



Investing in Stability – Conflict Risk, Markets and the Bottom Line

Executive Summary:

Conflict prevention is high on the list of global political priorities, but should it be a concern for firms in the financial sector? If conflict deters responsible finance and if finance can contribute to conflict, what concrete actions can firms in the financial sector take to reduce risks and deliver benefits both to peace and to the bottom line?

The aim of this paper is to stimulate debate on the interactions between finance and conflict, and to begin an exploration of opportunities to improve financial institutions' management of these interactions, thereby contributing to global and human security. It is a preliminary attempt to approach these issues in a comprehensive manner.

Concerning itself principally with the range of voluntary actions that private firms in the financial sector could take to reduce the risks posed by violent conflict, this paper seeks to identify mechanisms whereby firms could strengthen their positive development impact, help to reduce the negative economic impacts of violence and terrorism, and minimize the interactions between financial products, services and violent conflict.

The paper describes the current state of knowledge on the drivers and triggers of violent conflict, focusing on the role of economic factors in modern intra-state wars, rather than international conflicts. It then maps out the finance sector, and sets out the range of risks, conflict-finance interlinkages, and areas where the interests of peace, corporate citizenship and financial return may overlap. The paper concludes with a series of recommendations for financial sector practice, and for supportive public policy.

In spite of many years of research, there remains considerable debate on the causes of violent conflict and the necessary tools for securing peace. Consensus has emerged on the other hand that:

- The majority of modern conflicts are fought within the borders of existing states, rather than between states.
- The outbreak of violent conflict is often a symptom of rapid economic and social change, linked in part to inequity, underdevelopment and environmental stress. Three-quarters of those nations classed by UNDP as Least-Developed Countries experienced violent conflict in the 1990s.
- Violence emerges amid other governance failures such as state weakness, lack of accountability, corruption, proliferation of small arms, historical grievances, and structural inequities between groups.
- Civilians make up nearly 90% of casualties in contemporary wars.

Attention has recently focused on the implications of increased 'self-financing' by combatants - through licit and illicit natural resource trade, access to international finance networks and diaspora remittances - for the motivation, duration and character of armed conflicts.

How is this relevant to private firms in the financial sector? Because of the **importance of economic factors in many of today's conflicts**, and the tremendous financial impact of recent terrorist attacks, attention has turned to the role of this sector in conflict prevention, management and peace-building.

Access to a well-functioning financial sector is closely linked to positive economic development. The financial sector plays several vital roles in an economy, by facilitating commerce, mobilizing savings for investment, managing risk, identifying productive investment projects and monitoring their management. The private financial sector is highly diverse, and includes **Banks, Insurance and Reinsurance companies, and Asset Managers**. Each group of financial institutions has different products, and as a consequence, faces different conflict risks, uncertainties, and openings for positive action.

A survey of academic and advocacy literature suggests that the finance sector can become entangled in conflict scenarios as a consequence of long-standing investments or operations in formerly-peaceful countries, or through investment in projects whose impacts may generate local grievances. Armed groups and conflict entrepreneurs can misuse financial services, and the financial sector can be associated with contributing to or failing to prevent macroeconomic shocks that weaken the state.

On the other hand, **the financial sector can help to secure peace and manage or prevent conflict** through its core business – including through insuring or mobilizing finance for key infrastructure, energy and water services, through ensuring that projects are implemented in a conflict sensitive manner, and through spreading the financial impacts of conflict and terrorism over time and space. Finance can also contribute to peace through its social investments in communities and sustainability, through its engagement in knowledge sharing with the public sector, and through participation in policy dialogue to promote reconciliation, more-accountable governance and protection of human rights. Some financial institutions may be able to profit from win-win opportunities: mobilizing and managing funds from diaspora communities for post-conflict reconstruction, providing innovative services to companies and governments that help to predict and prevent conflict and terrorism, and identifying investment opportunities that will outperform competitors by managing or avoiding conflict-related risks.

The **key drivers moving violent conflict onto the agenda** of the finance sector are concerns about the uncertainty and rising costs of extreme terrorist acts, threats to reputation, staff and investments, emerging regulatory and litigation threats, and opportunities for competitive advantage. Some of these are material risks; others may become so in the future. Firms that start now to identify the emerging opportunities and risks posed by conflict/business interlinkages will be **better positioned** to respond if and when these do become material.

Government-led regulation and multilateral action remain the principal tools to prevent and resolve violent conflict. That said, voluntary private sector activities are worthy of further exploration in areas where private and public interests are clearly aligned. There is a need to better understand the linkages for which a business case exists that creates incentives for voluntary action, and those linkages which result from a market failure, where government intervention may instead be warranted. The proactive responses already being taken by some firms through public-private partnerships, voluntary codes of conduct and contributions to peace processes, suggest particular **areas where the private financial sector can contribute to conflict prevention and to the bottom line**

What concrete voluntary measures are these, and how can governments encourage them? The international community has often called for engagement with the private sector in conflict prevention and post-conflict reconstruction, yet currently lacks the appropriate framework for doing so in the case of the financial sector.

Very little useful information has emerged to guide financial firms towards engagement in post-conflict reconstruction, and towards encouraging better management - if not prevention - of conflict issues by those in whom they invest. Moreover, firms are without guidance on

appropriate behaviour in instances where the context in which their investment has taken place changes from peace to conflict or oppression.

It is critical to recognize the dilemmas that managers must face in tackling these issues, due to uncertainty both of the causes and nature of conflict, and of the means whereby conflict can be prevented or resolved. A nuanced approach to conflict is needed, one which includes a strong element of public communication.

One approach would be to **build upon ‘win-win’ opportunities**, including :

- working together to improve conflict risk assessment;
- introducing new products, services and public-private partnerships that mobilize private finance for post conflict reconstruction;
- and developing guidance on good-practice in the control of financial flows into and out of conflict zones.

Firms that adopt these measures may take on additional financial commitments, and may increase their exposure to liability. To offset these risks, **governments can offer regulatory and economic incentives, and help to reduce learning and implementation costs**. With conflict high on the international political agenda, the feasibility of launching a multi-stakeholder platform for more-sophisticated and informed dialogue and learning towards these ends should be assessed, and appropriate convenors and participants identified.