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Private Sector Investment by Diaspora Communities to Fragile States: Lessons from Somalia

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The Paradox

There appears to be emerging consensus that foreign direct investment can only be attracted to developing countries if key preconditions are met. Country specific as well as comparative studies highlight that countries with poor governance and economic indicators are destined to depend on development aid rather than investment and trade. The most challenged amongst such countries are those which are affected by conflict. Levels of infrastructure, institutions and human resource capabilities in such countries are certainly not attractive to foreign businesses which are looking for opportunities. Therefore, one would not expect such countries to develop through private investment in competitive market conditions. Rather, they are often destined for long-term support from humanitarian led, grant-based interventions. However, Somalia has proved to be an exception to these general trends, almost completely due to the influence of its diaspora, which has invested in their fragile country giving economic and social returns. The reasons behind Somali diaspora investment, particularly in less violent regions of Somaliland and Puntland offer interesting insights on how prosperity can be increased in communities that appear to attract humanitarian and development aid. These insights into a peace promoting private sector alternative is especially invaluable as global institutional donor funding sources decline.

Background

Conditions needed for private sector investment in developing countries are common knowledge to large investors – good governance, strong and stable economic policies, rule of law, absence of conflict, abundant resources, good infrastructure and access to markets, amongst others. It comes as no surprise that the countries that are least attractive to foreign investors are fragile states, which lack most of these conditions. Foreign direct investment cannot be attracted to these countries easily because the risk appetite of most investors, whatever their level of resources, is generally low. Indeed, countries that have none of the required conditions face serious challenges.

Somalia (including Somaliland and Puntland) is the most fragile state in the world[2]. It has not even made it into global country lists comparing investment potential for decades. At first

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[2] Fragile States Index 2016, Fund for Peace

glance, few places seem less attractive for business investment – it is a country ravaged by conflict for over thirty years and was until 2012 stateless. Yet, in recent years, the Somali diaspora has invested considerable funds to help boost the economy through profit making businesses that have given strong returns. This is in addition to philanthropic ventures and social outcome projects by the diaspora. Indeed, these private sector investments have helped to generate employment and support peacebuilding, and created the foundation for other investors to follow.

What makes Somalia an attractive investment destination for its diaspora?

Somali diaspora investors overcome significant challenges to succeed. These include risking their life savings, not having guidance or support from business coaches or business incubators, facing poor infrastructure and institutional systems such as banking facilities, not having sufficient government protection of local goods, poorly trained staff and perhaps most significantly facing the risk associated with continued Al Shabab related violence.

Despite these obstacles, many Somali diaspora investors consider investments back home as being more attractive than investments in places that appear to have better investment-attracting indicators. These home country investments are felt to be lower risk, comparatively safe and more profit generating. This is due to several push and pull factors. The most significant pull factors are the diaspora communities' overwhelming love for country, continued dreams of going back home, strong existing local networks and connections based on clans, and calls by the political leadership for the Somali diaspora to return. While there are no formal incentives to attract investment, lower government barriers for business, less competition due to first mover advantages, and poor tax and regulation structures are important informal incentives.

The push factors are just as noteworthy. Important among such factors is the fact that many in the diaspora have foreign citizenship, which allows them to leave Somalia as a safety net. Moreover, their inability to fully integrate into host countries, and their desire to use skills and knowledge for the benefit of Somalia are significant push factors. Many have accumulated funds to finance business and have travelled multiple times to Somalia before taking decisions whilst maintaining strong professional networks in other countries.

It is, however, important to note that many other countries such as Djibouti, Kenya and UAE have also benefitted from Somali entrepreneurship. Dubai has been the single largest beneficiary of Somali investors who are keen on more global markets and stronger business systems. Nairobi has also grown significantly as a business hub because of Somali investment. Its proximity to Somalia makes it a strong alternative for those entrepreneurs who wish to be closer to home. In addition, Somaliland's more stable political structure within the state of Somalia has brought in more investment.

What are the key lessons for other countries?

The Somalia example shows that the key factors affecting foreign direct investment are not entirely relevant when considering diaspora investment. The most important factors for the diaspora are primarily political stability, trust and networks within the local community, clear investment and market opportunities, a sense of national identity and access to finance. Other fragile states or underdeveloped regions of developing countries can also benefit greatly from diaspora investment if conditions both in host and home countries align towards directing investment flows. Importantly, however, it is important to stress that parallel efforts should be made to ensure that there are big strides to end extremist violence, improve governance and promote business development that is conflict sensitive.