatory frameworks** governing AML/CFT, public finance management, investment, quality standards and specific sectors such as telecommunication have been passed
- The government has made **strides in the security sector reforms**, especially in transparency
- The implementation of **tax policy reforms increased transparency and accountability** over public institutions and resources, and **revenue collection has increased**
- Somalia National Development Plan lays out infrastructure needs, **and the framework Public Private Dialogue framework is established**
- The Central Bank of Somalia improved its inspection capacity and launched institutions to combat money laundering, **strengthening its capacity to regulate the financial sector**
- The government has **initiated a process to refine and streamline aid architecture** and improve the efficiency of coordination structures
- Development partners such as EU are supporting the government with **projects focused on developing productive sectors**
- **However, structural issues still remain and the COVID-19 pandemic exposed pre-existing vulnerabilities** that need to be addressed through structural reforms
 - **Flow of remittances to Somalia has been impacted**; additionally, there is a decrease in trade activity and economic loss due to restrictive measures, and pressure of a struggling healthcare system
 - There are new threats stemming from COVID-19 such as disruption to supply chains

*Based on Hausmann-Rodrik-Velasco Growth Diagnostics Decision Tree

Particularly, market and financial constraints are the most immediate

High level growth diagnostic indicates that Somalia is facing multiple constraints to growth*



... and this study focuses on market and financial constraints

Social & Environmental Constraints	Government Constraints	Market Constraints	Financial Constraints
+ Poor infrastructure (e.g., road, ports, etc.) + Low utilization of human capital + High cost and limited supply of energy + Gaps in meeting skilled labor needs	+ Weak regulatory oversight and enforcement + High political & security risk + Monetary & fiscal instability + High micro risks relating to cost of doing business e.g., property rights, contracts	+ Under-developed industries + Lack of growth/new entrants to market + Weak competition + Coordination failure + Asymmetric information	+ Limited access to external finance + High cost of local financing (high rate, short duration) + Weak financial intermediaries + Low investments & savings

Focus Areas

As much work has been done in assessing and developing reform programs targeted at macro level constraints, **this study takes a more micro and practical approach to assessing constraints, focusing on actions that can be taken to promote early engagement of DFIs**

Through our interviews we **identified five thematic challenges facing DFI engagement** that mainly fall under market and financial constraints

This roadmap lays out actions to address these types of immediate challenges to early DFI engagement, while the larger reforms to improve the investment climate are underway

*Based on Hausmann-Rodrik-Velasco Growth Diagnostics Decision Tree

From interviews, we identified five thematic challenges with implications for the design of the roadmap

	A Limited access to market information and reliable partners	B DFI risk profile misaligned with fragile markets	C Weak and unstable financial services	D Lack of trust and opaque business environment	E Fragile market with limited capacity and size
Quotes	“ <i>It costs a lot for us to start engaging; I need to worry about security, logistics, and I don't even know what's out there yet</i> <i>Specific and niche data is missing; it is just as important to understand fisheries, real estate, electricity sectors, etc.</i>	<i>The deal approval takes too long for Somalia; we are spending a lot on getting waivers for everything</i> <i>We are taking a step back due to uncertainty of the market; there are just some markets that don't make the first cut</i>	<i>I was able to get a loan because someone high up in the bank knew me and my family</i> <i>The banks don't have the ability to screen credit history of customers or eligibility for loans</i>	<i>Business will not even share their plans for fear that someone will take their idea</i> <i>There are no reliable professional services here; even though there are people who have the capacity to do so, it is not really seen as a viable business</i>	<i>You have to kiss a lot of frogs to find a prince (quality company)</i> <i>A challenge is finding the right partner with the right opportunity within our limits</i> ”
Implications for Roadmap	Roadmap should address ways in which collaboration and exchange of information can take place in a more structured way	Roadmap should call for a separate engagement strategy for fragile states, that will not compete with more developed markets, e.g., Somalia-specific fund with different mandate and constraints	Roadmap should be linked with reforms targeting financial sector and ensure early actions include partnering with local financial institutions, for example, to build capacity within banks	- Roadmap should explore ways to leverage existing entities or funds as platform to begin engagement - Leverage pooled technical assistance in due diligence work	Roadmap should consider options or pathways for low-risk involvement in the market to learn and accelerate investment readiness

We probed further to understand specific challenges

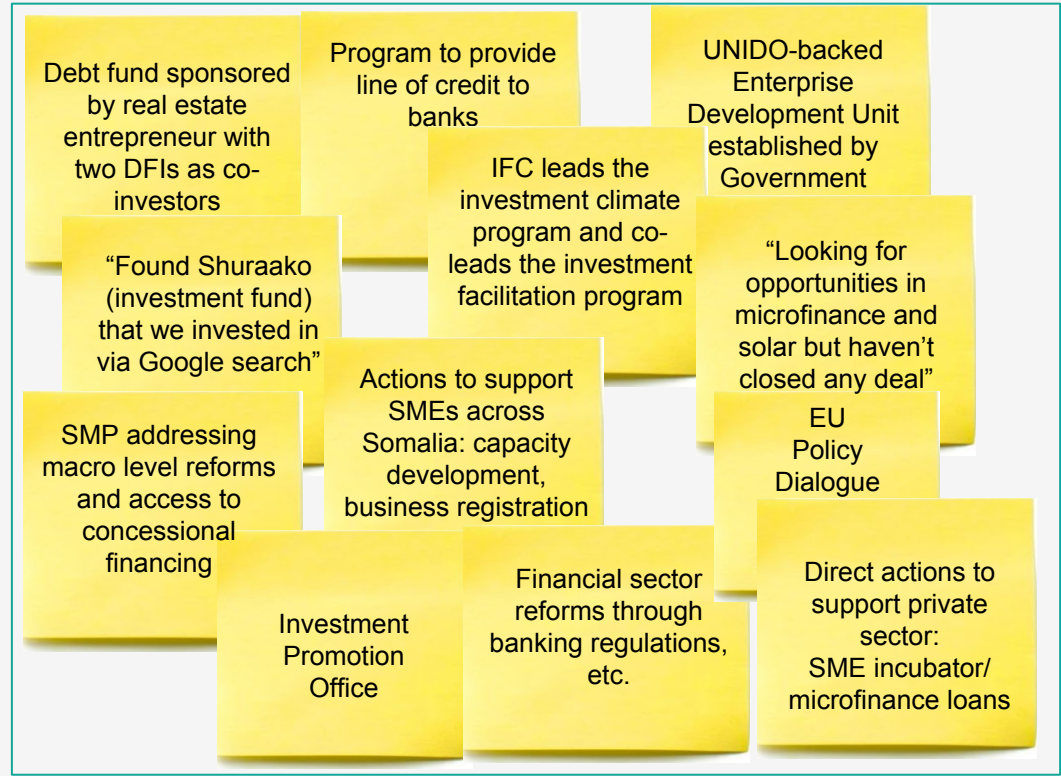
Challenges

A Limited access to market information and reliable partners	B DFI risk profile misaligned with fragile markets	C Weak and unstable financial services	D Lack of trust and opaque business environment	E Fragile market with limited capacity and size
- Limited public information on market and companies - Market information is often unreliable - Lack of understanding of the market and a high cost associated with learning and experimentation - Limited information exchange between DFIs and foreign players in Somalia - For example, NGOs may not share information due to competitive advantage of data and difficulty/cost of gaining market knowledge - DFIs do not have the necessary information or relationships to find partners in Somalia	- DFI risk managers may be focused on retaining high credit rating - Projects and companies in Somalia compete with those in lower risk markets such as Kenya - DFI investment officers are disincentivized to focus on Somalia as per higher risk, higher transaction cost and lower ticket size - For example, an investment officer may have to deal with reputational risk to convince an investment committee to approve investment in Somalia over alternative opportunities in other developing countries on a case by case basis	- Banks are unable to give long-term loans due to inadequate funds and liquidity mismatch - Banks may be forced to maintain high liquidity to respond to customers' frequent and short-term withdrawals of deposits - Limited financing is extended with high rates, short duration and high collateralization - Uncertainty about the requirements of Islamic financing and banks handle this differently - There may not be enough of an incentive for banks to innovate and deliver new products	- Limited regulation and requirements leading to difficulties in verifying legitimate businesses and conducting due diligence - Lack of audited financial statements and low level of sophistication make it challenging to understand business prospects - Business owners are skeptical of sharing information to protect competitive advantage - Lack of large anchor businesses and business clusters reduce pace of evolution of value chain - High single transaction cost due to lack of economies of scale or shared resources	- Market not accustomed to equity investment as equity investment is less common than loans - Entrepreneurs are more comfortable with loans than equity - Lack of understanding of structuring big deals and preparing bankable projects - Large projects are hard to come by considering the nascence of the private sector - Minimal experience with structuring complex deals - Focus of financing on smaller projects

Roadmap should bring together actions currently occurring in silos to achieve shared purpose

What it looks like today...

Much reform activities are underway at micro and macro levels but some are occurring in silos and alignment to DFI investment is unclear 



What targeted success can look like...

Value of roadmap is in being proactive about DFI engagement addressing push/pull factors and organizing around coordinated set of actions

Proposed roadmap has three principles:



Coordinated Action

Roadmap has clear set of coordinated actions supported by shared or pooled resources, and facilitated by convening actor(s) for prioritization and collaboration



Adaptable Approach

Engagement strategy allows for flexibility and different actors to engage at different stages



Multisectoral Involvement

Clear roles for stakeholders across sectors, with support from convening actor(s)



Roadmap



Coordinated Action

Coordination between stakeholders and across programs is critical to overcome challenges



	A Limited access to market information and reliable partners	B DFI risk profile misaligned with fragile markets	C Weak and unstable financial services	D Lack of trust and opaque business environment	E Fragile market with limited capacity and size
1 Adoption of shared principles and strategy for operating in fragile states, specifically Somalia		✓	✓		✓
2 Effective mechanism for DFI coordination and collaboration including key stakeholders that serve as convening actors	✓			✓	
3 Shared and pooled resources to allow for risk reduction, increase in market knowledge as well as relationship and trust building	✓		✓	✓	✓
4 Targeted support for private sector readiness working with key stakeholders (e.g., government and development partners) on priorities	✓	✓	✓	✓	✓
5 Special consideration for improving the financial sector as key part of DFI engagement strategy	✓		✓	✓	✓



We found different opportunities for coordination between stakeholders

Highlighted below are some of the key recommendations:

1

Adoption of shared principles and strategy for operating in fragile states, specifically Somalia

- Top-down mandate for **differentiated fragile state investment strategy aligned with Somalia context**, e.g., longer investment horizon, higher risk and allow for volatility
- **Align incentives for investment team to prioritize early engagement in Somalia by creating funds specifically for Somalia**, and lobbying DFIs and member countries at the political level to support this

2

Effective mechanism for DFI coordination and collaboration including key stakeholders that serve as convening actors

- **Forum for DFIs and key stakeholders including government representatives to collaborate**, share best practices, and identify and remove obstacles
- Convening actor from development partners to **manage forum or DFI-funded “secretariat” in partnership with government**

3

Shared and pooled resources to allow for risk reduction, increase in market knowledge as well as relationship and trust building

- **Co-investment in existing or new funds that target SMEs and current companies** in the short-term while developing pipeline for large projects and companies, **as well as alternative deal structures**, e.g., using profits to buy out investors over time
- Share market development cost through **pooled funds for market studies, feasibility studies, technical assistance, et cetera**

4

Targeted support for private sector readiness working with key stakeholders (e.g., government and development partners) on priorities

- Coordinate technical assistance to address **identified private sector gaps, such as corporate governance and accounting standards**, in collaboration with trade associations and existing platforms such as Shuraako and Gargaara
- Similarly, provide **technical support to support public sector gaps such as contract enforcement and ease of doing business**

5

Special consideration for improving the financial sector as key part of DFI engagement strategy

- Prioritize **support for local financial institutions, for example, training for AML/CFT, risk management, Islamic finance**, et cetera
- Launch **accelerator program to prepare financial institutions** such as banks for investment



Coordinated Action (I/V)

1 Adoption of shared principles and strategy for operating in fragile states, specifically Somalia

Diagnostic Insights

What is the problem?

Key Recommendations

What needs to be done?

Country Specific Actions (Examples)

What does this look like?

- Though at a high level there is rhetoric calling for more funds to be channeled to fragile states, this has not translated to implementation at the country level due to misalignment of both risks and incentives.
 - With poverty becoming more concentrated in fragile states, they cannot continue to be overlooked for more developed markets.
 - DFIs need to make a distinction between fragile states (post-conflict) and developing markets, adopting an investment strategy specifically for fragile states based on a set of principles tailored for frontier and uncertain environments. This mandate needs to be clear and top-down.
 - As part of the new strategy, rethink benchmarks for success, accepting longer time horizons, higher risk and allow for volatility. In addition, introduce new benchmarks that incentivize learning by doing, building relationships and laying the groundwork for pipeline of potential projects.
 - Behavioral shift from simply evaluating potential investment targets to being more proactive in opportunity generation. DFIs should come in early and partner with existing actors in private and public sector to better understand the market and support market development.
 - Establish funds at either regional or country level that are earmarked for fragile states with clear investment targets. These funds may come with de-risking tools, such as blended financing or guarantees. This will ensure that fragile countries such as Somalia are not competing for investment with more developed countries such as Kenya.
 - Change the negative narratives around investment in fragile states using evidence of positive results that can be replicated and scaled.
-
- Adopt a common DFI engagement strategy for Somalia with shared set of guidelines, tools and training to support investment managers to operate in fragile environments that is context specific.
 - At a practical level, develop shared approach for operationalizing country level risk and conflict assessments.
 - Consider pilot programs to support investment preparation. This can be in a form of establishing separate investment funds for Somalia that will create incentives for the DFIs to meet targets. Create a forum of investment professionals seconded from multiple DFIs to develop investment strategy in Somalia.



2 Effective mechanism for DFI coordination and collaboration including key stakeholders that serve as convening actors

Diagnostic Insights

What is the problem?

Key Recommendations

What needs to be done?

- Limited information exchange between DFIs and other foreign investors in Somalia, for example due to perceived competitive advantage of data, lack of convening forums and limited knowledge of actors already on the ground.
- Though many institutional reforms are underway at a macro level, there is a lack of coordinated effort to promote direct investment.
- Bring together DFIs and other relevant stakeholders into an organized and regular forum where barriers to private investment are identified at country level and collaborate with governments, development partners and other stakeholders to remove them. This should be focused on the most binding direct constraints on early engagement and can mature over time.
- Regularly share lessons learned during these forums, building on collective knowledge and experience.
- Create clear value proposition for collaboration to minimize need to withhold information for competitive advantage.
- Fully collaborate on activities leading to investments to build the pipeline of projects. Hold regular dialogue with development partners and government actors to manage financial and non-financial risks, and work together on reforms. This will make it easier to identify where the development partners might intervene to remove blockages in the investment environment.
- Cooperate on shared services and approach leading up to investment, such as undertaking diagnostics and assessments of country or sector. Agree on common methodology to ensure the needs and requirements of all DFIs are met. This presents another opportunity where development agencies can lend technical assistance (TA).
- Create pool of fund to support this forum and/or set aside funds tied to addressing DFI specific activities for promoting or easing engagement, e.g. TA support for providing standard ESG impact assessment tools and mitigation measures, access to professional services, etc.

Country Specific Actions (Examples)

What does this look like?

- Build on existing Public Private Dialogue forum and initiate a sub-stream that is specifically for DFI engagement agenda.
- Select convening actor from development partners that can take on the coordination/support of this agenda in partnership with government.
- This can be the forum where the shared roadmap/strategy to address barriers can be monitored. This forum can be used to adopt and publish the shared principles, guidelines and best practices for fragile states (similar to mutual accountability framework).
- Through this coordination forum, establish specialist teams (through secondment or consultancies) to take on the shared services such as country risk assessments, evaluation of new projects, etc.
- Provide TA to Somalia Investment Promotion Office to support the coordination activities and respond to DFI needs.



Coordinated Action (III/V)

3 Shared and pooled resources to allow for risk reduction, increase in market knowledge as well as relationship and trust building

Diagnostic Insights	• DFI risk profile is misaligned with fragile markets, with high transaction costs, including finding and structuring opportunities as well as conducting due diligence. • Accessing reliable market data is difficult, trusted intermediaries are limited and finding local partners and projects requires significant lead-time and know-how.
<i>What is the problem?</i>	• Sponsorship of market studies and sector specific analysis for the consumption of entire forum of DFIs. Other types of upfront shared analysis can also include political economic analyses, private sector-focused fragility assessments, feasibility studies, conflict analysis, etc. • Use of existing funds in Somalia that have the market knowledge and relationships for channeling capital into the market, for example, at first targeting debt financing for SMEs and providing options for scale. • The transaction costs in fragile markets of finding, conducting due diligence, and structuring these opportunities are often quite high. There is potential to share resources for investment facilitation and transaction support activities. This can be funded by development partners. • There is a need for reliable partners with local expertise when operating in these types of high environments. Seek opportunities to bring in these local expertise into shared facility. These local expertise can be leveraged for performing due diligence, and other types of professional services for companies. • Encourage co-investment with other DFIs into pooled funds, including existing funds. This can also allow for standardization of appraisal, environmental, social, and governance standards, etc. • Introduce risk sharing through establishing pooled funds that allow for blended finance, guarantees and other instruments.
Key Recommendations	• Hold formal meetings to share learnings from existing funds, e.g., Shuraako and Gargaara, with DFI forum. Seats on Board of Directors/ Advisors for these funds reserved for DFIs. • Provide TA to conduct and issue market studies and other types of assessments through shared services linked to the coordination forum. • Establish channel to request data from forum with support from Somalia Investment Promotion Office while the office plays key role in forum. • Create pooled fund for phase of discovery to test what instruments work best in this context and design and share best practices/standards. • Consideration given to DFI target industries and preferred funding models (e.g., debt versus equity) in design of subsequent exiting funding
<i>What needs to be done?</i>	
Country Specific Actions (Examples)	
<i>What does this look like?</i>	



4 Targeted support for private sector readiness working with key stakeholders (e.g., gov't and development partners) on priorities

Diagnostic Insights

What is the problem?

- Though fragile state markets are underdeveloped and have weak regulations and institutions, waiting for the investment climate to reform prior to DFIs engagement is not ideal. DFIs should see themselves as part of the reform process.
- Highly informal private sector operating in an opaque business environment, with limited pioneering firms that allow for growth.

Key Recommendations

What needs to be done?

- Though there is much benefit in inclusive development targeting micro businesses and loans, there needs to be differentiation between providing access to finance for subsistence versus growth. DFIs' role is better suited for the latter and on investments that have greater impact on the market ecosystem.
- DFI investments should aim to be catalytic and support the growth of pioneering firms that ease the way for clusters of other firms to follow. Due to the nature of fragile states, DFIs need to engage much earlier with the private sector and be more proactive about creating a pipeline of projects, including coordinating/supporting efforts by other development partners to strengthen private sector.
- Together with other relevant actors, DFIs can identify immediate gaps for engagement and mobilize coordinated TA support for actions such as building capacity for corporate governance, accounting standards, market assessment, project formulation, etc.
- On the public sector end, similar TA needs can be provided to address market frictions such as lack of formal contract enforcement, assessing legitimacy of firms, information flows, ease of doing business, etc.
- Dedicate funds to support private sector readiness such as TA to companies garnering DFI interest for investment readiness. If DFIs do not have a TA program, they can partner with other development partners to build critical business skills and provide rigorous environmental and social impact assessments, and mitigation measures.

Country Specific Actions (Examples)

What does this look like?

- Provide TA to government (coordinated through Investment Promotion Office) to play active role in identifying and structuring large projects and engaging DFIs on such projects.
- Provide TA in supporting private sector in forming trade association that will better organize the private sector to self regulate.
- Undertake services that provide access to professional services such as accounting, auditing, legal and other costly activities that pioneering companies need.
- Earmark additional funds to support investment preparation, for example, grants to help target companies meet ESG requirement.
- TA projects to help understand the market, providing business intelligence and identifying potential clients. There needs to be a more systematic effort to integrate TA projects into investment operations.



5 Special consideration for improving the financial sector as key part of DFI engagement strategy

Diagnostic Insights

What is the problem?

- As DFI investments are concentrated in the finance sector, it is critical that the financial sector in Somalia does not remain a barrier to entry. DFIs should find ways to integrate improving the financial sector in their investment strategies and technical assistance activities.

Key Recommendations

What needs to be done?

- Much is already underway to support financial sector reform at a macro level, with banking regulations underway, implementation of AML/CFT supported by National IDs, national payment systems, currency reform, etc. Taking a DFI lens into the prioritization of these reforms may be useful in determining what practical actions can be taken now and what stop-gap measures can be in place while these reforms mature.
- At a micro level, DFIs and development partners can work with the local financial institutions to provide direct technical assistance on capacity gaps identified such as expanding Islamic finance instruments by linking Somali banks with Sharia boards from other Islamic countries.
- Provide courses/training in areas where the constraints are similar across the industry and focus is on meeting industry standards, e.g., AML/CFT, options for risk assessment in fragile/uncertain environments, etc.
- Launch accelerator program to prepare financial services companies for investments and expose promising companies to DFIs.
- Use existing funds that issue financing through local banks to help target creation of new markets (productive sectors), population segments, different company sizes and introduce new products and terms. This will allow to test the market to better understand businesses, risk profiles, and encourage more appropriate loan terms. In addition, less mature financial instruments such as equity financing can be understood on trial basis and better prepare the market for larger investments.

Country Specific Actions (Examples)

What does this look like?

- Coordinate technical assistance working with the Somali Bankers Association as well as the Central Bank of Somalia, and provide training/courses on the areas raised above, including Islamic Finance, AML/CFT, risk management, etc. Curriculum can be developed with SBA and CBS and given to cohorts from the local banks.
- An accelerator program can be launched for banks, remittance companies, insurance providers, etc.
- Set 'discovery' benchmarks/goals for existing funds that will help with the above understanding of market, risks, products, etc.



Adaptable Approach



All DFIs are not created equal but can be put into four broad categories based on engagement timeline



Roles

Grantors and Advisors

First Movers

Fast Followers

Late Entrants

Description

- Support public and private sectors with **technical assistance** especially in the early stages

- Engage early in frontier markets to **prove concept**
- **Separate strategy** for frontier markets or fragile states
- Higher risk appetite
- **Flexible** in initial approach, for example starting out with small loans to SMEs

- History of operating in frontier markets once market opportunity is proven
- Investment mandate (risk, returns, et cetera) **aligned with frontier markets**

- Broader mandate for emerging markets that is not specific to fragile states and frontier markets
- **Rigid risk management process**, for example focus on credit rating and cost of capital
- Preference for large ticket sizes, for example \$5-10M



Adaptable investment approach allowing for experimentation, learning and engagement at different stages



Engagement and Technical Assistance

- Increase DFI understanding of the market
- Increase transparency and support the development of the market
- **Accelerate investment readiness** by addressing targeted private sector reforms via technical assistance
- **Modify risk approach** based on the shared strategy for fragile states



Shared and Pooled Resources

- **Build relationships** with stakeholders in interest of future investment opportunities
- **Test concepts** in the market such as loan worthiness and ability to service long-term loans
- **Incorporate DFI priorities in current market activities**, such as loans from existing funds, Shuraako and Gargaara
- Identify high-potential enterprises as future investment targets
- **Finetune DFI investment strategy** as per learnings from existing funds



Direct Investment

- **Accelerate investment readiness** of most-promising large enterprises and banks
- Increase supply of bankable projects and demand for large investment cheques
- **More proactive** seeking and development of opportunities, partnering with public and private actors
- Accumulate sufficient knowledge of context and market to adapt to windows of opportunity



DFI participation is needed to support growth of SMEs and sectors in Somalia

Impact investment needs and goals differ based on SME profile			
SME segment and characteristics:	Micro enterprise: 0-10 employees; weak records; no credit history; struggle with fluctuating revenues	Small Enterprise: 10-50 employees; unreliable financial history; minimal access to credit and capital; recurring revenue	Medium Enterprise: >50 employees; better financial records; access to local credit and capital; large market share
Impact investment goals:	Providing funds to micro businesses strengthens livelihoods and generates subsistence-level revenue; however, it is not a growth strategy	- Investments improve enablers for growth with broader impact on growth of SMEs - Identify investments that have wider reach, e.g., financial intermediation	Targeted investments in specific large projects and companies that promote sector development - Small specialized companies to provide inputs and services to large companies
How to support segment:	Micro loans through platforms; access to small funds for sustenance	Loans through local financial intermediaries Technical services that have wider reach, e.g., professional services	- Long-horizon direct investment by DFIs, i.e., patient capital - Alternative deal structures, e.g., using profits to buy out investors over time - PPPs; sector-specific strategies
Current support and investment in this segment:	Mainly NGOs (with funds provided by larger development partners); local banks, remittance, family members, etc.	- Limited local funds (supported by development partners) and banks - Limited financial instruments supporting more established but vulnerable SMEs - Technical assistance	- Local private sector and banks (e.g., large real estate projects rely on domestic investors) - Limited foreign investment (e.g., from diaspora)
Main limitations:	Difficulty scaling	Access to funds, professional management and networks	Access to foreign direct investment (FDI)
Alignment with DFI investment:	Low	Medium	High



Multisectoral Involvement



A multisectoral approach by key stakeholders is necessary for success

High-level description of stakeholder roles for the roadmap

Government

- Government should ensure **clarity of mandate among ministries**, ensure proper ministerial coordination and support **execution of roadmap potentially via the Investment Promotion Office with support from a secretariat**
- Example stakeholders: Somali government ministries and agencies such as Ministries of Finance, Commerce and Planning

Private Sector

- Private sector should seek more opportunities to **self organize and regulate**; **trade associations can increase information sharing** and support due diligence in line with investment readiness
- Example stakeholders: Somali businesses and trade organizations such as Somali Bankers Association, commercial banks and SMEs

DFIs

- DFIs can **engage early via this coordination forum** to improve investment readiness and play **active role in existing funds, e.g., via board seats**
- Example stakeholders: DFI investment and advisory teams with relevant mandate, e.g., focus on Somalia, Africa or fragile states

Development Partners

- Development partners can support coordination, **set up pooled funds and provide technical assistance** to address barriers; they may provide engagement path for DFIs, as well as **lobbying at HQ level** for fragile state specific investment strategies and mandates
- Example stakeholders: Bilateral and multilateral partners operating in Somalia such as World Bank and IFC advisory teams, and partner country organizations with relevant mandates

EU and Other Convening Actor(s)

- Convening actors should support the coordination and joint action of multiple stakeholders to execute roadmap, **potentially through a program or secretariat**
- Example stakeholders: European Union Delegate and/or development partner and/or DFI

Relevant Stakeholders

Private Sector

Government

DFIs

Development Partners

EU & Convening Actor(s)



Government has key role in execution of roadmap especially via Investment Promotion Office



-  Staff team with representatives from key ministries to support forum for DFI engagement, for example, through secretariat responsible for overseeing the action plan from the roadmap
-  Develop strategy for lobbying DFI and member countries at political level to adopt fragile states and Somalia-specific approach and funds that better align incentives
-  Incorporate feedback on target industries, constraints and needs of DFIs in work plan
-  Support development of market studies and market education programs
-  Create formal channel to request market data and support from Investment Promotion Office
-  Government representatives participate in formal meetings to capture learnings from existing funds such as Shuraako and Gargaara
-  Investment Promotion Office supports promotion of high-potential medium enterprises
-  Government develops investment strategy with tiered approach, flexible enough to change course as required
-  Investment Promotion Office along with other relevant government actors plays active role in coordinating large projects and engaging stakeholders
-  Investment Promotion Office works with government agencies to address obstacles identified with potential investment, for example, licenses, company registration, et cetera



Trade associations can increase information sharing and support due diligence in line with investment readiness



- ⚙️ Participate in forum for DFI engagement, for example, via trade association reps
 - ⚙️ Trade associations encourage members to share information to support market studies
 - ⚙️ Participate in market education programs such as SME seminars
 - ⚙️ Access to professional services, for example, audits, through trade associations
 - ⚙️ Trade associations educate members on benefits of openness to due diligence
-
- 🔗 Participate in accelerator program to prepare banks for investments
 - 🔗 Collaborate with Investment Promotion Office to build business case for large projects
 - 🔗 Engage government actors early to promote large enterprises and remove obstacles
-
- 👤 Private sector offered platform to support basic management and accounting functions
 - 👤 Trade associations engage members during commercial and financial due diligence
 - 👤 Collaborate with stakeholders to accelerate investment readiness, for example, improving ESG compliance



-  Provide technical assistance to promising SMEs through existing vehicles or funds such as Shuraako and provide technical assistance to prepare banks for investment
 -  Adopt investment strategy for Somalia and earmark fund for this to align incentive
 -  Earmark funds for investment preparation, for example, grants to help target companies meet ESG requirement, studies, etc.
 -  Engage with and provide technical assistance to Investment Promotion Office
-
-  Consider investing as limited partners in future funds of existing fund managers
 -  Request for seats on Board of Advisors for existing funds
 -  Identify potential direct investing opportunities, for example, high-potential and fast growing medium enterprises, with support from stakeholders such as trade associations and banks
-
-  Dedicate DFI funds to support private sector readiness such as technical assistance to large companies for investment readiness
 -  Provide technical assistance to most-promising large enterprises
 -  Collaborate with Investment Promotion Office and relevant government and private sector actors to build business case for large projects
 -  Lead direct investment in appropriate large enterprises and banks



-  Increase technical assistance to Investment Promotion Office and private sector through new or existing programs, and banks to prepare for investment
 -  Lobby DFIs and member states at decision-making level to adopt fragile state specific strategies and funds to align incentives
 -  Support short-term prioritization of barriers to investment in target industries (roadmap)
 -  Sponsor studies (market studies, conflict assessment, etc.) for the consumption of entire forum of DFIs
 -  Provide TA for market education programs, access to professional services, and development of trade associations
-
-  Prioritize support to DFIs on front-end preparation activities over focus on implementation of programs
 -  Contribute to pooled funds for technical assistance and investment in Somalia, for example, blended finance to reduce or share risk
 -  Share with DFIs potential direct investing opportunities, for example, high-potential and fast growing medium enterprises
-
-  Lobby affiliated DFIs to create mandate to prioritize investment in Somalia
 -  Provide platform for improving basic management and accounting functions to support investment readiness and source of market insight

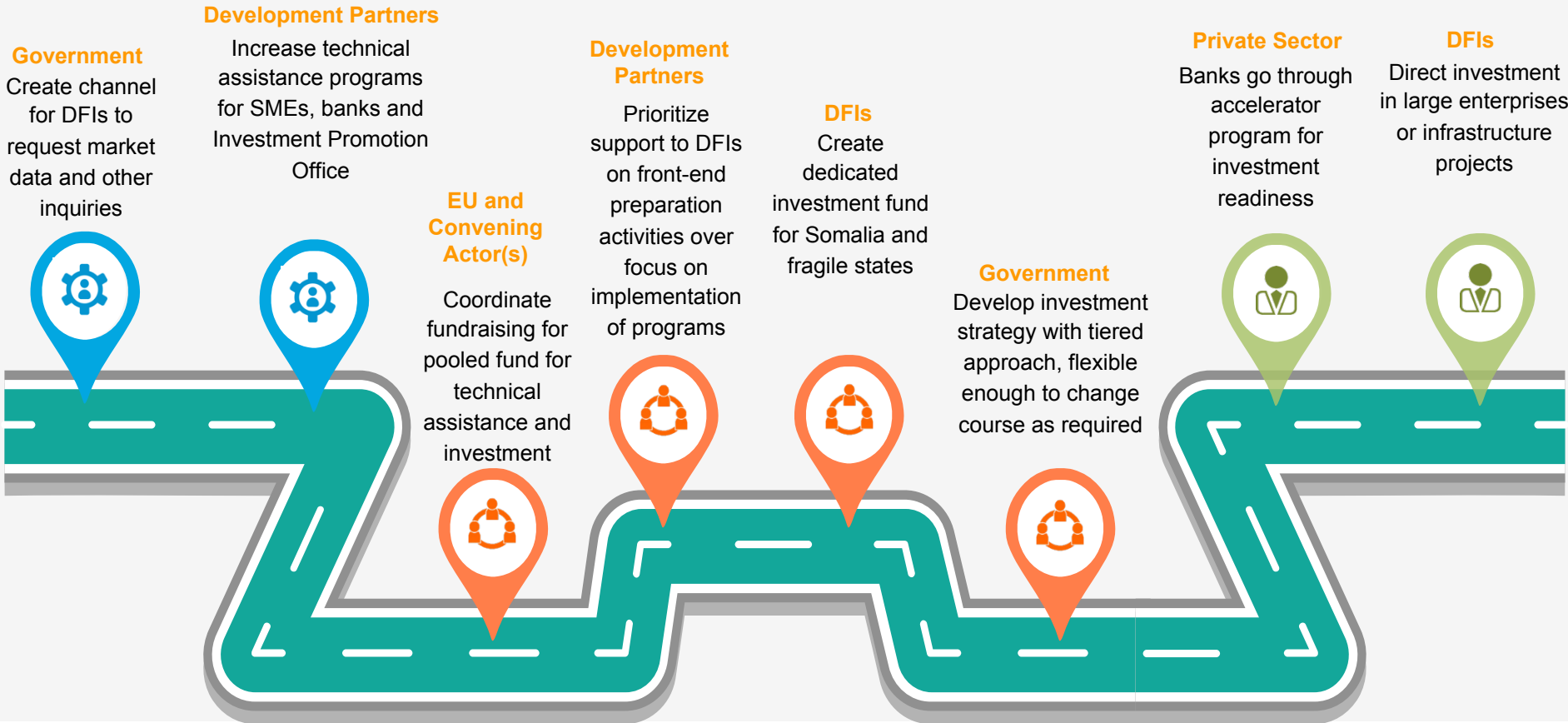


- Establish secretariat or program to manage DFI engagement and convene stakeholders to implement recommendations of the roadmap
- Establish pooled fund to support secretariat and implementation of recommendations, including working with the Investment Promotion Office
- Through secretariat, monitor progress of roadmap and track implementation of recommendations
- Support planning for DFI forum meetings and events, including presentations, investment pitch days, etc.
- Convene European DFIs and member countries at the political level and lobby for Somalia specific strategy and fund; support Somali government in lobbying effort
- Use Somalia as case study to pitch in formal European Development Finance Institutions meetings for new or updated DFI strategy for fragile states
- Promote Somalia as pilot country for initiatives of global fora such as the Oxford DFI Forum
- Establish or coordinate pooled funds for Somalia to support technical assistance and investment

There is a roadmap for stakeholders from early engagement via technical assistance to direct investment in large companies and projects



FOR ILLUSTRATION ONLY



Implementation

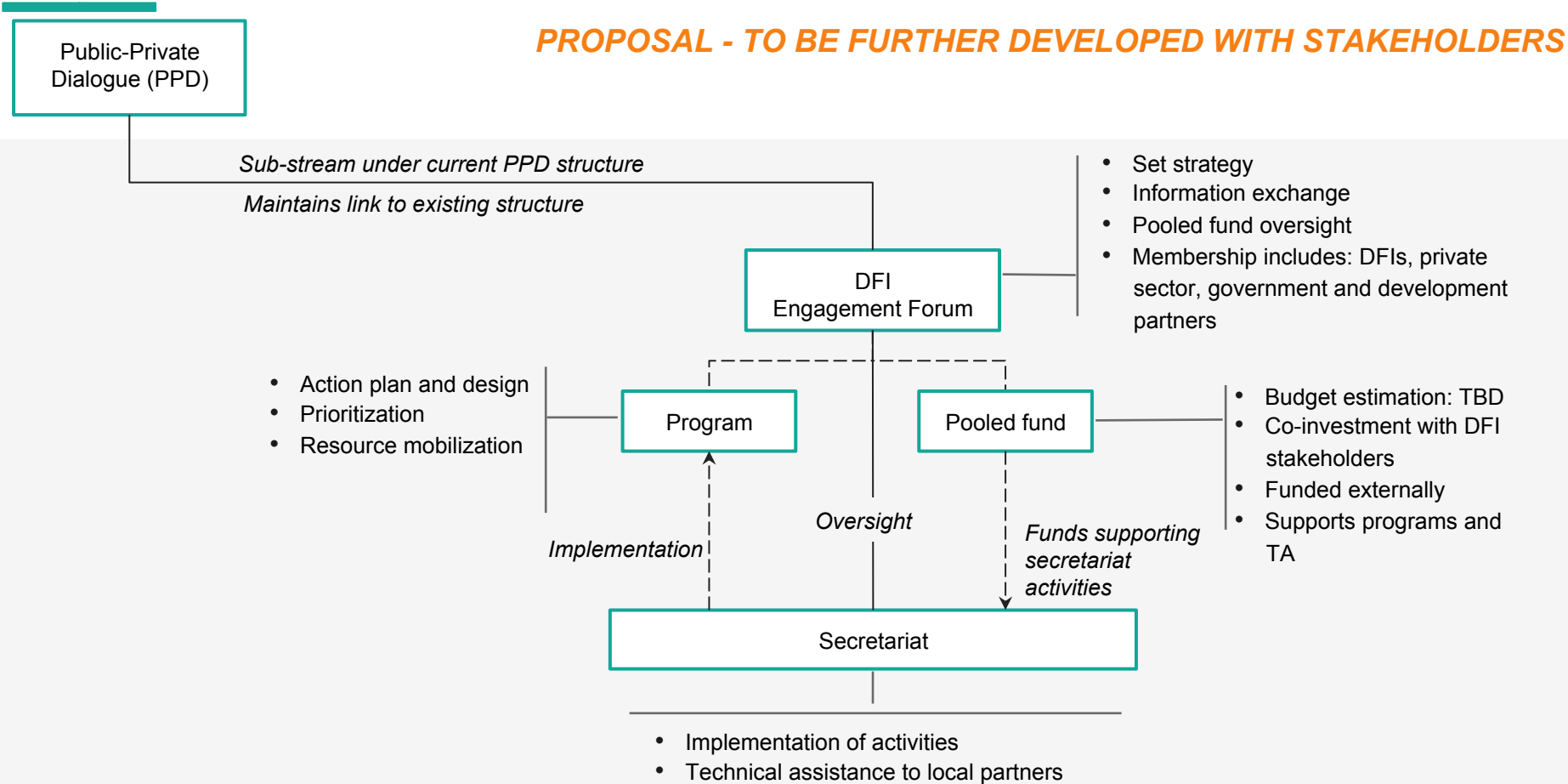
TO BE FURTHER DEVELOPED WITH STAKEHOLDERS

A shared implementation plan among stakeholders is critical

12 Months Action Plan

*FOR ILLUSTRATION ONLY
TO BE FURTHER DEVELOPED WITH STAKEHOLDERS*

Workstream	Target start date
1. Adoption of shared principles and strategy for operating in fragile states Host a dialogue forum with stakeholders to discuss best practices for DFI engagement in Somalia that outlines a shared approach, set of guidelines, and tools for investment	September 2020
2. Accelerated implementation of ongoing reforms to improve investment climate Outline barriers to fully implement investment climate reforms (e.g., Ease of Doing Business), and outline support needed and responsible parties	September 2020
3. Effective mechanism for DFI coordination and collaboration including key stakeholders Build on existing PPD forum by establishing sub-working group within Financial Sector Working Group to facilitate regular information exchange among key stakeholders, and disseminate lessons learned, shared investment strategies and resources	October 2020
4. Shared and pooled resources to allow for risk reduction, increase in market knowledge, and relationship and trust building - Establish formal channel that engages reliable local sources, knowledge and market information with support from Investment Promotion Office - Design funding model that encourages co-investment with other DFIs into pooled funds	November 2020
5. Targeted support for private sector readiness working with key stakeholders on priorities Engage Investment Promotion Office to establish investment-readiness indicators/strategy/roadmap etc. that aims to support capacity-building and market education of private sector actors	January 2021
6. Special consideration for improving the financial sector as key part of DFI engagement strategy Design accelerator program to prepare high-potential banks for direct investment	November 2020
7. Coordination of long-term implementation of roadmap Host roundtable among stakeholders to discuss progress on roadmap, barriers to full implementation and plan for the future	April 2021
	June 2021



APPENDIX

We interviewed over 35 representatives from over 30 organizations



NOT EXHAUSTIVE

Government



Private Sector



DFIs



Development Partners



List of interview questions

NOT EXHAUSTIVE

Role of DFIs

- What is your strategy for fragile states?
- Do you provide technical or advisory services? How does that fit into your framework?
- How much do you collaborate with local partner organizations?
- Does your organization have different parameters in regards to risk?
- Do you have preference for direct investment or fund of funds investment?
- What is a good candidate for a grant?
- What are DFI mandates in regards to investment returns?

Challenges and Constraints

- What are the main challenges impacting DFIs operating Somalia?
- What are the main constraints for DFIs that are early entrants?
- What risks have DFIs encountered while operating in fragile states?
- What would be the best strategy for DFIs to begin investment in Somalia?
- What would be your recommendations for DFIs to come sooner?
- How can Somalia address micro-level gaps and barriers to development?
- How would you advise the EU and other DFIs to help bridge these gaps?

Role of Government

- What should the government's role be to support DFI engagement in Somalia?
- What specific actions should be done to support this process?
- What may DFIs not understand about engaging the public sector and doing business in fragile states?
- What has been done to improve trade facilitation and the ease of doing business?
- What plans are in the works for regulatory reform, e.g., fiscal?

List of interview questions

NOT EXHAUSTIVE

Private Sector and Banks

- Are you facing any challenges with regard to the lending process?
- What are the challenges that need to be overcome in terms of equity?
- Which sectors are preferred by local banks?
- How has the government been helpful or not helpful?
- How do you ensure due diligence? Do you utilize support from in house or external actors?
- Is it important to protect intellectual capital? How willing are you to share this information?

Market

- What are the barriers for small businesses?
- What is the mechanism to get information on small businesses and the market?
- Are there constraints to accessing market information and data? What kind of data or information do you seek out?
- What are the top lucrative areas in the market that are untapped?

Capacity and Bankable Projects

- What is the availability of bankable projects in Somalia?
- What are the key issues in terms of private sector capacity?
- Is there a lack of capacity to finance big projects?
- What can be done to increase these bankable projects?

List of interview questions

NOT EXHAUSTIVE

COVID-19

- How is COVID-19 impacting small business owners and clients?
- Has COVID-19 increased challenges associated with receiving remittances?
- Has COVID-19 highlighted existing issues associated with infrastructure and development in Somalia?
- How should we think of engagement in a post-COVID world?

Shariah Compliance

- Are you restricted in terms of Shariah compliance?
- Is equity financing a workaround for Shariah compliance?
- Have you communicated with the government in this regard?

Conclusion

- What are you most optimistic about in Somalia?
- What you would find useful in this study?



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