



Private Sector Development in Conflict Regions: Viable Support Options in the West Bank and Gaza

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Introduction: As a result of the extensive security restrictions, growth in the West Bank and Gaza in the past has become dependent on aid contributions through the Palestinian Authority. However, sustainable and inclusive growth requires a strong private sector capable of absorbing a growing labor force. Consequently, the World Bank in partnership with the UK's Department for International Development (DFID) developed the Palestinian Facility for New Market Development (FNMD). This matching grant scheme was designed to reduce the risk of investing in the highly uncertain environment and encourage enterprises to upgrade their capabilities, develop new products and enter new markets. This Quick Note provides an overview of the design and outcomes of FNMD and highlights the lessons learned in implementing the project. Lessons learned from this initiative underline that there are viable private sector options, even in fragile environments such as Gaza.

Project Design: FNMD was jointly funded by the Bank and UK DIFD. The World Bank provided a grant to DFID from the Post Conflict Fund and DFID implemented the project from July 2008 through April 2011. The matching grant scheme was based on a similar project in Tunisia that supported investments in technology, business processes and skills. These included the purchase of databases,

support for product design and certification and access to standards, and market information. However, it did not cover capital investments. The goal of the scheme was to promote economic growth by enhancing the ability of Palestinian enterprises to enter new markets and produce higher value goods and services.

The grant scheme supported both individual firms and associated groups of companies. Individual enterprises received a maximum grant of up to 50% of their investment projects, with a cap of \$50,000. Associated groups of companies were provided with up to 70% of the cost of their projects with a cap of \$100,000.

Indicators and project outcomes: By its third year, FNMD was serving 226 client companies, 85% of which employed less than 20 workers, from a broad range of sectors, led by light manufacturing [32%], IT [18%], agro-business [17%], and services [12%]. 67% of companies were located in the West Bank and 33% in Gaza. The share of female owned or managed companies was 22%. FNMD outcomes are listed below:

- *Increased employment in recipient enterprise:* FNMD employed 903 new employees; 54 of which were women.
- *Increase in sales and exports by recipient enterprises:* FNMD generated new local sales far more quickly than new sales in export markets. By the end of Year 3, total incremental sales related to activities co-financed by FNMD increased by 31%, reaching USD 56.4 million. New export sales – USD 13.2 million. 8.4% of clients became first time exporters, which is less than the original target of 10%.

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- *Increase in the number of Palestinian enterprises selling in new markets:* 50 companies entered new export markets (22% of FNMD clients and 45% of those companies that targeted new export markets) and 134 companies entered new local markets (59% of FNMD clients and 97% of companies that targeted new local markets). 114 new export markets were entered by end of Year 3, with export sales to countries including Egypt, France, Germany, Kuwait, Malaysia, Sudan, Turkey, and Yemen.
- *Increase in the number of Palestinian enterprises selling new/improved products:* 113 firms out of the 226 firms which benefited from FNMD developed/improved products, exceeding the original target of 30%. 41% of firms developed a new product or a new product line; 23% declared that they had improved an existing product or service. By end of the third year, the total number of new products developed by FNMD clients was 106; exceeding the target of 22. The total number of products improved was 74, including 25 products that are now certified by international and local standard-setting bodies – exceeding the project target of 60.
- *Increase in the number of project beneficiaries willing to pay for business services without a subsidy:* FNMD grant investment financed marketing materials [8%]; marketing campaigns and product launches [24%]; and expenditures on trade shows and Business to Business meetings [11%]. 10% of all FNMD funding was spent on market research and marketing plans. This is a significant achievement, considering that more than 58% of FNMD clients had not previously engaged Business Service Providers (BSPs).

Investing in new local, as opposed to export markets, was more attractive to firms. The investment required to enter new markets was very high, both in terms of funding and time resources. FNMD clients were relatively confident and well positioned in the local market, and saw entering new local markets as less of a risk than export markets. Clients focus on local markets also anticipated a quicker return on investment from

local marketing campaigns, which was important in terms of financial liquidity. New product development or product re-design did not require major investment or time commitment for clients targeting local markets.

Considering the entire FNMD portfolio, FNMD management estimates that 32% of all projects would not have proceeded without FNMD support. 30% would have been delayed and 30% would have been scaled back. Around 15% of projects would have proceeded, but in a less effective manner.

Challenges and responses: The FNMD was operating in an economy under siege where the success of projects could easily be thwarted by external factors and urgent issues that required immediate support could arise at any time.

Specific challenges and FNMD responses:

Restrictions to movement: Palestinian firms in Gaza were not allowed to import most raw materials or export their products for most of the project's life. In addition, it was not possible to obtain permits for staff from the implementing agency's headquarters in the West Bank to enter Gaza to supervise local staff hired in Gaza.

Response: The project was successfully implemented by using video conferencing, supervision missions by World Bank staff and obtaining permits to bring staff from Gaza to the West Bank. Since no exports were allowed, the World Bank office in Gaza concentrated on helping firms serve the local market so that they could survive and be prepared to resume exporting when the situation allowed.

Challenges to working with the Palestinian Authority (PA) in project design and implementation. When the project was initially conceived, HAMAS had recently won elections and the government of the United Kingdom, the recipient of the grant, could have no contact with the PA.

Response: the project was designed with the help of the private sector and ran independently of the PA. Therefore, the design of the project allowed the World Bank to support the private sector in partnership with the UK's DFID, no matter the composition of the PA.

Spurring a sustainable market for BSPs: Most BSPs needed to upgrade their portfolio of services, refine their services, particularly in terms of new market identification, market intelligence, and facilitating overseas market penetration by their clients.

Response: The FNMD set up a searchable database of reputable BSPs, who applied to FNMD and were selected for registration on the roster based on their proven capacity to provide services in relevant technical areas and across a range of sectors. The Roster was 'open', meaning that regional/international consulting companies as well as local firms were allowed to join. At the end of each consulting assignment, the FNMD client firm evaluated the performance of the BSP and provided feedback to the FNMD to update the roster. Information sessions were also carried out with a cluster of BSPs to identify ways to enhance their service offering.

Inexperience of most FNMD clients – Well over half of FNMD client companies had never hired professional BSPs or participated in a donor project, and more than 50 percent had never exported abroad

Response: FNMD staff worked closely with clients and managed a very large number of small grant agreements. FNMD account managers oversaw the full grant life cycle, encouraged clients at inception phase, and supported clients in developing sound business plans, procuring the right business services, helping with implementation, reporting on results, and complying with the various requirements. Despite this challenge, FNMD was successful in reaching out to the "missing middle" of the Palestinian private sector: small and medium-sized enterprises (SMEs), generally family owned and employing less than 20 workers.

Lessons learned:

Enterprises in conflict countries don't know what they don't know - maintaining close contact with clients is essential to success. FNMD was designed to be demand driven where enterprises approach the fund to obtain grants to help offset the risk of investing, with the assumption that enterprises would have their own ideas and know what they needed. Palestinian firms, however, had been cut off from international markets for so long that many

entrepreneurs did not know what they needed to do to access new markets, or even that they needed to make changes to begin with. Enterprises emerging from years of conflict may not be as sophisticated as those in countries with similar income levels. Therefore, the most important assistance provided to FNMD clients was not financial support, but rather the technical assistance from business development officers who worked hand in hand with client enterprises. In addition to helping the individual enterprises, the FNMD team's daily contact with local enterprises provided a wealth of knowledge to policy makers on the major business constraints and how the business environment could be improved. Future projects will have to build-in more resources to provide this type of technical assistance.

Matching Grants schemes take time. A subsidy is designed to help remove a market failure and eventually matching grants schemes should work themselves out of business. However, it takes a number of years for them to be effective. It took FNMD more than a year to establish its procedures and build a pipeline of clients and another year to begin producing successful results. Just as demand increased in its last year, it was time to begin closing the program. The original idea was to demonstrate the concept and then attract additional donor financing to keep the program running for a number of years. The uncertainty around the project's extension led to a discontinuity, where the program essentially shut down and stopped accepting applications, thus losing momentum. Future matching grant schemes should have a clear time frame that extends for several years.

Independence from government is helpful. The success of a private sector grant program depends upon being seen as independent of government and immune to political pressure. In a small society such as West bank and Gaza, many enterprises indicated that they would be unwilling to share their books and business plans if they thought they could be seen by government officials or their competitors. The FNMD implementing agency was seen as completely independent and making decisions strictly on technical grounds. In addition, working through a private agency and not through government ensured that no matter which political party was in control, the project could continue to deliver services to the private sector despite changes

in government. Government is needed on an advisory board to ensure that the project supports the government's development strategy, but no ministry should be involved in directly running the project, especially in conflict countries where governance is often weak.

Conflict requires flexibility. As noted above, one of the strengths of FNMD was that it could quickly react to changes on the ground. When Israel relaxed restrictions on Gaza, DFID used FNMD to implement a back to work program, which allowed firms to rehire and retrain technical workers. Any future private sector development project in a conflict country needs to retain such flexibility. However, this is extremely difficult under Bank procedures which require detailed project designs and board approval to make substantial changes. Thus the initial design should attempt to include as much flexibility as possible.

Close supervision. The DFID and World Bank team worked closely to supervise FNMD. Because the Bank team was located in the West Bank along with DFID and the implementing agency, it was possible to solve many problems before they became significant. It allowed the Bank team to maintain a close watch on the project and develop a deep understanding of the private sector issues. It also allowed the Bank to maintain a close and easy relationship with DFID. If possible, Bank Teams, or at least their Task Team Leaders, for complicated projects in conflict environments should be field-based.

Impact evaluation is difficult. Impact evaluation of a matching grant scheme is difficult and needs to be addressed in the initial design. FNMD was unable to do a counterfactual analysis of a matching grant scheme. It is not possible politically, especially in small societies such as WB&G, to run an experiment where enterprises are randomly picked or denied access to the project. In such a small society it is also nearly impossible to find similar enterprises to do a matching evaluation. Enterprises that apply to a matching grant scheme are by definition more capable than those that do not have ideas to be funded. It is also difficult to obtain information on performance from enterprises that do not participate in a program. Given the rapid changes in the security environment, it is also not possible to make comparisons over time. How such programs can be

effectively evaluated is an area that requires further work.

Broader project impact: Because of the success of the FNMD project, DFID and the EU have asked the Bank to establish a large multi-donor trust fund to support private sector operations in West Bank and Gaza. This trust fund is currently being established and a large private sector development intervention program is being designed. As a part of this effort, the Bank itself has agreed to establish a small project to support private sector development using its own funds. In short, the very small initial investment by the Bank has led to a much larger and sustained intervention to develop the private sector.

The FNMD project experience will be able to be replicated in other countries and has already informed the development of a similar project in Afghanistan.

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