Policy Brief

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Overview

Although the impacts of violent conflict on investment, production, incomes and inequality have been widely studied on an aggregate level, comparatively less is known about the more diverse impacts of such conflict at the micro (particularly firm) level. Understanding such impacts can improve policies to mitigate the human and financial costs of violent conflict in developing countries. This policy brief discusses lessons from recent studies to address this gap.

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Business and the Barrel of a Gun: Understanding Entrepreneurship and Violent Conflict in Developing Countries

THE RELATIONSHIP BETWEEN CONFLICT AND entrepreneurship, and small business in particular, is not well understood in the scientific literature. This is due, amongst others, to the assumption of peace in most theoretical models, the absence of suitable theories in economics about the causes and consequences of conflict, the difficulty of collecting data in conflict-affected areas, the dominance of macro-level approaches in political science, and the disproportionate concern in the aid community for the impact of violent conflict on multinational enterprises.

Furthermore, conflict is most often a characteristic or defining feature of what have been described as "fragile" states. Fragile states are amongst the poorest states, and they lack the authority, legitimacy and capacity to promote their citizens' well-being – often due to but also because of violent conflict. Given the widespread occurrence of violent conflicts in Africa, Latin America, the Middle East and South Asia, as well as the rising concern about fragile states and their repercussions for global development, the lack of research on the emergence of and challenges to entrepreneurship and small businesses during violent conflict is a significant lacuna.

The UNU-WIDER project "Promoting Entrepreneurial Capacity" addresses this gap. Its findings were recently published in two special journal issues. The analyses contained in these issues are both empirical and theoretical, and cover a diverse range of affected countries from Africa, the Middle East, Asia and Latin America. In this policy brief we set out the main concepts, share lessons and draw out the implications for policy.

Concepts and definitions

Violent conflict

Violent conflict refers to the systematic use of violence by armed groups to reach political objectives. The word "systematic" is important as it indicates that we are focusing here on violent conflict that goes beyond its association with crime, although protracted civil conflicts are accompanied by the rise and spread of organized crime. Violent conflict is instrumental and purposeful. It is often related to a contest for political power under the form of a civil war, with the state as one of the contending parties, but it also includes inter-ethnic violence where the state is not a direct participant. Empirically, violent conflict at the micro level is hard to measure. At the aggregate level, violent conflict is often defined by thresholds of "victims of fighting per year" – for example, 1,000 dead per year due to fighting.

In an analysis of conflict and entrepreneurship it makes sense to distinguish between conflicts that deplete the capital stock of a country (including buildings, infrastructure, hospitals, land and cattle) and conflicts that mainly target the civilian population (e.g. through displacement or with a heavy death toll). In addition to the human toll, the latter will deplete the human capital of the country and affect the quantity and the quality of the labour force and the dependency ratio, and thus the operations of firms. When a conflict mainly destroys a country's capital stock, a firm's operations will also be affected.

Entrepreneurship

In this policy brief we approach entrepreneurship from an economic perspective. Within economics it is usual to take a behavioural and/or occupational view of entrepreneurship and the entrepreneur. Thus entrepreneurship is either what an entrepreneur does, such as starting or running a business firm, or a person's occupational choice to be self-employed. Very often the choice of self-employment leads an individual to start up and run a new business. Hence, for present purposes, it is useful to understand entrepreneurs as people who create and manage a firm, and who are therefore classified as either being self-employed or earning income from a small business source.

"The lack of research on entrepreneurship and violent conflict is a lacuna hampering aid to fragile states"

However, given the particular nature of business in developing countries, we also adopt a view of entrepreneurship which includes informally self-employed and smallholder or subsistence farmers. Analytically, these people face the same optimization problem as more narrowly defined entrepreneurs in developed countries.

At this point it needs to be mentioned that the vast majority of research on the topic deals only with existing entrepreneurs, as survey data comes from existing firms and households. Latent entrepreneurship (defined as someone who is actively looking for an opportunity to start their own business) and nascent entrepreneurship (early stage start-up activity) are typically not studied. This is not to imply that these phenomena are unimportant, but merely to reflect inadequacies in current data availability.

Findings and policy lessons

The impacts of war and civil conflict on broader macroeconomic outcomes have been studied in detail. The impacts of civil war, especially its indirect impacts, are substantial and tend to persist. They include direct costs in terms of destruction of infrastructure and diverted (military) expenditure, as well as much higher indirect costs, such as disruption of markets and increase in risk and uncertainty. The cost includes destroyed capital, technological regress and a massive shortfall in income.

It is clear that violent conflict is bad for business and bad for entrepreneurship. Destroyed infrastructure, insecure property rights or falling consumer demand all increase transaction costs and the ease of doing business. It also diminishes productivity, increases the constraints underlying entrepreneurial decisions and hinders international entrepreneurship, which depends on reliable access to transport and logistical infrastructure that are often the first to be damaged in a war.

Hence development agencies, donors and governments can possibly do much in the way of preventing, dampening and mitigating the impacts of conflict. They can also facilitate post-conflict recovery by assisting local entrepreneurs, particularly small businesses, in adjusting and/or coping with conflict and the legacies of conflict. For such assistance to have the most beneficial impact, however, it is necessary for policy makers to understand the relationship between entrepreneurship and conflict at the micro level. In the remainder of this policy brief we outline six findings and lessons.

The social context matters

Entrepreneurs make their decisions in a social context. The individual entrepreneur cannot change that context, but their actions can have a dampening or stimulating effect on violent conflict. It can have a dampening effect on conflict when, for example, the private sector entrepreneur provides jobs to young men who may otherwise join a rebel army. The actions of entrepreneurs, however, may also stimulate or stir up conflict when they mobilize potential recruits, provide or trade weapons, or smuggle illicit drugs to finance a rebellion. Political entrepreneurs may use their oratory skills to spread propaganda and hatred among the general population against a chosen enemy.

Different conflicts, different impacts

The channel through which entrepreneurs may benefit or suffer from violent conflict depends not only on the characteristics of the particular entrepreneur and firm, but also on the type of violent conflict. A business may lose its employees (to displacement or death) and/or its main assets may be destroyed. If conflict affects a business in a one-off, shock-like manner, then activities may be resumed following a cessation of violence, resulting in a temporary dip in profits.

In contrast more persistent conflict may have a pernicious impact on firm-level investment and growth over the long term, and may result in growing numbers of business failures. From an economic point of view, we can distinguish between conflicts that deplete the capital stock of a country and its firms (including buildings, infrastructure, hospitals, land and cattle) and conflicts

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that mainly target the civilian population (e.g. through displacement or with a heavy death toll). All conflicts have elements of both, but for analytical reasons it is worth making this distinction. For example, the wars in Mozambique or Angola were notorious for their use of landmines. This has obvious consequences in terms of human suffering, but it also prohibits the use of the land as a productive asset during and many years after the war. Thus, an entrepreneur (e.g. a large commercial farmer) in such a setting will be handicapped by the land being unavailable. The Rwandan genocide is a case in point. Here the main target was not the country's capital stock, but its civilian Tutsi population. This led to a massive loss in human capital, to the extent that the victims were better educated and urbanized than the national average.

Different activities, different impacts

It is not only violent conflict itself that affects entrepreneurship, but also the interaction of violent conflict with a variety of factors, including the characteristics of a specific sector, the motivation and strategies of the armed actors as well as the government, plus the broader regional and institutional setting. The most devastating impact occurs when the activities of the armed forces – such as their systematic displacement of local populations – are at odds with entrepreneurial needs. For instance in Colombia the decades-old conflict has much more adversely affected entrepreneurs in banana and palm oil production where large areas of rural land need to be cultivated. In contrast, the flower sector in Colombia has not been as seriously affected by violent conflict as its main growing areas tend to be closer to urban centres and governmental institutions.

From the long-running Colombian conflict it has also been found that where labour standards are implemented and monitored, the contact surface for guerrilla propaganda is relatively small and backing from the workforce reduced. On the other hand, enclave sectors, such as oil extraction, usually deliver high benefits only to a specific group of workers while leaving large parts of the population unaffected. Those activities substantially increase the probability of social tensions, even if the sector is highly regulated by the state and controlled by international capital. Also highly regulated, but with benefits more equally distributed, the relatively more peaceful coffee-growing regions only got involved in the conflict after a significant decline in international coffee prices.

"The most detrimental impact of conflict on entrepreneurship is on human capital"

Forgetting by not doing

The most detrimental impact of conflict on entrepreneurship is undoubtedly through its impact on human capital. Conflict-induced losses in human capital are always significant, start before violent conflict breaks out, rise to acute levels during the conflict and give rise to a lack of skilled workers in the post-conflict environment.

One way in which human capital and know-how is eroded during conflict has been described by Paul Collier and Marguerite Duponcel as "forgetting by not doing". The disruption of production due to electricity shortages or fear of looting, as well as the return to inefficient production techniques, with its vast effects on production and income, though reversible in principle, has been found to lead to an atrophy of skills which decelerates economic recovery in the long run.

Tenacious but not indestructible

Entrepreneurship is tenacious, but in a qualified manner – tenacious in firm start-ups, the survival of certain types of firms and in recovery, but fragile in terms of failing more often during conflict. For instance, it has been found in Colombia that although conflict leads to a reduction in entrepreneurial activities in locations directly affected, it leads to an increase in self-employment elsewhere. This reflects the fact the people will move from conflict areas, causing the proportion of self-employed to fall. However, in their destination municipalities, the influx of refugees can lead to an increase in the survivalist type of self-employment and in self-employment in pursuit of profitable opportunities, as the influx of migrants may raise the demand for a range of goods. Hence because civil war has a differential impact geographically, it may lead to both an increase and a decrease in entrepreneurial activity.

As far as entrepreneurial failure during conflict is concerned, it is clear that violent conflict has a deleterious and significant effect on firm survival. More specifically, the impact of violent conflict is predominantly on smaller firms, and on very young and very old firms. The firms most likely to survive violent conflict are thus middle-aged (experienced and networked) and larger firms (more resources).

Over time and following conflict, a "phoenix effect" may be found. For instance the idea that farmers revert to subsistence farming when confronted with violence from civil war can be challenged. Evidence suggests for instance that farmers in Burundi who were confronted with civil war violence in their home communities increased export and cash crop-growing activities, invested more in public goods, and revealed higher levels of subjective welfare evaluations after hostilities ended.

Always negative

While entrepreneurship may be tenacious and even benefit from conflict in certain cases, the long-run impact of conflict on entrepreneurship is unambiguously negative. The longer-term impacts of persistent conflict will always overshadow short-term effects. If one only considers the short-term impacts, entrepreneurship may seem much more unfazed by conflict than a more long-term view may suggest.

Over the long run, violent conflict or the risk of violent conflict will reduce investment in long-term technologies, in line with the finding already mentioned that conflict leads to a reduction in the technological sophistication of firms. Violent conflict thus diminishes not only human capital, but also technology and innovation, and these impacts are likely to have a serious adverse impact on a country's long-run economic and development prospects.

Post-conflict reconstruction

Entrepreneurial activities during civil war are often aimed at providing public goods that the state cannot or does not want to provide. Entrepreneurs can also be involved actively in peace-building initiatives following conflict. Some entrepreneurs, called social entrepreneurs, make it the explicit goal of their activity to improve the welfare of citizens affected by violent events, illness, poverty and crime. The latter include microfinance institutions, not-for-profit organizations, philanthropists and others.

Post-conflict, joint entrepreneurial activity can promote the development of trust between distinct groups that have been engaged in conflict. For instance in post-genocide Rwanda, the liberalization of the coffee sector provided many opportunities for entrepreneurs. The deregulation of coffee cultivation, processing and trade allowed the producers to affiliate and to produce higher-quality coffee with the help of the so-called washing stations. Such economic success, combined with the necessity to work together, has been found to enhance reconciliation in the long run. Importantly, this type of working together can fulfil four conditions that have been proposed to be necessary for intergroup contact to reduce prejudice: equal group status, common goals, intergroup co-operation and the support of authorities, law or custom.

Concluding remarks and policy recommendations

Understanding how entrepreneurs are affected by conflict, and how their behaviour in turn may shape conflict, is of obvious importance to donors, peacekeepers, development agencies, governments and entrepreneurs themselves. However, whereas the impacts of violent conflict on investment, production, incomes and inequality have been much studied on an aggregate level, comparatively less is known about the more diverse impact of such conflict on entrepreneurship. Understanding such impacts is important to inform policies towards mitigating the human and financial costs of violent conflict in developing countries.

This policy brief discussed seven broad findings and lessons emanating from recent studies to address this gap. These findings and lessons have a number of implications.

First, policies aimed at assisting entrepreneurs in countries racked by civil war need to be geographically differentiated and focused. Entrepreneurs in rural areas are often the worst affected, and for them ensuring reliable and adequate supplies of material inputs as well as skilled labour is often the most pressing challenge. Because international trade is easily disrupted by conflict, it may be wise for local firms to find, as early as possible, local sources of supply. Sometimes, in contrast to suffering entrepreneurs in rural or intensely affected areas of a country, those in urban areas are not directly affected by conflict. As a destination for internally displaced people, increasing opportunities for profitable business may result. Here, steps to ease business conditions and reduce the obstacles in business formation may be useful to support entrepreneurs making use of such opportunities and also to provide alternative occupational choices to the influx of refugees.

> "Management capabilities of entrepreneurs can determine the survival of firms during violent conflict"

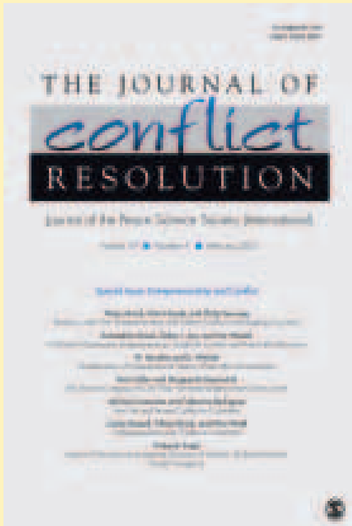
	Positive Impact	Negative Impact
Start-ups	Increase in rate of new firms Regional opportunities New opportunities related to safety and security	More necessity firms More informal firms "Wrong" sector Insider–outsider firms Lack of opportunity recognition
Firm growth	Potential short-term benefits for connected or protected firms	Reduction in growth Smaller average firms Regressive "innovation" Gangsterism
Internationalization	Diaspora networks International aid	Reduction in exports Emigration Flight of firms Smuggling
Disposal/transfer	More women-owned firms Family business prominence	Reduced ability to sell firm More difficulties for women entrepreneurs Family business stagnation
Firm exit	Higher serial and portfolio entrepreneurship	Higher firm failure rate

Second, entrepreneurs need to adopt risk management or coping strategies in the face of violent conflict, such as reducing technological sophistication, relocating supply chains and production locations, and reducing long-term investment. Although such adjustments reduce the profitability and even the size of firms, they may contribute towards their survival. After all, many small firms do not survive conflict. The social networks, experience, access and use of information, forward planning and management capabilities of entrepreneurs were emphasized as being important factors contributing to the survival of firms during civil conflict. This implies that policy should aim to support and strengthen the risk management and adaptive abilities of small firms.

Third, policy support for entrepreneurs in conflict areas needs to be based on the realization that a smart recourse for firms is to keep the business in the family. In family firms, issues of trust, uncertainty and investment are dealt with in ways that internalize the risks of conflict. Often however, firms get hamstrung by this, such as when women take over the reins in many firms during periods of civil war and subsequently face discrimination in markets and society. Empowerment of women, boosting of female entrepreneurship and understanding family business better could thus be potent instruments to manage the risk of conflict and facilitate firm survival and recovery.

Fourth, policy makers and development agencies should note that it is helpful if entrepreneurs themselves can understand the impact that violent conflict has on their and other businesses. The impacts of violent conflict include the destruction of infrastructure, diverted (military) expenditure as well as the much higher indirect costs of disrupted markets, increased risk and uncertainty. Violent conflict is thus bad for business and bad for entrepreneurship. Destroyed infrastructure, insecure property rights and falling consumer demand all increase transaction costs and the ease of doing business. They also diminish productivity, increase the constraints underlying entrepreneurial decisions, and hinder international entrepreneurship as the latter depends on reliable access to transport and logistical infrastructure, often the first to be damaged in a war. This is all well understood. What is less well understood is that the impacts of such violent conflict tend to be different – depending on type of firm, ownership, location, and the stage at which the firm is in its lifecycle. Hence some firms can be positively affected, and some negatively. The diagram on the previous page summarizes the salient impacts of violent conflict on the firm across its lifecycle and provides a handle on tailoring support to entrepreneurs caught up in conflict environments.

Finally, although conflict-affected firms may do less well and pose significant challenges to their entrepreneurs, their survival may be important for post-conflict reconstruction. One of the needs of post-conflict reconstruction is to establish economic gains and economic growth so as to absorb demobilized combatants and reduce any possible grievances from leading to a resumption of hostilities. The fragility of peace agreements is well known. Hence there is a positive message in this policy brief in that entrepreneurial activity may quickly rebound once hostilities cease. Thus support for entrepreneurship during post-conflict reconstruction may be called for and justified. How this support is tailored, however, is a topic that is not addressed in this policy brief and remains a topic for future research. Given the nature of conflict and entrepreneurship, it seems clear that institutional strengthening, particularly of property rights and the rule of law, remains a critical, complementary ingredient to supporting entrepreneurship during post-war reconstruction.



This policy brief is based on two recent special journal issues on violent conflict and entrepreneurship emanating from the UNU-WIDER project "Promoting Entrepreneurial Capacity". They are a Special Issue of the *Journal of Small Business and Entrepreneurship* (2011, 24(2)) and a Special Issue of the *Journal of Conflict Resolution* (2013, 57(1)).

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INSIDE:

Policy Brief

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Understanding the impacts of violent conflict on entrepreneurship is important to inform policies towards mitigating the human and financial costs of such conflict in developing countries. Such policies need to support entrepreneurs' risk management or coping strategies and provide a facilitating, supportive environment during post-conflict reconstruction.

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