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# Composition Over Volume

## FIRM SIZE, FDI, AND THE COMPACT WITH AFRICA, PHASE 2

Álvaro S. González

### Abstract

The Group of Twenty (G20) Compact with Africa (CwA) enters its second phase (2025–2033) supported by a new World Bank Group multi-donor fund and expanded bilateral financial commitments. This expansion has been accompanied by a recent empirical analysis (International Monetary Fund [IMF] Working Paper WP/25/189) that estimates the causal effect of CwA membership on aggregate foreign direct investment (FDI) inflows. The analysis answers the question posed within the G20 Finance Track, the finance-ministry workstream that houses the Compact: did CwA increase aggregate investment? But the development payoff of that investment—the formal jobs, supply-chain linkages, and productivity spillovers for which member countries seek it—turns on the composition of FDI, not its volume. The Leaders' Declaration named these goals. The analysis misses whether the investment the Compact attracts delivers jobs.

Firm size is the key variable the aggregate-FDI metric omits. Project-level greenfield FDI data (Lakemann et al. 2025) and original weighted tabulations from World Bank Enterprise Surveys for all 15 CwA member countries show that large firms dominate employment across the 15 CwA economies. Large firms (100 or more employees) account for 61.5 percent of formal employment among surveyed firms, and foreign ownership is more than four times as prevalent among large firms as among small ones, and large firms are more likely than small firms to have foreign owners in every member country. Foreign-owned large firms account for 15.9 percent of large-firm employment across the membership, and 29.4 percent once Egypt, whose surveyed large firms are overwhelmingly domestically owned, is excluded.

To align the initiative with its stated development objectives, CwA Phase 2 should adopt a decomposed monitoring framework that disaggregates FDI by firm size, sector, and employment intensity; incorporate firm-size distribution metrics into reform benchmarking; and deploy mechanism design instruments—including security-bid frameworks and competitive monopoly auctions—to address the distinct risk structures impeding large-firm investment in frontier markets.

## Composition Over Volume: Firm Size, FDI, and the Compact with Africa, Phase 2

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## Contents

1. Introduction	1
2. What the IMF working paper does	2
3. Three gaps in the current framework	3
3.1 FDI as volume: The aggregation problem	3
3.2 FDI is inherently a large-firm activity	5
3.3 The representative firm	7
3.4 Business environment as firm-neutral	8
4. Risk is the binding constraint in fragile and conflict-affected states	9
5. Implications for CwA phase 2: From diagnosis to design	10
5.1 Monitoring: Decomposing the dependent variable	11
5.2 Reform benchmarking: Firm-size distribution indicators	12
5.3 Instrument design: Addressing the risk structure	14
6. Conclusion	17
References	18
Appendix A. Data availability for the proposed monitoring indicators	20

## Tables

1. Greenfield FDI in Africa by sector, 2013–2020	4
2. Foreign ownership and employment by firm size, CwA member countries (weighted aggregate)	6
3. CwA monitoring framework vs. firm-level evidence	11

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# 1. Introduction

In Tangier, a Renault assembly plant employs thousands of Moroccan workers and sources parts from hundreds of domestic suppliers. In Guinea, a bauxite concession of roughly equivalent capital value employs fewer people than a mid-sized garment factory. Both are the kind of foreign direct investment that the G20 Compact with Africa, the eight-year-old initiative now covering 15 African countries, was designed to attract. The Compact treats both investments as equally beneficial.

The Compact just entered a second phase backed by €3.2 billion in fresh German funding. I argue that these two types of investment are not equally beneficial. The second phase presents an opportunity to redesign the Compact's architecture to attract FDI, which creates more jobs.

Africa's economies need large formal firms (those with 100 or more employees) to generate the formal jobs, supply-chain linkages, and productivity spillovers that drive structural transformation. The imperative is sharpest in the low-income and fragile members, where the formal large-firm base is thinnest to begin with. Large firms account for most formal employment in developing economies, generate the bulk of productivity spillovers, and anchor the supplier networks on which small and medium enterprise (SME) ecosystems depend (International Finance Corporation 2021). In CwA economies, firms with 100 or more employees account for a disproportionate share of formal employment among surveyed firms.

The CwA framework does not yet capture this focus on large, job-creating firms. The initiative's monitoring reports track macroeconomic indicators, reform commitment scorecards, and aggregate FDI flows. They do not track the outcomes that make the investment worth attracting in the first place: job creation, the number of formal firms, youth employment, or the employment intensity of invested capital.

In November 2025, G20 leaders met in Johannesburg, endorsed CwA's second phase (2025–2033), backed by a new World Bank Group multi-donor fund and expanded membership encompassing 15 African countries from Angola to Zambia. The most rigorous recent assessment of the CwA's impact is an IMF working paper. Weeks before the Johannesburg summit, Gemayel, Isakova, and Maheshwari (2025) released an IMF working paper asking whether CwA membership caused higher FDI inflows. The authors statistically matched CwA countries with similar non-CwA countries to isolate the initiative's effect. They cannot conclusively establish causality: CwA countries received more FDI, but these countries were already receiving more before the initiative began.

This analysis is careful. But it measures the Compact's success in a single number—aggregate net FDI as a share of gross domestic product (GDP)—and that number says nothing about what the investment does once it arrives. CwA membership is the treatment; aggregate net FDI is the outcome. Behind both sits an implicit theory of change: reforms make a country more attractive to foreign investors, who then deploy more capital.

The theory of change is not wrong that reforms can attract capital. The problem is the measure. For aggregate FDI volume to track the development that member countries seek, three conditions would have to hold, and the evidence defeats each. The first is that FDI is homogeneous, that a dollar in a gold mine and a dollar in a manufacturing plant carry the same employment and supply-chain consequences; they differ by an order of magnitude. The second is that investment responds at the margin of a representative firm, when the firms that draw foreign capital and carry formal employment are large and atypical. The third, and the decisive one, is that the business environment is firm-neutral, that the constraints binding a five-person workshop and a 500-worker factory differ only in degree; they differ in kind. The binding constraint on formal employment in CwA economies is not the volume of investment but the market architecture that large firms need to operate.

A focus on large firms may lead to the employment and development impacts the CwA aims to have. Large firms anchor the supply chains, thicken the labor markets, and set the productivity standards that let smaller firms form and survive around them. If economy-wide formal employment is the goal, then large-firm formation is the channel through which a compact built on private investment can reach it. The framework I propose measures that channel.

These recommendations are based on established research. Alfaro (2003) and Javorcik (2004) showed that the development impact of FDI depends on its sectoral composition and supply-chain linkages. Tybout (2000), Hsieh and Klenow (2009, 2014), and the IFC's *Making It Big* (2021) established the firm-size distribution as an indicator of allocative efficiency. Engel, Fischer, and Galetovic (2001, 2014) and the Laffont-Tirole tradition provide the mechanism design tools—security-bid frameworks and Least Present Value of Support (LPVS) auctions—that the instrument proposals in Section 5 draw on.

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## 2. What the IMF working paper does

The IMF analysis of the CwA, authored by Gemayel, Isakova, and Maheshwari (2025), works around a difficult identification problem: the African economies that are part of the Compact self-select into the initiative. The characteristics that make a country likely to join—institutional quality, macroeconomic stability, reform momentum—are the same characteristics that attract FDI independently of any initiative.

The authors address self-selection by employing entropy balancing (Hainmueller 2012). They construct a synthetic comparison group to allow them to statistically reweight non-CwA countries so that their average characteristics (GDP per capita, institutional quality, infrastructure, human development) match those of CwA members before the initiative began. This lets the authors attribute any post-2017 difference in FDI performance to CwA membership rather than to pre-existing advantages.

The authors' results show that CwA membership had no causal effect on FDI inflows. While CwA countries had stronger FDI performance, this advantage predated the initiative. In sum, the Compact recruited countries that were already doing well on the dimensions the CwA sought to improve. CwA functioned partly as a signaling and commitment device for already-reforming governments rather than as a catalyst for new reform trajectories.

Alongside the CwA analysis, the IMF published a companion paper: WP/25/188, "Bottlenecks to Private Sector Development in Sub-Saharan Africa: A Firm-Level Analysis" (Amine, Zhang, Hakobyan, and Goel 2025). The authors used World Bank Enterprise Surveys data to identify the most binding constraints on firm performance in Sub-Saharan Africa (SSA). The paper employs both perception-based measures (what firms report as their biggest obstacles) and proxy-based measures (objective indicators of constraint severity). The central finding is a divergence between the two: firms report infrastructure as their primary concern, while the proxy-based analysis identifies corruption and financial constraints as the most severe impediments to growth.

The same companion paper also reported that "small and medium-sized enterprises face disproportionate challenges compared to large firms, especially regarding "financial access and human capital limitations." This finding reaffirms this paper's claim that constraints in the business environment are not firm-neutral.

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### 3. Three gaps in the current framework

Taken together, the analysis and its companion paper share a framework that produces a theory of change poorly suited to guide CwA Phase 2's goals of employment growth and development.

#### 3.1 FDI as volume: The aggregation problem

The analysis measures success in aggregate net FDI inflows relative to GDP, treating foreign direct investment as a homogeneous input: more is better, regardless of composition. Two decades of research on FDI and development point in the opposite direction.

Alfaro (2003) found that FDI in the primary sector has a negative effect on growth while manufacturing FDI has a positive effect. Alfaro and Charlton (2009) extended this finding. Their research indicates that the quality of FDI matters more than volume for host-country growth. They measured the quality of FDI by the technological sophistication and skill intensity of the invested sectors. Additionally, Javorcik (2004) documented that FDI's productivity spillovers operate through backward linkages in supply chains that foreign firms source locally. In turn, this productivity spillover effect depends on whether FDI operates in sectors where there is domestic supply-chain potential. Blomström and Kokko (1998) showed that spillover magnitudes vary dramatically by sector, host-country absorptive capacity, and the competitive structure of the receiving industry.

The same divergence appears across CwA economies. Guinea's FDI is dominated by extractive industries. For example, bauxite mining operations that are capital-intensive, employ few workers per dollar invested, and generate limited domestic supply-chain linkages. At the same time, a single large bauxite concession can represent the majority of Guinea's FDI stock. In comparison, Morocco's FDI is concentrated in manufacturing. Investments in Morocco's automotive and aerospace assembly employ thousands of workers and source from hundreds of domestic tier-two and tier-three suppliers. Egypt's FDI profile has shifted over time, with real estate and hydrocarbon investments competing with manufacturing and services; the employment implications of these compositional shifts dwarf the implications of changes in total volume.

Job creation per dollar of FDI varies markedly across sectors. Capital-intensive extractives such as mining yield the lowest employment return per dollar invested, while labor-intensive manufacturing (textiles, food processing, light assembly) yields far more. In addition, employment can also vary depending on whether FDI sources its inputs through local supply chains. Services FDI varies widely, from capital-intensive telecoms infrastructure to labor-intensive business process outsourcing.

United Nations Conference on Trade and Development (UNCTAD) FDI data reveal significant divergence in sectoral composition across CwA members. In resource-rich members such as Guinea and the Democratic Republic of Congo (DRC), extractive sectors account for the dominant share of FDI stocks. In Morocco and Tunisia, manufacturing and services represent larger shares.

Greenfield FDI-project data from fDi Markets confirm the pattern. Announced manufacturing projects in Morocco outnumber those in Guinea by a factor of 10 or more, while Guinea's project-level FDI is concentrated in a handful of large mining operations. When the IMF analysis aggregates net FDI as a share of GDP, this wipes out the variation into a single number.

Project-level data make the compositional pattern concrete. Table 1 reports findings from Tafese, Lakemann, Lay, and Schnars (2025), who consolidated 11,233 greenfield FDI projects across 54 African countries for 2013–2020.

**TABLE 1. Greenfield FDI in Africa by sector, 2013–2020**

Sector	Share of Projects	Avg. jobs per Project	Jobs per \$10 million Invested	Share of Greenfield Jobs
Manufacturing	19%	634	249	54%
Services	73%	~106	240	33%
Mining	~4%	645	lowest	~13%
Construction & utilities	~4%	low	low	—

Source: Tafese, Lakemann, Lay, and Schnars (2025), Table 4 and Figure 5. Four sector categories aggregate International Standard Industrial Classification (ISIC) sections: Mining (B); Manufacturing (C); Construction & Utilities (D, E, F); Services (G–U).

Manufacturing accounts for only 19 percent of project announcements but 54 percent of all greenfield jobs—about 1.4 million jobs over the period. That means that a country attracting 10 manufacturing projects can generate more formal employment than a country attracting 50 mining concessions. Mining produces the highest job count per project (645) but the lowest jobs per dollar invested, because its projects are large in dollar terms yet thin in employment. Manufacturing, by contrast, generates close to 250 jobs per \$10 million invested, in line with broader estimates of 140 to 240 jobs per \$10 million for capital investment generally (Randolph Beard, Ford, and Kim 2014).

The aggregation problem is compounded by a composition problem within aggregate figures. Net FDI includes reinvested earnings, which in extractive sectors often reflect commodity price cycles rather than new productive investment. A commodity price boom can inflate a CWA member's net FDI-to-GDP ratio without any new firm entry, any new employment, or any change in market structure. Conversely, a country that attracts multiple small-to-medium manufacturing investors, each generating high employment relative to capital deployed, may show modest FDI-to-GDP figures while experiencing the kind of private sector development CWA is designed to catalyze.

### 3.2 FDI is inherently a large-firm activity

The Lakemann, Lay, Schnars, and Tafese (2025) database indicates that FDI is predominantly undertaken by large firms. Across every sector in Table 1, including the services projects that dominate by count, at 73 percent of the total, the average project employs well above the 100-employee threshold that *Making It Big* identifies as the large-firm boundary.

Greenfield investment accounts for roughly 87 percent of total FDI volume in Africa (Lakemann et al. 2025). Mergers and acquisitions make up the rest. The aggregate FDI the IMF analysis tracks is therefore overwhelmingly a record of greenfield activity, the new productive operations that foreign firms establish.

Aggregate FDI, the paper's outcome variable, is large-firm capital: large new firms entering through greenfield projects, and stakes in existing large firms through acquisition. Yet the framework contains no large-firm variable, no discussion of firm size, and no recommendation that turns on it.

The contribution of greenfield FDI to formal employment creation concentrates in manufacturing and services. Lakemann et al. (2025), drawing on greenfield projects over 2013–2020, find that greenfield jobs account for 30 percent of formal employment growth in manufacturing and 21 percent in services across the 14 African countries with sufficient data. In several countries, including Côte d'Ivoire and Rwanda, greenfield FDI is a primary driver of formal manufacturing job creation. But greenfield job creation is small relative to total job creation (approximately 1.9 percent), because informal employment dominates. FDI's development impact operates through the formal employment channel, which is a large-firm channel.

The World Bank’s own Enterprise Surveys microdata confirm the pattern at the firm level. I tabulate the most recent survey wave for each of the 15 CwA member countries, applying the surveys’ sampling weights to produce nationally representative estimates.<sup>1</sup> The sample combines the Africa surveys (Angola, Benin, Burkina Faso, Côte d’Ivoire, DRC, Ethiopia, Ghana, Guinea, Rwanda, Senegal, Togo, and Zambia) with the Middle East and North Africa surveys covering Egypt, Morocco, and Tunisia. Every member has a recent wave, with survey years running from 2023 to 2025. I use the most recent available wave for each country to avoid double-counting. The same analysis applied to the World Bank Enterprise Surveys data across all seven World Bank regions (roughly 180 economies and about 107,000 firms) confirms that the pattern of foreign ownership concentrating in large firms holds across all developing regions, with Sub-Saharan Africa exhibiting one of the steepest gradients.

Foreign ownership concentrates at the top of the firm-size distribution. Across the 15 CwA economies, 3.6 percent of small firms (5–19 employees) have any foreign ownership stake, compared to 8.6 percent of medium firms (20–99 employees) and 15.1 percent of large firms (100 or more employees). Excluding Egypt, the corresponding figures are 5.4, 12.3, and 23.5 percent. In either sample, foreign ownership is more than four times as prevalent among large firms as among small ones, and large firms are more likely than small firms to have foreign owners in every one of the 15 members. Table 2 presents the gradient.

Egypt is reported separately for two reasons. Pooled estimates weight each firm by its sampling weight, so the largest economies dominate: Egypt alone accounts for nearly half of the weighted employment in the 15-country pool, and only 4.4 percent of its surveyed large firms have any foreign ownership. That figure partly reflects the survey frame. The Enterprise Surveys cover the formal, non-extractive private sector, which leaves out the hydrocarbon and real estate investments where Egyptian FDI concentrates (Section 3.1) and the state-linked enterprises that dominate Egypt’s large-firm landscape. Reporting the membership with and without Egypt brackets the influence of a single dominant economy on the pooled figures; the firm-size gradient itself holds in both samples and in each member country individually.

**TABLE 2. Foreign ownership and employment by firm size, CwA member countries (weighted aggregate)**

Firm Size Category	Share with Foreign Ownership, All 15 Members (Excluding Egypt)	Share of All Formal Employment, All 15 Members (Excluding Egypt)
Small (5–19 employees)	3.6% (5.4%)	—
Medium (20–99 employees)	8.6% (12.3%)	—
Large (100+ employees)	15.1% (23.5%)	61.5% (57.0%)

Source: Author’s tabulations from World Bank Enterprise Surveys, most recent wave for each of the 15 CwA member countries (2023–2025), combining the Africa and Middle East and North Africa survey programs. Sampling weights applied. Figures in parentheses exclude Egypt. Employment shares are reported only for the large-firm category; em dashes denote categories not separately tabulated.

1 Employment is measured as permanent full-time employees, and a firm is classified as foreign-owned if it reports any foreign ownership stake. Shares, means, and medians are weighted by Enterprise Survey sampling weights.

Enterprise Survey sampling frames in smaller CwA economies capture few large firms in absolute terms. The surveys also exclude microenterprises (firms with fewer than five employees) and are not designed to be nationally representative of total employment, so these shares describe the distribution of formal employment across surveyed firms rather than the national workforce. The pattern is consistent across all 15 countries in the sample and aligns with the IFC’s cross-country findings from a larger dataset.

Large firms dominate the employment landscape. In CwA economies, firms with 100 or more employees account for 61.5 percent of weighted formal employment among surveyed firms (57.0 percent excluding Egypt), a figure consistent with the IFC’s *Making It Big* estimates but derived here directly from the Enterprise Surveys microdata for the CwA membership. Foreign-owned large firms account for 9.8 percent of all employment across all firm sizes and 15.9 percent of all large-firm employment; excluding Egypt, the figures are 16.8 and 29.4 percent. Outside Egypt, nearly a third of the formal employment anchor in CwA economies is foreign-owned.

Foreign-owned firms are larger than domestic firms. In CwA economies, the weighted mean size of foreign-owned firms is 79 employees, compared to 31 for domestic firms; excluding Egypt, 87 versus 30. The weighted median is 18 versus 9.

### 3.3 The representative firm

Both the IMF paper and the bottleneck analysis operate with an implicit model of a representative firm responding to business environment improvements. In the former, the mechanism includes reforms to improve the investment climate because it is assumed that the representative foreign investor responds by deploying more capital. However, in the bottleneck paper, the mechanism is based on identifying constraints that firms report (or that objective proxies reveal), alleviating those constraints, and firms grow.

Neither paper engages with the firm-size distribution—the defining characteristic of private sectors in CwA economies, which looks nothing like the distribution that a representative-firm model implicitly assumes.

The typical CwA economy has a firm-size distribution characterized by pronounced bimodality: a broad base of informal microenterprises (driven by necessity entrepreneurship, the self-employment people turn to when wage jobs are scarce) with fewer than five employees; a thin and fragile layer of SMEs; and a near-total absence of large formal firms in tradable sectors. The distribution exhibits a “missing middle” documented across developing economies since at least Tybout (2000). Recent work specific to Sub-Saharan Africa refines this account. The studies in the Teal (2023) Journal of African Economies symposium find that the manufacturing size distribution turns less on an absent middle than on the scarcity of the largest firms—the top 1 percent that carry a disproportionate share of value added and employment. Hsieh and Klenow (2009, 2014)

showed that the firm-size distribution is an indicator of allocative efficiency, with distortions that prevent firms from reaching their optimal size accounting for a substantial share of the productivity gap between developing and advanced economies. Poschke (2018) formalized the missing middle as an equilibrium outcome of institutional constraints—a stable equilibrium sustained by the same institutional failures that CwA’s reform agenda seeks to address.

The IFC’s *Making It Big: Why Developing Countries Need More Large Firms* (2021) provides the definitive empirical treatment of this pattern. Firms with 100 or more employees account for most formal employment in developing economies because each one employs orders of magnitude more workers than the typical SME. In addition, large firms exhibit higher productivity, pay higher wages, generate more tax revenue per worker, and anchor the supply-chain networks where many smaller firms operate.

The effects large firms have on a business environment may matter most for SMEs. Amine, Zhang, Hakobyan, and Goel (2025), a paper cited previously, find that SMEs face disproportionate constraints. A second interpretation, alongside the one the authors draw, can be that SMEs face more constraints in part because they exist in market architecture that lacks the large-firm anchors that would reduce those constraints. Supply-chain demand, labor market depth, and the infrastructure investments that large firms catalyze would alleviate several SME constraints. On this reading, the finding is as consistent with large-firm absence as with a case for SME-targeted intervention.

Large firms may be necessary for SME development. The cross-country evidence runs strongly against the view that SME development generates the conditions for large-firm formation. Korea, Taiwan, and later Vietnam and Bangladesh built large-firm export sectors first. SME suppliers grew around those large-firm export firms. Causation runs from the large firms to the suppliers that grow around them, not the reverse. Small and informal firms account for most employment by headcount, but they are not the engine of formal job creation or productivity growth; a reform agenda that works on their constraints before the large-firm anchors exist is pushing on the wrong end of the chain.

### **3.4 Business environment as firm-neutral**

Macroeconomic stability, regulatory quality, infrastructure, and governance comprise the CwA reform framework. The framework is based on the Hausmann, Rodrik, and Velasco (2005) growth diagnostics approach. That approach has a theory of change that instructs users to first identify the binding constraints on growth, then reform them to relax those constraints. More investment will follow.

But the framework treats these improvements as firm-neutral. This would assume that a better business environment benefits all firms equally and the resulting investment response is simply a scaled-up version of the status quo. This assumption was always questionable. Rodrik moved away

from it. His later work on industrial policy (Rodrik 2004, 2008) argued that the binding constraint depends on which economic activities a country is trying to promote. The binding constraint depends on the sector and the firm type. The constraints that prevent a five-person tailoring workshop from growing to ten employees are structurally different from the constraints that prevent a foreign manufacturer from building a 500-worker factory.

For large firms, uncertainty may matter more than the overall quality of the business environment. Whether a firm can amortize large fixed investments over a long horizon depends on the credibility of long-duration contracts and regulatory commitments. Whether foreign investors will commit equity capital depends on the enforceability of property rights and minority shareholder protections. And the political economy of large investments can deter them outright: the risk of expropriation, discriminatory regulation, and renegotiated terms.

For microenterprises, a costly and difficult to navigate business environment is a nuisance. For large firms contemplating multi-year, multi-million-dollar investments, it is a fundamental deterrent, because the expected cost of corruption scales with the size and visibility of the investment and because corruption introduces uncertainty into the regulatory environment that is hard to hedge.

The CwA reform framework does not address the unpredictability specific to large-firm formation. To address this type of unspecifiable risk, the instrument developed in Section 5 reduces unpredictability and risk. CwA Phase 1 included reforms aimed at macroeconomic stability, improved regulatory quality, better infrastructure, and cleaner governance. Phase 2 needs an instrument to address uncertainty.

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## 4. Risk is the binding constraint in fragile and conflict-affected states

Fragile and conflict-affected states (FCS) are characterized by a mass of informal microenterprises at the bottom and a minuscule number of large firms. Most commonly, these large firms are in extractives, telecommunications, banking, or state-connected enterprises. The middle of the distribution, the SME layer that conventional development policy seeks to cultivate, is absent. This is the developing-economy missing middle in sharper form, the same bimodality the firm-size literature documents for low-income economies (Tybout 2000; Poschke 2018; Teal 2023), compressed further by conflict and weak institutions.

Because the middle of the firm-size distribution is nearly nonexistent, large firms account for an even larger share of total formal employment in FCS economies than in non-FCS economies. The few large firms that exist carry the entire formal labor market, and their survival becomes a systemic stability condition. When a large employer fails or exits an FCS economy, the labor market

consequence is a collapse of formal employment in the affected region, because no other firms of comparable scale exist to absorb the displaced workers.

The macroeconomic volatility of FCS economies compounds this structural fragility. The IMF's work on fragility documents a pattern where external shocks hit fragile states harder and for longer, forcing sharper, more procyclical contractions than non-fragile peers experience (Miksjuk et al. 2026; Chen et al. 2025). My own analysis of IMF World Economic Outlook forecast errors (González, manuscript-a) is consistent with the IMF's findings. While forecast errors for non-FCS economies cluster around modest deviations, errors for FCS economies exhibit extreme dispersion—large forecast misses happen routinely. For a large firm considering a multi-year investment, this macroeconomic unpredictability translates into uninsurable risk (uncertainty). The expected return on investment may be positive, but the range of possible outcomes is so wide, and extreme losses so probable, that the investment becomes irrational at market prices.

Several CwA members, including the DRC, Ethiopia, Guinea, and Burkina Faso, are classified as fragile or conflict-affected or exhibit the defining characteristics of FCS. For these countries, the IMF analysis's representative-firm framework implicitly assumes a market architecture that bears little resemblance to the one that exists. Designing reform benchmarks for a "representative firm" in the DRC is like designing transportation policy for a "representative vehicle" in a country where 95 percent of the population walks and 5 percent ride bicycles. The average is uninformative because the distribution is bimodal.

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## 5. Implications for CwA phase 2: From diagnosis to design

The G20 Leaders' Declaration at Johannesburg states that CwA's objective is to "increase attractiveness of private investment" in member countries through "substantial improvements of the macro, business and financing frameworks." CwA's own founding documents define the purpose as promoting "private sector led development," and the Africa Advisory Group's terms of reference commit it to monitoring "progress, future ambitions and measurable targets."

CwA's monitoring reports, produced by the World Bank Group with the IMF and the African Development Bank as data contributors and independent reviews from the African Center for Economic Transformation (ACET), only track macroeconomic indicators, reform commitment scorecards, and aggregate FDI flows, but none of the employment outcomes the founding documents invoke. The Phase 1 multi-donor trust fund's public results reporting tracks firms reached (1,600+) and people served (13.5 million) but does not disaggregate by firm size, sector, or employment intensity. Table 3 sets the framework's outputs against what the firm-level evidence shows.

**TABLE 3. CwA monitoring framework vs. firm-level evidence**

What the CwA Framework Tracks	What the Firm-Level Evidence Shows
Aggregate net FDI as a share of GDP	FDI composition varies by an order of magnitude in employment intensity across sectors
Firms reached (1,600+); people served (13.5 million)	Large firms (100+ employees) account for 61.5% of formal employment among surveyed firms in CwA economies
Reform progress on business-environment scores	Foreign ownership is more than 4 times as prevalent in large firms as in small ones, in every member country
No disaggregation by firm size, sector, or employment intensity	Foreign-owned large firms account for 15.9% of all large-firm employment (29.4% excluding Egypt)

Sources: CwA Phase 1 multi-donor trust fund public results; author's tabulations from Enterprise Surveys.

Aligning what CwA measures with what it says it is trying to achieve requires corrections across monitoring, benchmarking, and instrument design. The corrections that follow track the large-firm channel and the formal economy that forms around it.

## 5.1 Monitoring: Decomposing the dependent variable

At present, CwA's monitoring reports track reform inputs (policy actions, legal changes, institutional reforms) and a single outcome measure (aggregate FDI inflows, typically reported as net FDI/GDP). But since FDI is not homogeneous, Phase 2 should consider replacing the single outcome measure with an FDI decomposition that includes firm-size distribution, and employment intensity. Appendix A maps how much of this can be done with data already in hand. Most of the indicators proposed below can be populated now or assembled from sources already in the field; the remaining gaps are concentrated in firm-size disaggregation rather than in the absence of data.

**Sectoral composition of FDI.** For each CwA member, track annual FDI inflows disaggregated by at minimum four ISIC-level categories: extractives (mining and quarrying), manufacturing, tradable services (information and communications technology [ICT], business process outsourcing, financial services), and non-tradable services (real estate, construction, retail). UNCTAD's bilateral FDI statistics already provide sectoral breakdowns for most CwA members at the two-digit ISIC level, and the fDi Markets database tracks greenfield project announcements with sector, estimated capital expenditure, and estimated employment. The monitoring dashboard would report the employment-weighted composition: what share of inflows went to sectors with above-median employment intensity per dollar invested.

**Firm-size distribution of FDI-receiving entities.** For each CwA member, track the number and employment share of formal firms with 100 or more employees, disaggregated by domestic and foreign-owned. In this instance, the World Bank's Enterprise Surveys would be the primary source of data. The Enterprise Surveys are conducted in most CwA countries on a three-to-five-year cycle. For years between surveys, national statistical office firm registries and tax authority records may

be able to provide interim estimates. IFC's project-level data, on investee firms, could supply the foreign-owned component directly.

**Employment intensity of FDI.** For each CwA member, track formal jobs created per \$10 million of FDI inflow. This would be disaggregated by sector and firm size. This indicator connects investment flows to the employment outcomes that CwA's founding documents invoke. The International Labour Organization's (ILO) ILOSTAT database provides formal employment data that can be linked to firm-size categories; national social security registries (where they exist) provide the most accurate real-time data on formal payroll employment. A country receiving \$500 million in extractive FDI creating 200 formal jobs would be evaluated differently from a country receiving \$200 million in manufacturing FDI creating 5,000.

The Africa Advisory Group may want to adopt a decomposed monitoring template, which CGD and ACET, which already provides independent CwA progress reviews, could develop together and pilot in two or three member countries in the first year of Phase 2. Decomposed monitoring also serves the interests of the governments financing Phase 2. The German backers of the €3.2 billion commitment are not primarily seeking aggregate FDI ratios; they want to identify where bankable opportunities for their own firms are emerging, and sector- and firm-level data shows exactly that. Reporting that connects reform to identifiable investment is easier to defend before a donor parliament than movement on a regulatory-quality index.

## 5.2 Reform benchmarking: Firm-size distribution indicators

CwA's reform benchmarks track macroeconomic indicators, business-environment scores, and infrastructure metrics. However, based on the current tracking system, a country can improve on every CwA benchmark without necessarily creating or attracting a single new large formal firm to enter the market. The relationship between reform and large-firm investment is not continuous. For example, a country that remains below the contract enforcement and infrastructure thresholds that large firms require may improve its business environment without ever seeing large firms invest. To address this, the Phase 2 monitoring framework may need benchmarks that track the firm-size distribution itself.

**Large-firm density.** The number of formal firms with 100+ employees per million population. The relevant benchmark is a peer comparison. For example, Morocco has roughly 15–20 large formal manufacturing firms per million population. Guinea has fewer than three.

The *Making It Big* dataset provides cross-country baselines while the Enterprise Surveys and national firm registries provide country-level data. Where capital-intensive extractive operations inflate the count without generating the desired employment or supply-chain effects, this metric should be reported alongside the employment-intensity indicator from Section 5.1. Doing this would avoid

recreating the aggregation problem at the firm level. The Africa Advisory Group would track both metrics annually and indicate countries where large-firm density is rising but employment intensity is not. This pattern would signal a threshold failure of the kind addressed by the next benchmark.

**Formal employment share.** This metric connects structural reform to labor market outcomes directly. It is defined as the share of working-age population in formal wage employment, disaggregated by firm size. ILOSTAT supplies formal-employment estimates and United Nations data the working-age denominator. For firm-size disaggregation, ILOSTAT draws on national labor force surveys, which rarely break employment down by firm size and are themselves unavailable or dated in several members. Alternatively, the Enterprise Surveys cover only the formal, non-extractive firm sector and are not nationally representative. The two measure different universes and cannot be pieced into a single series. For many members, the indicator will therefore have to be assembled from whatever source exists, with coverage gaps reported. A rising formal employment share driven entirely by microenterprise formalization is a different outcome from a rising share driven by large-firm expansion, and the policy implications diverge.

**Threshold indicators.** These indicators are binary or near-binary. They are designed to indicate whether an economy has crossed thresholds necessary for large-firm operations. One indicator would be *Domestic credit to the private sector as a share of GDP*. The aim is to show that a country below the financial depth threshold could improve its regulatory quality score, reduce business registration costs, build roads, and still attract no large-firm manufacturing FDI, because the financial system cannot support it.

The broader financial development literature suggest that below approximately 20–25 percent of GDP<sup>2</sup> in domestic private credit, the formal financial sector lacks the depth to support the working capital and investment finance needs of firms above the SME scale. Several CwA members, including Burkina Faso, Guinea, and the DRC, are below this threshold.

Similar thresholds could developed for contract enforcement (measured by the time and cost to resolve a commercial dispute), infrastructure reliability (measured by hours of power outages per month), and regulatory predictability (measured by the frequency of significant regulatory changes affecting business operations).

Below certain levels in each one these thresholds indicate a business environment that is difficult to predict, creating uncertainty. Investment uncertainty makes large investments of long-duration prohibitive. What deters a large investor is not the level of any single indicator but its volatility and the perceived risk of large, discontinuous changes—expropriation, abrupt regulatory reversal, contract renegotiation—which a frequency count captures only crudely. Constructing a usable measure of that risk is itself a research task, separate from the level-based thresholds above.

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2 Drawn from the IFC's *Making It Big* (2021).

To make sure countries are aware of the effects of their business environment, the proposal is for each CwA member to have a dashboard that would show which thresholds have been crossed or not. Below-threshold dimensions would be flagged as binding constraints. This reframes the reform dialogue. Instead of asking “how much has your business environment improved?,” the new framework asks, “Have you crossed the specific thresholds that large-firm investors require?” Asking this question leaves less room for ambiguity, but it connects reform effort to investment outcomes in a way that continuous indices cannot.

Identifying threshold values for each CwA country requires combining cross-country evidence on conditions associated with large-firm presence (from *Making It Big* and related work). It also requires country-specific data on where binding constraints lie (from Enterprise Surveys and firm-level datasets) and threshold-detection methods from the financial development and market integration literatures. CGD, in collaboration with ACET, is well-positioned to produce these diagnostics as a concrete input into the Africa Advisory Group’s Phase 2 review process. This is a research agenda rather than an off-the-shelf instrument. Several of the indicators proposed here are not yet available on a consistent basis across the 15 members and assembling them is itself part of the work; the framework should be read as a direction for Phase 2 monitoring to build toward, not a dataset that can be switched on today.

### 5.3 Instrument design: Addressing the risk structure

The initiative’s current toolkit consists of reform commitments, peer-to-peer learning, technical assistance, and investor events. These instruments address information problems. Investors, governments, and peer countries face mutual information gaps about reform progress, investor concerns, and each other’s strategies.

While information problems are real, the most binding constraint to large firm FDI may be incalculable risk. This is the kind of risk an investor cannot diversify away, making it irrational to do anything other than wait when considering large, long-duration investments in frontier markets.

A large manufacturing firm considering a \$50 million investment with a 15-year payback horizon faces risks that no amount of business-environment information can resolve in the most volatile of CwA economies. Contracts may be renegotiated under political pressure. Regulatory frameworks may change in ways that strand the investment. Thin markets may lack the depth to absorb shocks.

Multilateral development bank (MDB) instruments designed for this problem exist in theory but have not been adopted within the CwA framework. These mechanisms are designed for the discontinuous market conditions described in Section 5.2, where incremental reform produces no investment response until a threshold is crossed, and where price discovery fails because markets are too thin to generate reliable signals. A clarification is in order here. The Compact’s Phase 2 fund does not itself finance investment proposals or hard assets; it underwrites technical assistance, country platforms,

peer learning, and the marketing of investment opportunities. The instruments below therefore operate on the MDB guarantee and private sector window facilities that the fund can help mobilize and coordinate, not on the fund's own resources. The fund's contribution is to host and administer the mechanism; the capital at risk comes from the development finance institutions it convenes.

**Security-bid frameworks.** One option is to have investors compete by specifying the minimum support package they require to invest (González, manuscript-b). This support package could include risk guarantees, regulatory commitments, or concessional co-investment. The bidding mechanism reverses the standard auction logic by instead soliciting bids that reveal the least support investors need to go ahead with their proposed investments. Designing the auction this way is informationally efficient because it reveals investors' true risk-adjusted willingness to invest without requiring the price discovery that systematically fails in markets where it is hard to price risk. For CwA, this could allocate MDB guarantees and concessional finance to large-firm investments in member countries, with the level of support determined by competitive revelation rather than administrative discretion.

**Competitive monopoly auctions for network industries.** Network industries in CwA economies, such as telecommunications, electricity distribution, logistics corridors, digital payments infrastructure, are most often monopolies or oligopolies. The conventional approach to inject competition into these markets is to either maintain state monopolies or privatize them through negotiated sales. Neither option is likely to generate the information about market viability that efficient allocation requires. Competitive auctions for time-limited monopoly rights in these sectors, designed to elicit private information about market size, cost structures, and risk profiles, can simultaneously attract large-firm investment and produce the market intelligence needed for regulatory calibration (González, manuscript-b).

**Rank-based allocation mechanisms.** In markets where there are too few bidders, too much uncertainty, too little market history, price discovery fails. In this case, rank-based mechanisms offer an alternative (González, manuscript-b). Rather than selecting investments based on price (unreliable in thin markets) or administrative judgment (vulnerable to capture), rank-based mechanisms allocate support based on the ordinal ranking of competing proposals on observable, verifiable criteria. The Least Present Value of Support (LPVS) approach is a specific instance. It adapts the Least Present Value of Revenue auction that Engel, Fischer, and Galetovic (2001, 2014) developed for highway concessions in Chile and later applied across Latin American infrastructure, substituting minimum support for minimum revenue as the bid variable. Competing investors bid the lowest net present value of government support they require, and the mechanism selects the investor demanding the least. The Chilean experience demonstrated that LPVS auctions not only reduced the fiscal cost of concessions but virtually eliminated the contract renegotiations that plagued negotiated concession processes—directly relevant to CwA countries, where contract renegotiation risk is a primary deterrent. Competitive allocation reduces but does not eliminate

ex-post renegotiation risk; host governments retain coercive power over sunk investments regardless of the initial allocation mechanism. The Chilean evidence suggests the reduction is substantial, but the constraint is real. For CwA, rank-based mechanisms could govern how MDB guarantees and private sector window finance are allocated across competing large-firm investments, so that scarce concessional resources flow to the investments that need the least distortionary support.

These instruments constitute the missing second pillar of CwA's reform agenda. These instruments address the risk and unpredictability that prevent large-scale, long-duration investment from occurring even when average conditions improve.

Competitive mechanisms also address risk of capture which is a persistent political vulnerability of MDB-facilitated investment programs. The standard MDB approach is administrative allocation of concessional resources. This approach creates opportunities for rent-seeking and invites the objection that public resources subsidize private profits. Competitive mechanisms allocate through transparent processes that minimize discretionary decision-making. The firm receiving support is the firm that demonstrated, through competitive revelation, that it requires the least.

These instruments require institutional sophistication that CwA member states may lack. To support that point, these are the same states where corruption and regulatory unpredictability are identified as binding constraints. However, the mechanisms should be administered not by host governments but through the Compact's fund and the partner MDB facilities it convenes, with the World Bank acting as a third-party auctioneer. The competitive mechanism externalizes the allocation decision from domestic institutions vulnerable to capture to a transparent, rules-based process. The MDB functions as a credible commitment device, binding both investors and host governments to rules that neither can unilaterally renegotiate.

The proposals may face resistance because monopoly rights, land concessions, and network licenses are sovereign prerogatives and ceding allocative discretion to a multilateral body is politically tricky. But the mechanism does not require wholesale transfer of allocative authority. It requires governments to opt in by choosing competitive allocation over negotiated allocation for specific investments supported by the fund. The sovereign decides which assets to put through the mechanism.

A government would opt in for two reasons. The mechanism offers a credibility premium: investors price the political risk of negotiated concessions into their bids; competitive allocation under MDB administration lowers that risk premium and translates into cheaper or larger capital flows. And the mechanism offers political cover: a minister who runs a competitive auction can tell domestic constituencies that the rules selected the winner, not discretionary negotiation. For governments facing capture allegations or factional pressure over concession allocation, this is a feature.

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## 6. Conclusion

The IMF's analysis answers whether participation in the CwA increased aggregate investment. It cannot answer the question that matters more, and that member countries attract investment to settle: whether the FDI the Compact draws builds a formal economy at scale. That question runs through the formation and expansion of large, formal firms.

CwA Phase 2 has the political backing, the financial resources, and the expanded membership to make a difference. Yet it still lacks a theory of change that matches the initiative's stated goals. The current framework treats FDI as homogeneous, assumes a representative firm, and treats reform as firm-neutral. The firm-size evidence runs counter to all three.

I propose three corrections that will fit the initiative's stated goals. A monitoring framework that tracks FDI by sector, firm size, and employment intensity. Benchmarks that include firm-size distribution metrics and threshold indicators. And mechanism design instruments—security-bid frameworks, competitive monopoly auctions, rank-based allocation—that address the risk structure of large-firm investment in frontier markets.

None of this requires dismantling what CwA built. The reform agenda, the peer-learning platform, and the investor engagement work all have a role. Needed alongside them is an explicit focus on the market architecture that supports large firms, and instruments capable of handling the risks that reform alone cannot.

The 15 member countries were convinced to partner with the G20 to attract the investment they needed. They promised reforms in return for this partnership. Reforms matter. However, the CwA economies deserve a framework honest about what reform alone can do, and instruments to address what it cannot.

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## Appendix A. Data availability for the proposed monitoring indicators

The table records, for each member and each indicator proposed in Sections 5.1 and 5.2, whether country-level data are currently available (A), partial (P), or absent (—). The pattern is encouraging. The firm-size, credit-depth, and infrastructure-reliability rows can be populated now, and the sectoral-composition row follows from existing greenfield-project data. The partial rows—employment intensity, large-firm density, and the firm-size-disaggregated employment share—can be assembled from sources already in the field, chiefly by adding firm-size disaggregation to data that exist in aggregate. Only regulatory predictability lacks any standard cross-country series, and Section 5.2 treats its construction as a research task.

Indicator	AGO	BEN	BFA	CIV	COD	EGY	ETH	GHA	GIN	MAR	RWA	SEN	TGO	TUN	ZMB
Sectoral composition of FDI	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A
Firm-size distribution of FDI recipients	P	A	P	A	P	A	A	A	P	A	A	A	P	A	A
Employment intensity of FDI	P	P	P	P	P	P	P	P	P	P	P	P	P	P	P
Large-firm density	P	P	P	P	P	P	P	P	P	P	P	P	P	P	P
Formal employment share (by firm size)	P	P	P	P	P	P	P	P	P	P	P	P	P	P	P
Domestic credit to private sector/GDP	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A
Contract enforcement (dispute resolution)	P	A	P	A	A	P	P	P	P	A	A	A	A	A	P
Infrastructure reliability (power outages)	A	A	A	A	A	A	A	A	A	A	A	A	A	A	A
Regulatory predictability	–	–	–	–	–	–	–	–	–	–	–	–	–	–	–

Notes: A = available (recent country-level data exist). P = partial (data exist but are incomplete, dated, or not disaggregated by firm size). – = absent (no standard cross-country series). Column headers are ISO3 country codes.

Sources: Sectoral composition: fDi Markets greenfield-project announcements (sector, capital expenditure, estimated jobs) and UNCTAD inward FDI. Firm-size distribution: World Bank Enterprise Surveys, 2023–2025 waves; partial where the surveyed large-firm cell holds fewer than 50 firms (Angola, Burkina Faso, DR Congo, Guinea, Togo). Employment intensity: fDi Markets estimated jobs per project and ILOSTAT, not yet disaggregated by firm size for any member. Large-firm density: estimable from Enterprise Survey weights and United Nations population data; no current firm-census or registry count is published uniformly. Formal employment share: United Nations population data (denominator) cover all members; ILOSTAT formal-employment coverage is uneven and not disaggregated by firm size. Domestic credit to private sector/GDP: World Bank World Development Indicators. Contract enforcement: World Bank Business Ready (B-READY) 2025 for covered members; legacy Doing Business data (through 2020) otherwise. Infrastructure reliability: Enterprise Surveys (power outages per month) and B-READY. Regulatory predictability: no standard cross-country series.