REDESIGN OF THE TECHNOLOGY INITIATIVE FOR THE PRIVATE SECTOR (TIPS) PROJECT

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By:

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This report represents independent findings and recommendations of the consultant. It does not necessarily represent official views of the Government of Sri Lanka or the Agency for International Development.

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TABLE OF CONTENTS

LIST OF ACRONYMS

ABLE	American Business Linkage Enterprise
AgEnt	Agro-Enterprise Project
ADB	Asian Development Bank
AITS	Swedish Agency for International Technical and Economic Cooperation
BESO	British Executive Service Overseas
BOI	Board of Investment
CBI	Centre for the Promotion of Imports from Developing Countries
CESO	Canadian Executive Service Organization
DFCC	Development Finance Corporation of Ceylon
ECP	Enhanced Credit Program
EDB	Export Development Board
EI	Entrepreneurs International
FDI	Foreign Direct Investment
FOB	Freight on Board
GDP	Gross Domestic Product
GSL	Government of Sri Lanka
IDP	Industrial Development Project
IESC	International Executive Service Corps
JETRO	Japanese Quasi-government Agency to Promote Trade
KFTA	Korean Foreign Traders Assn.
KINITI	Korea Institute of Industry & Technology Information
LOP	Life of Project
Ltd	Limited Liability Company (Pvt: Non-traded stock)
LPG	Loan Portfolio Guarantee Program
MD	Managing Director
MIS	Management Information System
MIST	Ministry of Industry, Science and Technology
NCH	Netherlands Council for Trade Promotion
NIBM	National Institute of Business Management
NIC	Newly Industrialized Country
NMCP	Netherlands Management Consultancy Programme
NORAD	Norwegian Agency for Development Cooperation
PACD	Project Activity Competition Date
PRODEC	Import/Export Office funded by the Finnish International Development Agency
PPDA	Peace, Prosperity & Democracy Act of 1994
RDLP	Research & Development Limited Partnership
Rs	Rupees
SLBDC	Sri Lanka Business Development Corporation
SLEDB	Sri Lanka Export Development Board (same as EDB)
SME	Small and Medium Enterprise
TA	Technical Assistance
TIPS	Technology Initiative for the Private Sector
TIS	Trade & Investment Services
UNDP	United Nations Development Project
USAID	U.S. Agency for International Development

PROJECT IDENTIFICATION DATA SHEET

1. **Country:** Sri Lanka

2. **Project Title:** Technology Initiative for the Private Sector (TIPS)

3. **Project Number:** 383-0108

4. **Project Dates:**

   a. First Project Agreement: Grant Agreement -- March 28, 1991
   Cooperative Agreement -- May 29, 1991

   b. Final Obligation Date: Planned -- December 31, 1996

   c. Project Assistance Completion Date (PACD): December 31, 1996

5. **Project Funding (obligated as of March 31, 1994):**

a.	A.I.D. Life of Project Funding:	$12,025,000
b.	Host Country, GSL, Contribution:	6,735,000
c.	Other sources:	-0-
	Total	$18,735,000

IESC/TIPS Component Funding (obligated as of March 31, 1994:

a.	Technology Promotional Program:	$ 3,850,000
b.	Technology Grants Program:	6,325,000
c.	IESC Technical Assistance Program:	1,350,000
d.	AID Project Evaluation and Costs:	500,000
	Total	$12,025,000

6. **Mode of Implementation:** International Executive Service Corps (IESC), Cooperative Agreement # 383-0108-A-00-1027.

7. **Project Designers:** USAID/Sri Lanka, the Government of Sri Lanka through the Ministry of Industries, Science and Technology (MIST), with initial project feasibility studies through the International Science and Technology Institute (ISTI).

8. **Responsible Mission Officials:**

   a. Mission Director: David A. Cohen

   b. Project Officers: Jon D. Lindborg, Nissanka Weerasekera, William S. Foerderer, and Dinesha de Silva.

1.0 EXECUTIVE SUMMARY

1.1 Purpose of the Report

The Technology Initiative for the Private Sector (TIPS) Project is expected to draw to a close in mid-1995 as a grant-issuing project. Although it will have responsibilities for client follow-up and disbursements through mid-1996, TIPS will meet its mandate much earlier than expected. Consequently, USAID/Sri Lanka and the GSL must concern themselves with a timely strategy to close down the existing project or redesign TIPS, retaining the project's core characteristics and benefits for private sector development.

The purpose of the assignment is to develop feasible options for USAID and GSL to redesign or reposition TIPS as a component project for private sector development. If a feasible option is not acceptable to USAID, then an exit strategy must be addressed for closing the project.

1.2 Rationale for Redesign

The TIPS project is a strong development project with a success record based on promotions and grants. From USAID's perspective, it provides a very high profile for private sector development, yet with new expectations, TIPS must be positioned to address foreign assistance priorities if it is to continue. TIPS was established with a limited life as an initial effort to create a demand-driven form of private sector development assistance. Clients were expected to contribute one-third of activity costs during first-round grants, then to incrementally contribute more during subsequent activities until they assumed the entire activity cost. Consequently, TIPS would eventually become a fee-based channel for facilitating client initiatives. When TIPS and its Sri Lankan clients reached this point, the project would close, having fulfilled its purpose, and clients would be in a position of sustaining their own development for technology and services.

As TIPS evolved, grant activity accelerated, and subsequent cost-sharing grant activities have not moved significantly toward market-priced supports. This may still happen before the project expires, but more importantly, the focus of sustainable development assistance has changed, and there are new initiatives available for credit, loans, and guarantees, that can be incorporated into TIPS. Although TIPS has been very successful, attaining an 8-to-1 ratio of economic benefits compared to project costs, it can be even more successful with an improved design and integrated assistance packaging.

With mounting pressure by GSL to continue TIPS, or to initiative a similar program through a multilateral donor or a government agency, USAID is not in a position to simply terminate TIPS. Although this paper also considers options for repositioning TIPS as a private for-profit (and as a not-for-profit) enterprise, it appears far more favorable for USAID to retain the core concept of TIPS and redesign it to accommodate foreign assistance priorities and to provide the agency with a highly effective development vehicle.

1.3 Summary of Design Alternatives

At the outset, many alternatives were considered, and although most were not feasible, the study resulted in six possible strategies for TIPS. As an ultimate decision, an exit strategy for project termination in 1996 also is addressed in the report. The six candidate alternatives are summarized below:

- Continuation under USAID/IESC. Fully fund the TIPS project in its existing configuration, extending the project life through the year 2000. The current project would end a year early and be replaced by the new project. An alternative to full-funding is also proposed.
- Redefine TIPS under USAID/IESC. Two options are presented. The first is to expand the current profile of program components, adding a function

for financial assistance. The second is to redefine TIPS in terms of "directed services" that address environmental, microenterprise, industrial, and human resource development. Funding requirements are slightly higher than "continuation" alternatives with the enhancement of new services.

- Reposition TIPS under a New Bilateral Donor. GSL and other local constituents are in favor of multilateral or new bilateral support for TIPS or a similar project. In essence, USAID would transfer control of TIPS to another donor, or to an agency funded through multilateral channels, and seek other conduits for private sector assistance.

- Reposition TIPS as a Government Agency Function. Because GSL has voiced strong support for TIPS and a commitment to continue similar efforts for industrial development, a transfer from USAID to GSL is considered, thus making TIPS an extension of government through an agency function.

- Establish TIPS as a For-Profit Enterprise. A proposal has been made by TIPS managers, and the option has been discussed with USAID, to privatize TIPS. Under this option, it would be become a fee-based consultancy and a domestic enterprise with start-up support from USAID and possible credit sources.

- Establish TIPS as a Not-for-Profit Association. A final option, and one that could be feasible in the long term, is for TIPS to be positioned as a not-for-profit association in an agency role for delivering assistance from USAID and other donors. The association would have donor support from a variety of agencies, including multilateral credit underwriting. Its purpose would be to provide advise, consulting services, access to grants and credit, to enhance trade, and to provide an educational component.

1.4 Recommendations

The recommended redesign strategy is to restructure TIPS on **directed services** that accommodate foreign assistance objectives and priorities of GSL and USAID in Sri Lanka. The project's services would address industrial and commercial development, environmental development, microenterprise development, and human resource development. It would continue as a grant-issuing project with integrated activity packaging to include direct loans, loan guarantees, access to earmarked grants from other donors, promotional support, marketing capabilities, technology sourcing, and network benefits from IESC technical assistance.

The redesigned TIPS would be fully funded at a net cost of $11.8 million, starting January 1, 1996, and ending December 31, 2000. The final year under the existing TIPS contract would end December 31, 1995, and be replaced by the new project with a recapture and reallocation of carryover funding. Changes would be required in management, staffing, and the manner in which funds are allocated to component services. A new monitoring system would be needed prior to implementing the project.

An immediate concern is that the TIPS CEO be replaced by a person with executive skills capable of managing the transition from August 1994 through 1996, and then directing the new project in its entirety. Consequently, management of the existing TA component would have to be reconciled by August 1994, and by early 1995, new staffing requirements and modifications to the monitoring system would have to be initiated.

In the event that a continuation of TIPS under USAID is not feasible, it is assumed that TIPS will be terminated earlier than anticipated in 1996. Consequently, an exit strategy is discussed in the report. In this situation, TIPS would not merely be terminated but be well-managed in its final months with a competent executive and adequate support systems in place.

2.0 THE TIPS PROJECT IN PERSPECTIVE

2.1 Purpose and Major Objectives

The Technology Initiative for the Private Sector (TIPS) project is a USAID activity positioned to assist Sri Lanka in **developing an effective and sustainable market economy.** Although TIPS was not designed to support other U.S. foreign assistance objectives, it has indirectly enhanced the democratic process through a nation strengthened by private enterprise and independent initiative. The focus of TIPS, articulated in the 1990 Project Paper, is captured in its statement of purpose:

> *To increase international competitiveness of and employment in Sri Lankan private industry improving its performance in choosing, acquiring and mastering technologies, with support from U.S. business and technology, and by facilitating removal of policy impediments.*

As TIPS evolved, several important refinements emerged to make the project a unique assistance vehicle. First, TIPS was established to be managed entirely separate from GSL involvement. Second, USAID emphasized at the outset that the TIPS team would have the flexibility to assist private sector clients independent of donor involvement in activity related decisions. Third, TIPS was designed to avoid focusing on any particular sector, excluding only those activities ineligible under U.S. law. And fourth, TIPS activities would be ***demand driven***, implying that client selection would not be subject to particular criteria such as size of organization, growth potential, asset base, or similar characteristics. "Demand driven" was expressed in terms of a client's commitment to embrace changes initiated with TIPS help by sharing risks through a percentage of matching funds with TIPS grants.

Consequently, a well-defined TIPS project was initiated with a focused goal: ***to generate economic growth and employment by developing and sustaining Sri Lanka's market economy.*** The project was solidified on the capabilities of IESC for implementing a four-component design. The components included:

1. *Technology Promotion Program.* TIPS will be aggressive in stimulating demand for technological change on the part of clients, thus establishing in their minds the need for improvement, resulting in higher productivity.

2. *Technology Grants Program.* TIPS will provide incentives, lowering costs for clients, to search for, select, and implement new technologies within guidelines for activities eligible for subsidies.

3. *Technical Assistance (IESC/VE) Program.* TIPS will provide IESC Volunteer Executives capable of specific technical assistance as a complement to the other components of the project.

4. *Assistance for Policy Reform.* As a component separate from the cooperative agreement, this will be a form of assistance to the GSL for policy reforms that can affect the business environment of private enterprise development in Sri Lanka.

The fourth component, *Assistance for Policy Reform*, was subsequently set apart from TIPS and addressed through a program with the Ministry of Industry, Science and Technology (MIST). By 1993, project activities outraced funding allocations, and a modification by USAID sharpened the mandate for assistance. Specifically, TIPS would be expected to "....finance a broad spectrum of activities to help managers and entrepreneurs in export industries to articulate their technology needs, appraise the payoffs of better technology and devote more resources to technology upgrading and management." This emphasis on ***exports*** subsequently restricted TIPS activities to clients who could demonstrate export potential.

In essence, TIPS is positioned to improve international competitiveness of Sri Lanka's private sector through technology transfer. Under its current mandate as a U.S. assistance program, TIPS and IESC have primarily achieved success by influencing changes using U.S. technology. Consequently, the TIPS strategic framework has been consistent with USAID assistance strategies and congruent with U.S. foreign policy aimed at enhancing opportunities for U.S. companies in foreign markets while helping nations to become self-reliant, democratic societies through market-driven economies.

Conceptually, TIPS was designed as a *catalyst of change*, and its activities have been structured to initiate change, motivating clients to take initiatives, and not to provide on-going support. As a catalyst, TIPS has sought to help clients overcome barriers to change and encourage them to take bolder steps toward sustained growth and self reliance. This assistance role suggests that TIPS should incubate changes, support client efforts to ensure sustainability, and then set them on a course free of assistance. TIPS established three objectives to fulfill this strategy:

1. To generate demand for technology improvements by private firms, helping them to diagnose their needs, to plan their efforts, and to formulate their requests for assistance.

2. To provide cost-sharing grants to help offset the financial burden of searching for technologies and resources that clients can pursue, either through acquisitions or linkages, thus stimulating technology transfer.

3. To provide information on, support for, or access to the international business community for new technology or markets to help clients achieve higher productivity and growth.

TIPS has been well-suited to fulfill these objectives through IESC by providing a bridge to U.S. business interests. However, TIPS has also been able to find "appropriate" technology, new markets, or access to information outside the United States without regard for political boundaries. As a U.S. assistance activity, TIPS has been subject to U.S. foreign policy constraints and laws that require the project to operate within certain boundaries.

The IESC organization has established a rapid-access conduit for client assistance through the TIPS/US team at IESC/Stamford headquarters. As detailed in the Mid-Term Evaluation, TIPS activities have been far-reaching, to include access to market information, technology sourcing, training in hard-side and soft-side technology, client involvement in the Entrepreneurs International program, trade show support, promotional development, environmental efforts, formal linkages, ABLE studies, and technical assistance. This list is far from inclusive and only hints at the depth of involvement by TIPS staff to help clients in management, systems development, and self-improvement.

In its current status, TIPS has fulfilled its objectives well ahead of expectations, and through client activities has demonstrated strong demand in Sri Lanka for private enterprise development. A summary of performance results and expectations through the scheduled project completion date in 1996 are provided in following sections.

2.2 Performance and Expectations

Performance results as of March 31, 1994, are summarized from two sources for this assignment. The first is the TIPS Project Activity Report, as of March 31, 1994. The second is a statistical follow-up summary prepared specifically for this assignment as of May 28, 1994, which covers 67 companies having completed grant activities and also having one-year post-activity data that could be analyzed.

The Activity Report shows a total of 1,014 subgrant activities approved with 463 completed through March 31, 1994. A total of $4,550,054 was allocated for approved grants. This represents approximately 72% of the total budgeted technology grant activity through the life of project, 1996. Recognizing that new activity approvals would not extend beyond the first quarter 1996 (to allow time for completion and disbursement), the allocations through the first 33 months of the project represent 61% of the planned project life; demand and subsequent subgrant activity is more than six months ahead of expectations. Expected subgrant activities through first quarter 1996 were 910 approvals and approximately 430 completions. Consequently, if current activities continue at the same pace, 100% of approvals will be made before August 1995, and 100% completed by August 1996.

The Mid-term Evaluation showed a greater acceleration of subgrant activity than now indicating that TIPS has purposely constrained approvals. In addition, the average subgrant at Mid-term was slightly more than $20,000 and as of March 31, 1994, that average had dropped to approximately $19,200, indicating that recent grant activities have been significantly smaller for more clients. Cancellations and expirations through March 1994 were nearly $1.4 million, reflecting more rigorous requirements for implementing subgrant activities. These measures have helped extend the project's life, but TIPS is expected to fully meet its objectives nine months before schedule, completing its entire disbursements five-to-seven months early.

Beginning in 1994, line-item categories were redefined into nine activities. These provide a sharper definition of TIPS' services than the seven general categories previously reported. Some interpretation was needed compare original objectives with expectations, but a reasonable summary is provided below:

Table 1

Expected and Actual Grant Activity

Activity/Service	Expected EOP/1996	Expected March 1994	Approved March 1994
Collaborator Assistance	-0-	-0-	7
Consultant Assistance	250	153	203
Financing Assistance	-0-	-0-	11
Marketing Assistance	100	62	70
Business Trip Assistance	250	153	188
Supplier Assistance	50	30	13
Technology Exposure	650	390	130
Trade Show Assistance	25	16	183
Commodity Procurement	175	106	209
Other: Marketing/Briefs/EI	-0-	-0-	122
Totals	1,500	910	1,136

(Note: 122 "other" activities are non-grant activities provided through IESC, Entrepreneurs International, and TIPS/US.) These data are based on the TIPS Activity Report, March 31, 1994.

The pattern of demand for activities is slightly different than initially expected with more interest in commodity procurement and business trips (primarily concerned with sourcing). Financial assistance was not in the original design but exists and is far understated by the data because TIPS has not encouraged financial assistance nor is the project staffed to provide channels to financial support. Marketing (actual assistance and trade show activities) has been in high demand, and consulting (for both technology and skills training) has been very strong.

The Mid-term evaluation in 1993 examined one-year post-activity results for 48 client companies. Measurable impact for that 48-firm study indicated an 8-to-1 leverage, benefits compared to costs. This took into account validated company performance compared to total project expenditures for the period. A similar approach was used in this study for 67 companies. Unlike the Mid-term evaluation which was based on actual company visits and validation of both company and TIPS records, this study was not commissioned for a formal evaluation and simply used project performance reports to summarize data.

Several limitations must be noted for the data. First, accounting practices among client companies are not consistent with western standards, and consequently sales are often recorded in cash (not accrued receivables), output is valued on variable costs (not fully costed), and assets often are carried at cost (depreciation methods are haphazard and market values of facilities are vague). Second, many clients, particularly newer and smaller ventures, did not have accurate baseline data prior to coming to TIPS, thus initial applications reflected estimated information. Third, during the first year follow-up monitoring, there has been "missing data" which apparently stems from two problems: companies lagged behind in accounting, or TIPS could not validate the results and therefore recorded the data as missing. It should also be noted that these problems existed and were articulated in 1993.

In order to compensate for these shortcomings, the 67-firm study eliminated firms that did not have verified information for both baseline and post-one-year results. The summary provided below includes 59 companies; data for 8 of the 67 studied were unacceptable. The results are:

- A 37% increase in completed new sales.
- A 24% increase in domestic sales.
- A 72% increase in exports.
- A 48% increase in full-time employees.
- A 36% increase in net output value.
- A 280% increase in U.S. imports to Sri Lanka.
- A 92% increase in non-U.S. imports.
- A 220% increase in domestic purchases.
- A 112% increase in expenditures on technology and equipment.
- A 130% increase in market research.
- A 31% increase in fixed assets.

When the total value of expenditures on new technology, domestic sales, imports, exports, market research, and new plant and equipment are summed, the figure exceeds ***$280 million for 59 clients***. If we assume that 500 clients will have completed activities by the end of the project, and a similar pattern of performance is maintained, the total value of economic activity will exceed $1.4 billion annually. However, first-year performance is unlikely to have a similar long term sustained record of growth, and approximately 55% of current clients are small companies with fewer than 50 employees which generate less dramatic nominal numbers, although growth is still impressive. Nevertheless, if first-year performance levels off in subsequent years, thus doing no more than matching domestic growth rates, total annual economic activity in 1997 will approach $1.1 billion, increasing by approximately 6% thereafter.

Compared to the Mid-term Evaluation results, the summary presented here is similar, but with a few notable differences. New sales through March 1994 versus Mid-term 1993 increased by a lesser percentage (37% vs 45%); export sales increased less (72% vs 100%); and employment increased at a lesser rate (48% vs 67%). Although the rates of growth were less for the expanded client base, the actual results were substantial, and in 1994 there were slight increases in U.S. imports, non-U.S. imports, and expenditures on technology.

Employment changes at the Mid-term evaluation showed an increase of 2,800 new full-time jobs for the 48-firm study. By March 1994, there was an additional 1,349 verified jobs reported for the composite 59 companies. This is a total increase of 4,149 jobs. More gains were reported among men than women; 2,730 new jobs went to men while 1,419 jobs went to women. This data is, however, understated. Two companies that were exempted from the 1994 study for lack of complete financial baseline data (Esjay Electronics and Simplex) had 519 and 181 employees, each recording post-activity increases of 223 and 112 respectively. A large majority in each company were women in production jobs, but precise data cannot be verified.

Although many companies report significant expansion in full-time workers, the data understates TIPS' aggregate impact on employment. Many TIPS grantees contract out various tasks to cottage industry. This may be due in part to restrictive government wage and employment policies that can be avoided by independent contractors. For example, Simplex management said they currently employ about 140 contract women for toy fabrication in addition to 181 full-time workers. The actual employment impact is unknown for all clients, but clearly it is understated for the total number employed and the number of women employed through cottage industry contracts or piece work.

2.3 Strengths and Weaknesses of TIPS

The TIPS project has several strategic *strengths* and few weaknesses, thus underscoring its importance as a development model that could not only be beneficially continued in Sri Lanka, but perhaps replicated elsewhere with appropriate funding and support. As a general statement, the beneficial strengths of TIPS have occurred because of an excellent project design and the cooperation of USAID and the current Government of Sri Lanka. Without the joint commitment of USAID and GSL constituents, TIPS might have faced a more tenuous situation in its development efforts. Consequently, political mandates of either government as parties to the bilateral effort, or changes in either government's foreign and domestic assistance policies could critically affect TIPS or a similar private enterprise development project.

2.3.1 Strengths of TIPS

The strategic strengths of TIPS are described in the Project Paper and the Mid-term Evaluation report. They are summarized here as a basis for either redesigning or repositioning TIPS after its scheduled completion in 1996.

- TIPS has an integrated project design, bringing together a network of contacts which, although primarily U.S. in context, reach European and Asian constituents. This includes an ability to coordinate industry, educational, and government resources, access data from a variety of private and public constituents, and provide an integrated array of business services. Access to brief information and marketing reports, to instigate ABLE studies, to source technology, and to bring to bear technical assistance (TA) with subgrant activities is unique.

- The IESC configuration of a local field project linked to a U.S. base office, and subsequently coupled to the Technical Assistance and Trade and Investment Services programs is a distinct competency not found in other projects or organizations.

- The demand-driven approach of TIPS works extremely well to "respond to" client needs rather than to presume what type of assistance is needed and then target assistance activities. Consequently, clients take the initiative to present proposals and through risk-sharing have a major vested interest in successful results.

- Non-targeted assistance avoids political or economic assumptions about sector preferences or capabilities. This not only averts potential conflicts in the host country but reinforces client confidence in the donor/contractor to impartially award grants on merit and initiative.

- TIPS provides a rapid response vehicle for efficient allocations and disbursements with a minimum of red tape for application processing. There are no significant bureaucratic barriers to making subgrants.

- The project enjoys *distance in governance*. Although USAID and MIST have been responsible for strategic oversight, activity decisions and project managers are given wide berth with maximum flexibility. This enhances credibility, minimizes administration overhead, and maximizes TIPS-Client operational communications.

- The TIPS project is "transparent" in the sense that it is seen as having "untied" assistance with no political interests. There is strong client confidence in TIPS leadership and its ability to avoid conflicts of interest, whether Sri Lankan or U.S. in nature, political or economic in character.

- As an untied, grant-allocating NGO project, TIPS is "noncompetitive." It does not pose a threat to fee-based domestic consulting firms, has no proprietary interest, and does not compete with other donor projects, public or private. Consequently, TIPS is unique and stands apart in Sri Lanka.

- Although TIPS is constrained by U.S. laws and USAID policies from working with clients in specific sectors such as textiles manufacturing and agriculture, the project has significant outreach capabilities, allowing assistance to the smallest microenterprises (rural or urban), entrepreneurial ventures, medium-sized firms, and larger enterprises.

- TIPS is unique in its ability to address private enterprise initiatives while also embracing special interests such as environmental concerns, women, and disadvantaged groups. This does not imply a "targeted" effort for assistance, but the lack of social and cultural restraints typical in many programs and societies, thus giving TIPS, in effect, an "equal opportunity" profile.

- Although the success of TIPS is judged primarily on measurable impact criteria, substantial hidden results occur through cottage industry employment and subsequent multiplier effects for growth in disposable income. This occurs as client companies, many of whom are engaged in low-skilled industry, contract out production as a common practice.

- TIPS clients do not have to be knowledgeable about loan applications, business proposals, or various aspects of business planning to be eligible for assistance. This is a significant factor for attracting participants who otherwise would be unable to obtain help, loans, or advice from most financial institutions, fee-based consultants, or competitive market channels.

- The integrated and coordinated efforts of TIPS is the catalytic element needed for encouraging independent initiative among clients. This is the basis for sustained economic growth of a market economy.

- Because TIPS requires cost-sharing by clients, grantees have a significant interest in, and commitment to, grant activities.

- Perhaps the greatest single strength of TIPS is that its collective efforts and operational profile promotes the concepts of ***self-worth*** and ***self-determination*** among clients. TIPS fosters behavioral changes among clients and those who witness the success of TIPS and its client base. As noted in the Mid-term Evaluation, it is the collective psyche of a people that is the "engine of growth," not temporary comparative advantage or unusual strength of a particular economic sector.

2.3.2 Weaknesses of TIPS

Although TIPS has significant strategic strengths, many attributable to the unusual character of IESC as the project contractor and the subsequent coordination of governance by USAID and MIST, there are several weaknesses. These could be more appropriately called "threats," as they are more latent than actual problems to address.

- The initial design of TIPS incorporated as one of its four components the Technical Assistance (TA) program. The TA program that existed prior to TIPS was subsequently brought under the umbrella of TIPS together with funding. However, management responsibilities were not clearly resolved. The TA Country Director became a senior director under a newly created position CEO/TIPS Sri Lanka. The CEO and TA senior director have worked together closely to accommodate ambiguous management responsibilities, yet management authority, succession, and specific job responsibilities have not been institutionalized. With different individuals involved, or changes in project leadership, there is no assurance that similar success could be sustained.

- Funding, although significant, is too little to have a major impact on the Sri Lankan economy. TIPS has a remarkable record of success with high leverage (8-to-1 or greater) benefit-to-cost ratio, but the limited grant resources do not begin to address the massive needs for private sector development in an economy of 17 million people. In addition, the administrative funding limits TIPS to a core office and small staff without provisions for growth. This restricts TIPS to activities that are cost-effective, and clients who can be easily reached, within the greater Colombo area. Although TIPS has reached clients in rural areas, it does not have an on-ground presence in other parts of Sri Lanka.

- TIPS is not in the business of providing venture capital, loans, or long term support. It is a catalyst of change based on well-devised activities that can be addressed through short-term grant assistance to motivate long term change. However, there is a pressing need by most clients for access to loans and capital, and the leverage that is created by TIPS through grants cannot be optimized. As the project stands, there are no channels for helping clients to take further steps toward securing debt or attracting equity investments.

- Because TIPS is a U.S. donor-supported effort, the exquisite network and integrated IESC system does not easily reach to European or Asian markets, organizations, or potential cooperative donors. The existing success of TIPS to span national boundaries has been a function of client contacts (or prerogatives) and serendipity. Donors from other countries do not actively seek cooperation with TIPS, and networked organizations other than those in the U.S. remain rather isolated. Subsequent leverage is therefore not maximized for market information, technology sourcing, or linkages.

- Several of the benefits of TIPS, such as distance in governance, transparency, and apolitical behavior, could be easily jeopardized by individuals in authority or government policies (U.S. or Sri Lankan) due to the limitations of a bilateral agreement. These benefits have occurred more as a result of individual commitments than structured agreements. Consequently, instability in domestic politics or changes in USAID (or higher U.S. levels of government) could suddenly alter TIPS' mandate and support. The project, as defined, cannot easily survive transition governments or political injunctions.

In summary, the strengths of TIPS far outweigh project weaknesses, and most weaknesses can be resolved or mitigated. The integrated design, as it exists, is very strong, and the demand for activities provided through TIPS will remain prominent for some time. Redressing some of the weaknesses would require additional funding, such as underwriting branch offices or more extensive work in microenterprise development, and policy changes concerning credit extension, loans or guarantee programs, and special interest programs for economically disadvantaged would require different staffing patterns. Such efforts might also lead to more complicated administration and monitoring activities. Nevertheless, TIPS' record of increased employment, export sales, and production indicate that it has had a profound and sustainable impact on household income and national economic growth. Clients purchased 220% more in domestically produced goods, meaning that there has been a substantial spillover to non-TIPS enterprises. Benefits from TIPS activities exceed costs by a factor of 8:1 indicating that the projects is an effective tool for U.S. Foreign Assistance.

3.0 FOREIGN ASSISTANCE AND USAID IN SRI LANKA

3.1 Strategic Framework for Development

The United States Agency for International Development (USAID) has begun a process of repositioning its strategic development efforts under the *Peace, Prosperity & Democracy Act (PPDA) of 1994*. As it relates to this study, the PPDA contains five program titles, each with operational objectives and guidelines that influence decisions about private sector development. These are briefly described below:

- **Sustainable Development.** The U.S. government's primary policy tool for generating economic growth and market-oriented policies in developing countries. USAID will promote broad-based, sustainable growth by addressing the factors that enhance capacity for growth and by working to remove obstacles that stand in the way of individual opportunity.

- **Building Democracy.** Under this program, assistance will be directed toward strengthening democratic institutions, supporting elements of a civil society, enhancing policies for human rights and civil justice, and establishing legal and social foundations for democratic pluralism.

- **Promoting Peace.** The U.S. will stand behind moral mandates to encourage demilitarization, peaceful resolution of conflicts, geopolitical cooperation, and democratic regimes committed to freedom engendered in democratic processes.

- **Providing Humanitarian Assistance.** U.S. assistance will encompass humanitarian relief, disaster planning, mitigation of manmade and natural disasters, and efforts to reduce suffering through integrated programs and international cooperation with the donor community.

- **Promoting Growth through Trade and Investment.** The primary provision to authorize programs of the EximBank, OPIC, and the Trade Development Agency to support specific business transactions through loans and guarantees, insurance, and feasibility studies. These initiatives are meant to help countries move up the economic ladder through export opportunities while supporting U.S. exporters to compete effectively.

The five program titles do not have equal applicability for private sector development. Promoting peace is largely a policy initiative rather than a specific development objective. Of course, peace is a desirable result of a vibrant and democratic country with a regime that takes a responsible role in the global community. Humanitarian assistance has far more pervasive implications for disaster relief than for private sector development. However, humanitarian efforts can be pursued through technology, social, health, and environmental initiatives.

The Building Democracy program assumes major initiatives to support institutional changes and policies to support democratic pluralism. Private sector development helps achieve democracy through a free market process and a sustainable economy based on the principles of self-determination. Promoting trade and investment is closely aligned to private sector development, and by bringing together constituent programs under PPDA directives, private sector development can be greatly enhanced.

The heart of USAID's assistance is *sustainable development*, mandated in the agency's ***Strategies for Sustainable Development*** (March 1994). USAID's strategic objectives follow closely those articulated in the PPDA, but with more specific operational information. Although it is beyond the scope of this report to present these points in detail, it is important to emphasize certain items that influence decisions about redesigning the TIPS project. The agency defines sustainable development as:

> Sustainable development is characterized by economic and social growth that does not exhaust the resources of a host country; that respects and safeguards the economic, cultural, and natural environment; that creates many incomes and chains of enterprises; that is nurtured by an enabling policy environment; and that builds indigenous institutions that involve and empower the citizenry. Development is "sustainable" when it permanently enhances the capacity of a society to improve its quality of life. Sustainable development enlarges the range of freedom and opportunity, not only day to day but generation to generation.(p.3)

This statement provides the rationale for USAID's future development initiatives, which are addressed in section 3.2 below. The USAID strategy document also articulates a new philosophy which emphasizes: (1) direct investment in human capital such as education, health, food security, and well-being; (2) collaboration with international donors and host nation constituents; (3) an integrated approach to development that leverages aid funds and improves coordination; and (4) building indigenous capacity through enhanced participation and empowerment of individuals and community groups.

USAID's strategies are coupled with PPDA directives and reinforced through notices and congressional hearings on foreign assistance to focus on development assistance efforts that address the following: (1) women who are disportionately represented among the economically disadvantaged; (2) microenterprise development as an initiative that can raise the quality of life among a country's poorest people; and (3) population, health, and environmental concerns that help people take control of their lives and improve conditions and prospects for themselves and their families.

Within this strategic framework, and under the umbrella of major PPDA objectives, the most critical element for development is *sustainability*. The term is reinforced throughout congressional testimony, agency documents, and policy directives. A detailed definition from the strategy document follows:

> USAID has an interest only in economic growth that is sustainable. Growth that occurs without regard for degradation of the natural resource base impoverishes future generations. Growth that depends on constant infusions of grants or subsidized financing from abroad is inherently unsustainable.
>
> Sustainability entails transformations. It requires the transformation of the work force so that it is healthier, better educated, and more inclusive. Concomitantly, sustainability entails increases in productivity that do not rely on the increased exploitation of workers. Sustainability requires an indigenous capacity to generate technology appropriate to local needs, as well as policies and institutions that facilitate the transfer and adaptation of technology from abroad. In predominately agrarian societies, sustainability entails the transformation of subsistence farming into an agriculture that can create surpluses and increase rural incomes. It depends upon a viable urban sector that can generate jobs, provide essential services, accommodate migration and boost productivity. Most important of all, sustainability mandates that greater involvement of individuals and communities in the decisions that affect their well-being. (p.31)

3.2 USAID Private Sector Priorities

The core thrust of USAID is sustainable development, and there are five focal objectives. These objectives, listed below, comprise a framework for establishing private sector assistance projects. Clearly, private sector initiatives are expected to support USAID objectives as one dimension of the overall effort in foreign assistance, and, consequently, private sector development has greater relevance, for example, to objectives concerning economic growth and environmental concerns than humanitarian assistance or stabilizing world population growth. The objectives are:

- Protecting the environment;
- Building democracy;
- Stabilizing world population growth and protecting human health;
- Encouraging broad-based economic growth; and
- Providing humanitarian assistance and aiding post-crisis transitions.

Appropriate private sector activities are expected to comply with the agency's strategic framework and to reinforce relevant major objectives. But private sector development is also expected to direct attention to women and the economically disadvantaged, microenterprise development, environmental preservation and conservation, and problems of health and human welfare. Consequently, private sector initiatives are expected to be tactically framed within these guidelines. These are described in the sections that follow together with implications relevant to redesigning the TIPS project.

<u>3.2.1 Microenterprise Development</u>

There seems to be an emphasis on microenterprise development as if foreign assistance resources are to be shifted away from other activities. In fact, the role of microenterprise development and its leverage affects are hotly debated in Congress and among development specialists. Therefore, the emphasis on microenterprise may be debatable as a development priority.

Proponents of microenterprise programs argue that, historically, major development assistance has often been less effective than expected because funds have funneled through developing country governments, often lining pockets of corrupt government officials or helping large enterprises become wealthier while doing little for the disadvantaged poor masses. This argument is steeped in the "trickle-down effect," noting that assistance was expected to generate infrastructure or major enterprises that would "pull" people into employment and "diffuse" income thereby raising standards of living. Growth in GNP and per capita income were used as impact criteria. Evidence presented in congressional hearings has been vague, but suggests that trickle-down effects are marginal; few economically disadvantaged persons seem to benefit from infrastructure and large-scale programs.

Opponents of microenterprise development do not argue in favor of infrastructure or large-scale programs, and they do not make a strong case for trickle-down effects. Instead, they argue that microenterprise development has very low leverage effects for assistance funds, and that microenterprises have little economic impact on a country's overall development. In addition, they argue that microentrepreneurs have great difficulty sustaining ventures that are typically subsistence in nature.

From a funding viewpoint, microenterprise development is expensive and requires "intense" delivery systems that often involve one-on-one mentoring and personal intervention. The results tend to be very small proprietorships or craft activities, seldom employing more than immediate family members (if anyone), and limited to narrowly localized sales. They are typically based on low-skilled activities, or make use of indigenous resources that cannot be expanded into export opportunities or domestic surpluses. Consequently, their subsistence nature creates little upward mobility and only marginal incomes.

From the viewpoint of sustainability, microenterprise development is an "immediate" activity for individuals. Shops, crafts, and services seldom provide continuity of enterprise or industrial growth. Consequently, immediate employment may be achieved as long as the individuals assisted can maintain their markets and manage their resources. Too often they fail (even in highly developed countries), or they must continue to rely on assistance to survive. Although no data exists for business failures among microenterprises in Sri Lanka, it would be difficult to envision a better record in Sri Lanka than in European nations or the United States where business failure rates range between 60% and 80% for small businesses within two years of inception. In any event, the microenterprise is an endeavor with limited profitability and income distribution. Most cannot generate surpluses or a capital base, and those that succeed provide little more than subsistence income. Consequently, they contribute little to the tax base or national income. If these arguments have merit, then sustainability, as defined earlier, is nct satisfied.

The arguments for and against microenterprise development seem to focus on extremes. Proponents make a strong case against large-scale efforts and for microenterprise development as a humanitarian necessity, but this seems to be a quantum jump from one end of the scale to the other. Opponents take up the gauntlet at the other extreme, arguing for large-scale infrastructure projects and against microenterprise as costly and inappropriate for sustainable economic development. Although opponents recognize the humanitarian value of helping the poor achieve self-sufficiency, they do not see how it achieves the objectives of broad-based growth in a market-driven economy. Unfortunately, neither side addresses enterprise development between the extremes; small and medium sized businesses, growth industries, distribution services, and middle-to-high skilled trades are not brought into the debate. The main thrust of many private sector initiatives, including TIPS, is, however, concerned with the broader spectrum of these activities.

3.2.2 Loans and Guarantees

A constructive effort is being made to use loans and loan guarantees more effectively in development activities. Under the Foreign Assistance Act Rewrite, proposals have been made for direct loans and guarantees through the Enhanced Credit Program (ECP). This may be added to agency credit programs in F/Y 1996, and applied through credit rules for development, environmental initiatives, sustainability efforts, and health-related projects. The micro and small business credit program (MSED) is proposed as successor to the Private Sector Investment Program, and could be integrated into private sector development. The Housing Guarantee program is less applicable, but may have applications to microenterprise and rural development.

The credit proposals are probably long overdue as assistance tools. Of course, the United States has had a long history of foreign aid based on variants of loans, guarantees, and transactions insurance. The EximBank has been involved in export-related transaction insurance, in effect underwriting export activity with developing countries. Debt relief as a form of aid has been a major (often majority) portion of Foreign Aid budgets as developing country debts held by the U.S. have been forgiven or exchanged through equity swaps. But until now, there has been much less effort to bring direct loans and guarantees to the enterprise level for private sector development.

In practical terms, the proposed credit programs may be extremely difficult to bring under a program such as TIPS. They cannot be components of a project, nor administered through a project, and there are no clear means of channeling clients into any of the loan initiatives. The Loan Portfolio Program (LPG) is a commercial endeavor, and although it may be strong tool for development (particularly at the microenterprise level), an NGO manager can hardly screen loan applicants or make referrals to commercial banks.

3.2.3 Innovation Initiatives

Described in the PPDA, USAID is directed to establish an innovation initiative that is focused on entrepreneurial activities and support through bilateral grants and multilateral resources for riskier enterprises. This has been positioned under the heading of a "microenterprise initiative," but has broader applications, including matching grants for PVOs, loans and guarantees for micro and small business, an educational element for information and learning about experimental activities, leveraging of multilateral bank resources, and provisions for start-up enterprise activities.

Although the innovation initiative is vague (and innovation itself is not defined for operational projects), it provides a foundation for potential private sector development activities. ome of these are listed below:

- Support for an innovation center that would provide tools, technology, and information needed by aspiring entrepreneurs to "incubate" their ideas, built prototypes, or plan new service enterprises.
- Support for university based programs much like the Small Business Institute (SBI) program under the SBA to use students in helping new ventures and small businesses through directed study programs.
- Establish networks for venture capital referrals, access information to loans and guarantees, and assistance to innovators who need help in business planning and management advice.
- Create a systematic means of sharing information with multilateral donors and other national donor agencies, such as monthly meetings, newsletters, electronic bulletin boards, and databases.
- Establish start-up grants for new enterprises as seed money for qualified innovations.
- Generate linkages with U.S. businesses who have the ability to commercialize innovations with aspiring entrepreneurs, inventors, incubator clients, or university researchers.
- Bring together private resources such as pro bono donations, PVO funds, and corporate contributions, perhaps supplemented by grants, loans, and guarantees, to underwrite innovation research and development.

3.2.4 Integrated Assistance

A general theme runs through the PPDA, recent USAID policy notices, directives, and congressional hearings that *integration* is essential. What is meant by "integration" is unclear, but there is a sense that projects within agencies often operate in isolation from one another, separated by funding and the competition for funds. In addition, national, multilateral, and regional donors or banks, including United Nations programs, tend to remain at arms length from one another. Integration is an effort to "think" in terms of packaging assistance, regardless of the source.

It is no surprise that when talking with various field agencies, donors, and host country organizations, revelations occur. One seems to stumble upon proposals for activities such as new training schools, job creation programs, earmarked loans, targeted grants for environmental activities, unallocated loans and guarantees, and significant duplication. Meanwhile, beneficiaries go begging or are bewildered by lack of assistance support when, in fact, assistance may often be readily available. For example, every development agency has voiced a sincere desire to find ways to address the problem of HIV/AIDS infection, yet in Sri lanka, the WHO director in charge of HIV/AIDS said that his project is "desperate for funds and given only superficial support by any agency." Asked how he was going to continue the project, the WHO director said he was considering a proposal to a private Japanese trust. Another example is in environmental efforts. The Trade Promotion Coordinating Committee, co-chaired by the U.S. Department of Commerce and USAID, helped launch the United States-Asia Environmental Partnership (US-AEP) in 1992, and there are no less than 19 Federal agencies involved in promoting the export of U.S. environmental technology. The US-AEP has a liaison officer in the ADB for Asia, and the US Foreign Commercial Service has nine technology offices in Asia, yet very few people seem to know about it.

3.3 Considerations for the Technology Initiative

The TIPS project is a strong development project with a success record based on promotions and grants. From USAID's perspective, it provides a very high profile for private sector development, yet with new expectations, TIPS must be positioned to address foreign assistance priorities. Redesign efforts could, however, undermine the simplicity of the project and its operations.

There are several important points to be taken into consideration. These are presented here under the assumption that USAID/Sri Lanka will want to retain TIPS as a development project, and also to protect the project's major benefits under an IESC contract.

- The focal objectives of sustainable development must be written into the project design as they apply (building democracy and humanitarian assistance may not be primary considerations, although both will be affected indirectly).

- Microenterprise development may be important as an adjunct activity, or the result of demand driven assistance, but to refocus TIPS on micro-enterprise implies reduced emphasis on small and medium industry which is precisely where TIPS has had its greatest success and assistance leverage. The SME sector is also targeted by GSL for development.

- Microenterprise development will require significant expansion of staff managers and field employees, and TIPS was not designed for this type of effort. Consequently, IESC would have to redefine staff requirements in TIPS to establish a capability for microenterprise development.

- A formal effort to include credit enhancement in TIPS would require substantial administrative costs and staffing changes. To become involved in direct loans or guarantees presumes knowledge of credit and commercial banking. A careful definition of the role TIPS would play in financial assistance is essential, yet this presents an opportunity through the credit programs for bringing vital resources to clients.

- An informal credit component for TIPS is possible, implemented through procedures that amalgamate direct loan and guarantee information, but that does not put TIPS people in the position of advocating loans, processing applications, or administering credit packages. TIPS would become a credit information office for "packaging" both grants and loans/guarantees so that a system evolves to screen applications, issue grants, refer clients to credit agencies, and coordinate grants with loans. TIPS would remain apart from lending activities and avoid activities that could be construed as conflicts of interest.

- A project similar to TIPS, whether a redesign effort or a new project, will require far better integration among USAID activities, and between USAID private sector development and complementary activities of other donors. This would include integration with domestic organizations for education, health, environment, and financial activities. Coordinating channels are necessary, not formal alliances for assistance.

- A newly funded project must be able to demonstrate how it can meet the focal objectives of foreign assistance through an effective monitoring system that captures impact criteria for the following:

  (1) *Broad-based economic development*. This is being effectively monitored through TIPS, perhaps as one of the few projects with clearly defined impact criteria such as employment, sales, output value, productivity, asset formation, and profitability.

  (2) *Environmental protection*. TIPS has had environmental impact, and project results are monitored, but a more concerted effort is needed. Consequently, activities could be rooted in a component activity or staff function to identify environmental needs and access grants through the World Bank, the ADB, or the US-AEP.

  (3) *Humanitarian (Human Relations & Health)*. Applicable aspects of objectives in "population & human health" and the "humanitarian" programs might be addressed selectively. TIPS would avoid issues of disaster relief and public health, but pursue activities concerned with *human resource development*, including industrial training and support for microentrepreneurs.

4.0 THE MACRO ENVIRONMENT IN SRI LANKA

4.1 Economic Performance

This report is not meant to be an economic study, nor to address in detail performance in Sri Lanka, however, there are several points to consider for development assistance. In general, some understanding is essential for *consumer* and *wholesale price* movements, *growth in GDP*, *output components*, *wage changes*, *unemployment*, and *commercial credit*. These are discussed in terms of current and projected performance in subsequent paragraphs with a note of caution that estimates are not the result of rigorous economic study but an attempt to solidify published information. Table 2 summarizes the data.

4.1.1 Growth factors

Gross Domestic Product (GDP) grew at a rate of 6.1% for 1993, slightly better than GSL estimated. Between 1990 and early 1994, an approximate six percent growth rate has been achieved, but this may drop slightly in 1995 and remain between 5.5% and 6.5% through 1999. Central Bank estimates are at the low end, between 4.8% for 1995 and 6.0% for 1996-1999, but the Institute of Policy Studies and private forecasters put the figures between 6.0% and 6.8%. These lower growth rates are expected as agricultural growth has slowed with falling prices for export teas and spices, rapidly rising production costs (e.g., electric power), and meager growth in tourism and travel services.

GDP growth appears to rest heavily on agricultural performance which has contributed about 23% to annual GDP during the past seven years. Industry has contributed approximately 18% during that period. These represent the leading sectors while retail, wholesale, trade services, banking, insurance, and real estate comprise, individually, somewhat less than 10%. The agricultural component is expected to ease slightly in contributions while industry (mainly factory output) is expected to increase slightly through the end of the century. Service trades and tourism are expected to remain reasonably constant as a percentage of GDP, although there have been periods of instability.

Consequently, real output growth in agriculture and industry essentially drive the economy. Climatic conditions and a world tea glut have been blamed for output problems in 1993 and 1994, and infrastructure bottlenecks continue to thwart growth rates for food products. Some confusion exists in policies for tea exports, customs on import materials used in food processing (e.g., sugar duties), and quality standards for exports (e.g., EC certifications). Therefore, agriculture may remain in a low-growth mode for several years.

Industrial (factory) output has increased dramatically. In 1993, the 9.6% growth rate nearly doubled that of agriculture (5.3%), and for subsequent years, industry is expected to nearly triple that of agriculture. Compared to other sectors, industry growth will remain the strongest, yet with changes in capital markets, lower interest rates, and more active bank lending, the financial sector will also post significant gains.

4.1.2 Price Factors

Domestic growth and significant increases in sector output will have little meaning if price levels remain high with increasing rates of both consumer and wholesale price indices. The Greater Colombo Consumer Price index, considered the primary indicator of inflation, had an 11.7% increase in 1993 over 1992. This was slightly down from previous years, and the rate of change is expected to edge down slightly more in 1995 and 1996, but the general range of price changes will remain high between 11 and 12 percent.

There is concern that inflation is understated by the Colombo index, and discussions with several economists at the Policy Institute and the Central Bank suggest that actual inflation could be between 14 and 16 percent. Two underpinning reasons may exist for this conclusion. First, the market basket

Table 2

Selected Key Indicators for Sri Lanka

Selected Item	1993	1994*	1995*	1996*
Gross Domestic Product (% Chg)	6.1	6.0	5.8	6.5
Colombo Consumer Prices (% Chg)	11.7	11.2	11.0	11.9
Wholesale Price Index (% Chg)	7.6	7.4	7.2	7.0
Unemployment (Annual rate):				
National Total of Eligible--	13.8	13.0	12.6	12.2
Domestic Graduates (est) --	16.9	14.1	12.7	12.5
Nondegree Other (est) --	13.2	12.5	12.3	12.0
Minimum Real Wage Rates (% Chg):				
All Wages & Board Trades --	1.8	3.2	3.0	3.0
Agriculture & Related Mfg --	4.9	2.1	3.0	4.8
Industry & Commerce --	-6.9	0.8	2.1	2.5
Services (nongovernment) --	-9.5	0.4	1.0	1.0
Government Employees --	18.3	4.8	3.8	3.0
Output Growth (% Chg):				
Agriculture (combined) --	5.3	3.1	4.0	4.5
Factory Industry --	9.6	11.0	11.5	12.8
Wholesale & Retail Trade --	6.5	6.5	4.0	4.0
Banking, Insurance, & RE --	7.0	7.0	7.4	7.4
Investment as percent of GDP	24.1	24.8	25.0	25.4
Average Prime Lending Rate (%) (* years estimated)	20.4	16.4	13.5	13.0

Sources: Annual Reports 1992 and 1993, and Monthly Bulletins, Central Bank of Sri Lanka; Performance of the Sri Lankan Economy, 1992-1996, Econsult (Pvt) Ltd. January 1994; and Public Investment Programme Report, Ministry of Policy and Planning, March 1994.

of goods comprising the index is based on a 1952 definition of consumer expenditures, and, second, the relative weight of key factors such as housing and energy are extremely low. More specifically, the 1952 basket of goods and services is heavily weighted on paddy/rice staples with relatively less emphasis on durable goods, while private expenditures in recent years has shifted disposable income more toward durables and consumer goods. Electricity rates have more than doubled in the past two years with a 60% increase in the six months preceding March 1994, and although Fuel Adjustment charges have been substantially removed, domestic per capita KW/H consumption has increased by more than 120% in two years.

Although it becomes rather complicated to second-guess consumer price effects, there are several trends to note. Domestic and industrial consumption of electricity has grown well out of proportion to electricity generation, and prices have outpaced income changes. If this pattern continues, the "official" consumer price index will make little sense. Coupled with rising housing costs and relative expenditures for durables, the published index is suspect and understated. On the other hand, the index is basically an "urban" indicators, and it does not capture price effects for rural families which have generally lower housing and durable expenditures; 70% have no domestic electricity, and food basket purchases are closer to subsistence costs. Consequently, there is a general sense that inflation in rural areas is lower than the Colombo rate.

Wholesale prices changed in 1993, officially, by only 7.6% over 1992, and the outlook through the end of the century is for wholesale prices to remain in the 7-8 percent range. Unfortunately, this index is far understated, perhaps even moreso than the consumer index. Electric power costs, as noted above, have increased dramatically, and yet energy consumption comprises barely 8% of the wholesale index. In reality, power for industrial use ranges between 15 and 20 percent of factory overhead in several key sectors. Facility costs (e.g., materials, land rents, direct labor) have escalated, and various petroleum material prices have risen at a rate more than double that for textiles and other raw materials. Customs duties complicate the calculation of producer prices further, such as the 25% surcharge on an existing 20% duty for paper board and stock. Essentially, duties have come down dramatically since 1989, but bottlenecks remain for many industries, such as printing and packaging, food processing, electronic fabrication, metals manufacturing, transport-related parts and products, and certain agricultural products.

4.1.3 Wage Factors

Wage rate changes are based on minimum wage rates traced through the Wages and Board Trades surveys. Since 1989, the general wage level has kept pace with official inflation rates. In 1993, the real wage change (minimum wage rates deflated by the Consumer price Index) stood at 1.8%. The data in Table 2, however, indicate that sectoral wages varied widely. Economic and Social Statistics for Sri Lanka published in 1993 show that for at least 18 years, those in nongovernment services have failed to keep pace with inflation, and for 12 years, those in industry & commerce have failed to keep pace. Real wages in aggregate have kept pace, only slightly, mainly due to non-estate agriculture and central government sector pay increases that have been positive, net gains on recorded price increases.

All wage changes are expected to remain positive for the next few years, increasing net of inflation by about 3.0% annually. This actually may prove to be somewhat conservative as current GSL policies mandating minimum wages by employers and social security payments coupled with new floor levels on PAYE withholding complicates the data. In general, it is fair to say that policy measures are being implemented to bring more employable persons onto official rolls, and that base wage rates will be biased upward. During the pst two years, efforts to support higher wage rates in agriculture and government services may account for the net positive gains. Government employees have had a substantial net real wage increase (18% in 1993), which may be attributable to catch-up GSL policies as well as general wage level restructuring in central and regional government offices. A certain fallout effect has accrued to agriculture resulting in a 4.9% increase, 1993 over 1992. Agriculture may not continue tc enjoy this rate of change in the near future, particularly in private sector activities, and government service wage rates are unlikely to spiral upward, yet they will remain strong.

Meanwhile, the service sector (exempting government) remains in a deficit position with a tremendous challenge to catch up. In 1993, services suffered further with the largest sector problem of a negative 9.5% real wage loss. The industry & commerce sector also had a negative real wage effect, losing 6.9% in 1993. Both sectors are expected to go position in 1994 and gain ground in subsequent years, but both face severe competitive pressures and have ample labor to draw from. Consequently, market wage rates are unlikely to rise substantially. In addition, the mandated minimum wage rate and requirements for various employer taxes might create distortions in the labor market, further affecting wages in industry and services. Specifically, the Rs 2,000 base requirement is expected to constrain employers from new hires, thus shifting some wage payments to contracted work and piece-rate systems. In effect, a movement could emerge for greater "unofficial employment" that avoids policy mandates thereby depressing wage rates.

4.1.4 Unemployment

Price and wage effects, coupled with government policies that appear to be targeted at a form of social welfare, complicate the unemployment picture. Without a doubt, there is a substantial unemployment problem among the rural population, many of whom are unemployable except in subsistence efforts. Very little clear data exists to illustrate the magnitude of the problem, but GSL unemployment data for the island, standing at 13.8% for 1993, is understated. In a 1993 Central Bank study, the rural unemployment rate was put at 16.0%, less than the urban rate of 17.3%, but higher than the average of 15.5% for the period. Estate and exempt government workers had very low rates thus pulling down the aggregates, but a trend was apparent in measurements of "economically active population" data which is a more accurate measure of the unemployed based on those seeking employment and at least 15 years of age. In this disaggregation, rural "employables" constituted 36.9% of the eligible labor force and may experience a higher rate of unemployment than urban workers, yet both groups exceeded the official rates by several percentage points. Preliminary statistics published in March 1994 indicate an "eligible" total labor force of 6.4 million persons (38% of the population), of which about 893,000 were unemployed. Adjusting for structural unemployment, GSL put the actual unemployment figure at 838,400 persons.

Although a rural problem exists, stemming from lack of access to industry or service jobs, lack of skills, and lack of access to appropriate training, the urban unemployment problem is different. Considering that 37.4% of the labor force is urban, the urban unemployed are approximately 314,000 persons. Of these, approximately 51.7% have secondary diplomas; about 8,000 in 1993 were educated at the tertiary degree level. Popular press reports may have exaggerated the unemployment problems for university graduates, quoting more than 50% of annual new registered unemployed persons among them, however, it is rather clear than graduates are severely "underemployed" at precisely a time when the country needs *qualified* graduates. The core issue is that an overwhelming majority of university graduates are educated in Sinhala and Tamil, not in English, and have pursued degrees in arts and social sciences, not business, science, or engineering.

According to discussions with people from the Ceylon Chamber of Commerce, the Federation of Chambers of Commerce & Industry, the University of Colombo, and the J.M.C.Jayasekera Management Centre, graduates in arts and social sciences are primarily employed in "less skilled" jobs in the service sector (mainly retail and tourism areas) which are among the lowest paid with few opportunities for professional advancement. Consequently, there appears to be significant job switching with on-again-off-again periods of temporary unemployment. Meanwhile, the bulk of urban unemployment occurs among so-called displaced persons who have moved to urban centers in search of jobs only to find that their skills (even if they exist) are not needed. Many are "street transients" who are likely to be "unemployable," even if given substantial assistance in finding jobs.

Current government policies aimed at employing graduates and relocating transients when possible seem positively motivated, but mask the employment problem. Forms of welfare subsistence to the less skilled and transients are certainly humanitarian and needed, but do not permanently improve standards of living or individual capabilities. For those graduates being placed in subsidized jobs (or expanded government functions) may be "make ready" positions lacking career objectives or capabilities for retraining in high-demand job categories. Consequently, unemployment figures are expected to show a consistent decline for several years, but there is little evidence to suggest that the newly employed will be in productive or skilled positions.

4.1.5 Commercial Credit

The prime lending rate has been reduced significantly in 1993 and early 1994. Standing at approximately 17.8% in March 1994, down from the year-end 1993 rate of 20.4%, the prime rate is expected to drop to a 12-month 1994 average of 16.4%, then drop further in 1995 and 1996. Lower rates clearly are essential to encourage commercial lending, thus stimulating industrial investment and capital formation. If we assume that inflation is "cost-based" rather than demand driven, then lower rates will not fuel inflationary spending or threaten unjustified wage rate increases. Commercial credit may be constrained, however, by administered rates and the possibility of T-bill rates that draw money away from current and saving accounts.

Closely associated with this is a system of rural credit schemes, usually directed by individuals in urban bank centers who allocate loans and subsidies for specific crops, land improvements, or targeted industries. As a result, loans and loan guarantees are impersonal channels for money that are poorly serviced and seldom meet individual or microenterprise needs in rural areas. This conclusion is drawn from several studies and articulated by the Central Bank which favors a commercial credit overhaul for rural and small enterprise development. The Central Bank specifically points to the Grameen Bank in Bangladesh and the Bank Rakyat of Indonesia as having demonstrated success through locally collateralized and communal group lending schemes. These have market rates, a low default rate, and high impact, yet have proven to be flexible, "non-directed" and "non-distorting" in nature. Similar conclusions were drawn in U.S. House Foreign Affairs testimony and in State Department Executive Briefings in late 1993 and early 1994.

4.2 Private Enterprise Development

The descriptive information and statistics in Section 3.1 above underscore the nature of private enterprise development in Sri Lanka. As a general statement, industrial development is the leading growth sector, fueled by domestic and export demand, yet lagging in real wage improvements. It is a sector hampered by lingering customs duties and tax levies, yet the core of Sri Lanka's market economy with the fewest subsidies and the least support for development assistance. The industry sector as the core of private enterprise development is faced with significant producer cost problems, most grounded in materials and energy factor prices beyond management control.

Industrial, commercial, and financial sectors face a shortage of qualified staff in several crucial areas. First, experienced senior managers (or those capable of promotion to senior ranks) are sparse and usually poorly educated in business disciplines. The number of annual graduates from Sri Lankan universities and graduate training institutes are approximately half the number currently required by companies, and they generally lack language skills to work in export oriented trade. For example, the University Grants Commission reported that 8,970 students will be eligible for undergraduate degrees in 1994 from Sri Lanka's nine universities. Of those, only 822 are expected to obtain degrees in Commerce & Management Studies. In a feasibility study for establishing a new industry management education scheme, the Ceylon Chamber of Commerce estimated current demand for undergraduate business-skilled students at 1,944. Postgraduate degrees are even fewer in number and student positions are severely restricted by funding. The University Grants Commission estimates that there will be 120 MBA or MA/MS graduates in 1994, while demand may exceed 400.

Second, skilled workers in trades such as tool-and-die making, quality control, process technology, and various engineering fields are not being trained in sufficient numbers nor are there significant matriculated students in the educational pipeline. In 1994, there were 36 technical institutes with approximately 18,000 students attending formal courses. Of these, 12,000 were enrolled in certificate or professional diploma courses, and only 2,500 in technical trades courses. Approximately 60% of all registered students were enrolled in programs or courses related to "information skills" (data entry, word processing, computer applications). These skills may be needed, but the data suggest that few students are being trained in other vocational trades.

Third, companies are hard-pressed to underwrite lower-skilled trades which may result from three factors: (1) Once trained, employees become mobile and a company's employee turnover increases; (2) paying a mandated minimum wage during initial training is considered uneconomic and thus avoided; and (3) with an ample supply of cheap labor in urban and "peri-urban" areas, companies more readily accept the conditions for replacement as cost-effective and therefore do not invest in human resource development.

4.3 Demand for Development Assistance

The economic summaries presented above suggest several patterns of change where assistance can be important. Those of primary concern for this study relate to areas of development and include: **infrastructure, industry, capital formation**, and **education & training**. There are many other potential categories to explore, such as minority employment, rural development, health care, and environmental engineering, but they are not necessarily directly related to TIPS or similar programs.

4.3.1 Infrastructure Development

TIPS is not positioned to have a direct impact on infrastructure, and any similar project is unlikely to be considered a force in infrastructure development. However, the *collective* results of a sustained transfer of technology can alter process methods, energy consumption, and distribution systems. For example, a solar-powered cell technology for steam generation at one TIPS project, if replicated among companies of similar size and power needs could reduce dependence on fossil fuels and hydro power. In the client plant, solar cells reduced peak power needs by about 22 percent in one year. New kiln processes in another plant improved productive output eight-fold and reduced fossil fuel consumption by more than 70 percent. Similar adaptations, diffused to others, could achieve a rather impression cumulative effect.

The point is that although most assistance is client-specific for most development efforts, there are many small (sometimes impressive) innovations that could become models for widespread application. Perhaps it is stretching the point to suggest an impact on infrastructure, yet a continuation of TIPS activities coupled with **diffusion** of innovations could have significant results in the long run.

4.3.2 Industry Development

The main thrust of TIPS has been in industrial development. Sri Lanka's industry and commerce sector represents 17.6% of aggregate GDP. That compares very poorly with Asian NICs. South Korea has 33.4% of GDP from industry; Singapore 29%; Taiwan 32%; Hong Kong 29%; and the Philippines 26%. These data do not include trade and commerce that directly support industry, or the figures would be 45-52% for the countries listed. Economies such as Singapore and Hong Kong are *not* known for industry but for service and commerce, yet their industrial sectors are far stronger than Sri Lanka's. The Philippines, not considered to have NIC status, also outpaces Sri Lanka. India and Pakistan's industrial sectors contribute roughly 22% and 24% respectively.

Consequently, Sri Lanka must aggressively pursue industry and commerce to not only achieve growth but to set a course for economic development comparable to other regional economies. In order to reach an approximate 20% GDP contribution for industry, the sector would have to grow nearly 6% faster than the national rate, absorbing a comparable number of jobs per year as it has plus an additional 80,000 new jobs annually for at least five years. This is based on a simple calculation of the per capita GDP and projected increases between 1995 and 2000. If we assume that the existing pattern of new company registrations and subsequent employment continues at the growth rate of about 11%, then a net growth of about 4.5% will occur in the sector. At that rate, Sri Lanka's industrial sector contribution to GDP will only rise to about 19% by the year 2000, still far below other Asian economies.

It is fair to conclude that industry assistance will continue to be strongly needed for at least the next five years, even with accelerated growth, and perhaps as long as 20 years in the country's current pattern, to achieve a viable economic profile within the region. If we consider the projected number of graduates and the population who will come of age annually, the demand for employment is for approximately 195,000 new jobs per year, 12,000 of those with tertiary education. In order to reduce the level of unemployment to less than 10%, a total of nearly 220,000 new jobs must be created annually. This rough estimate would absorb 90% of new labor market entrants and reduce existing unemployment by about a half-percent per year.

If all sectors improve to the extent of "replacement" growth plus 2% (i.e., about 7%, as in Banking, Insurance and Real Estate), then the Industry and Commerce sector would be able to absorb new-employment needs with an 11% rate of growth. This is more complicated than it sounds and assumes that productivity remains constant, company closures do not accelerate, and policy distortions do not occur. Fundamentally, there is an annual need for nearly 3,200 newly registered companies that can employ on average 50 persons and sustain approximately 6% compound growth over the next five years. Of course, exiting companies could achieve the same results with an accelerated growth rate in productive employment. A similar effort through microenterprise development would require extraordinary numbers of new company registrations with an unusually high survival rate.

4.3.3 Capital Formation

Assuming that capital market development and securities exchange measures are being addressed separately, private sector development does not have a specific mandate for improving capital formation. However, The TIPS experience shows that client assets were systematically improved providing a foundation for debt financing and more attractive equity investments among those who received assistance. Consequently, developing company asset strength is a direct result of technology assistance and helps reposition companies for both domestic and foreign capitalization.

In effect, TIPS has focused at the micro level to address company needs for asset development. The economic analyses presented earlier indicate a pressing need for more capital resources, particularly among rural businesses and enterprises headed by economically disadvantaged. Without specifically targeting assistance, a TIPS-like project can have significant impact, but demand for debt and equity underwriting will continue to outpace supply by a wide margin. Declining interest rates for commercial loans and greater dispersion of bank branches will partially alleviate the problem. Access to direct assistance loans, facility mortgages, loan guarantees, operating capital loans, environmental grants, subsidies for rural development, and various export promotion programs will also help. Some of these may create market distortions, but overall, assistance could be enhanced with better packaged activities that include grant and loan (or loan guarantee) support.

4.3.4 Education & Training development

The total number of students in undergraduate and graduate programs for Sri Lanka is about 33,000. Approximately 12,000 newly qualified individuals will enter the job market each year, inclusive of postgraduate programs and diploma or professional institutes. As shown earlier, the number of persons with new trade skills or technical certification will increase by about 2,500 annually. These data taken together represent a very small proportion of the total number of persons who are likely to become eligible for employment each year; between 5% and 7%. Compared to Hong Kong, Singapore, South Korea, and Taiwan, the total number of tertiary degreed individuals is very low (these countries graduate between 18% and 22% annually with rates increasing).

Because there is such a low number of students with both language and business skills being graduated, and because projected demand is far in excess of the numbers currently in the educational pipelines, Sri Lankan universities increased their new student intake for business and commerce degrees by about 45% between 1990 and 1993. As noted earlier, there is a far greater shortfall, and consequently, the Ceylon Chamber of Commerce has, in 1994, put forward a proposal to GSL (targeted for World bank support) for a US $100 million educational program. The initial pilot program was expected to start by June 1994, and would be targeted to industry specific skills training and demand driven professional development. In the long term, the program is expected to provide MBA and executive development education in degree and diploma courses while also addressing industry and trade skills training.

Foreign assistance will play a pivotal role, either through GSL-directed loans, loan guarantees, grants obtained with multilateral funding, or through direct aid, such as the Netherlands Fellowship Program. But these efforts are long term and viewed as less-than-sufficient to meet Sri Lankan needs with expected economic growth. A TIPS-like project is not going to have significant impact on education and training except through the technological upgrading that occurs with client growth and process development. This should not be short-changed -- it is important -- but not sufficient. Nevertheless, an intervention form of assistance like TIPS generates tremendous network effects through promotional programs, grants, and technical assistance. There are ample opportunities to identify education and training needs, and if the mechanism existed, for helping clients gain access to existing programs.

4.4 Factors to Consider in a Redesign Strategy

From an economic perspective, there are several factors to consider for development assistance. These are summarized as considerations below:

- If Sri Lanka is to continue its progress toward NIC status, thus raising standards of living and reducing foreign debt dependency, it must lower internal transfer payments and subsidies through higher employment in productive enterprises. Thus industry and commerce contributions to national income and employment must be increased at an accelerated pace with sustainable performance.

- Development progress for infrastructure is vital, particularly in new electric power generation for supporting domestic household consumption and industrial growth. Perhaps of near equal importance is development of transportation and telecommunications infrastructure, but a lack of cost-effective power seems to be paramount. Historically, foreign assistance has played a major role in infrastructure development, and more recently, infrastructure projects have been pursued through private sector development, but USAID's private sector programs do not emphasize infrastructure or large-scale capital activities.

- The trickle-down effect may be an illusion. There is no evidence that major assistance projects have resulted in significant employment opportunities for those at lower socio-economic levels in a developing country. As noted earlier, recipient governments and vested interests of large-scale enterprises often profit, but benefits are seldom widely distributed. Also, GNP may improve, but the economically disadvantaged are seldom better off. Consequently, more intense assistance with enterprises that have productive employment is crucial.

- Microenterprises, although important, tend to be subsistence efforts, and most are started by individuals who are already employed or that have employable skills. Consequently, assistance for microenterprises may be important for humanitarian reasons but may not have significant impact on national development, employment, or disposable income.

- With the number of people becoming eligible for employment, new company formations must increase by 3,200 or more annually for several years to absorb those individuals and systematically reduce unemployment. If Sri Lanka is also going to meet its economic goals, these companies must add to the country's *productive output* and have *income-generating employment*, not merely be government-supported jobs.

- The leverage needed in industrial development is for companies that can generate and sustain more than subsistence employment. Consequently, small and medium sized companies, whether positioned for domestic or export activities, are the strongest prospects for using assistance for leveraged results.

- Commercial credit availability and a stronger equity base for private and non-public stock companies must be addressed. An active securities market is essential, but it has a scope limited to public companies, not the small and medium sized companies that require access to operating capital. Assistance can address this need through projects that help companies strengthen their asset base and sales performance.

- Capital formation also includes assistance requirements for improved access to loans and guarantee programs. This suggests a coordinated effort to network assistance projects within a donor agency and among other donors, domestic organizations, and affiliated institutions.

- A strong development effort requires equally strong education and training efforts. Industrial development, even among microenterprises, cannot be achieved without managerial, technical, and skilled trade personnel. Considering Sri Lanka's profile of education and training for these professionals and skilled workers, there is probably a structural problem in formal education that cannot be addressed through assistance, yet assistance can be directed at "demand driven" efforts such as company specific skill needs, executive management development, process technology training, and technical assistance.

- Environmental concerns exist at the national, industry, and enterprise levels. Assistance can do little at the national level except through cumulative effects, and it would require a major assistance effort to address industry problems except as an extension of education. But project assistance can be directed to enterprise problems with direct grants, loans for technology, and packaged assistance that includes environmentally friendly initiatives. Unfortunately, individual firms are unlikely to make a serious effort to solve environmental problems in the face of widespread abuse and weak enforcement. Companies are more likely to ignore environmental issues, unless cost-effective.

- Human resource issues have always been important elements of foreign assistance, in particular through activities targeted at the most severely disadvantaged groups. A private sector development project does not fit neatly into this mold, yet has direct and measurable impact through job creation, income effects of enhanced skills, and transfer effects of taxable income. That does not preclude a private sector project from making a more determined effort to address human resource requirements, but to do so through means that a project has at its disposal. A private sector project should be held accountable for what it can do, but not become a variant of the Peace Corps.

5.0 REDESIGN ALTERNATIVES FOR TIPS

5.1 Continuation under USAID and IESC

The TIPS project has been very successful, and the project design concept has been studied closely, indicating that its benefits are well worth U.S. Foreign Assistance support. Consequently, the primary alternative to consider is retaining TIPS, essentially unchanged, as a private enterprise development project. Subtle changes may occur, and there are several scenarios to consider as possible strategies. Each of the scenarios that follow assume that IESC will continue as the implementing contractor and USAID as the donor.

5.1.1 Replication of TIPS Project

Fund a new five-year project almost identical to the existing one with a similar budget and mandate. Only those changes that help resolve weaknesses described earlier should be addressed, namely: (1) TIPS and TA management control would be reconciled either by separating the two components or by putting both under one executive; (2) create a liaison capability with other USAID initiatives to access direct loans and loan guarantee programs; and (3) strengthen network activities with missions and projects of other countries to enhance client services.

Under this scenario, TIPS would not be "redesigned" nor "repositioned," but simply "continued." The actual size of the budget allocation might be altered slightly, but not substantially, and TIPS would remain engaged in activities as it is now. Changes in USAID policies or U.S. Foreign Assistance would not be ignored, but TIPS would remain demand-driven and would not be redirected away from its current purpose and strategic objectives.

TIPS could be feasibly underwritten for a five-year period (1996-2000) with a new budget of $12.0 million. The project would be funded at that level, but require net new allocations of approximately $10.8 million. This could be accomplished by recapturing the 1996 carryover of an estimated $1.2 million, thus ending the existing project in 1995, and implementing the new project contract in 1996. This full-funding option would require less for promotions than the original project because TIPS would have the advantage of on-going operations; monitoring, and project support systems are in place. In addition, the IESC/TA budget could be reduced if management is consolidated under TIPS. More important, a greater percentage of funds could be allocated to grants.

This option provides the best leverage of experience, management, and network activities established during the first TIPS project. It assures project continuity at full strength from the end of 1995 onward. If pending credit initiatives are implemented, the TIPS project would become an extremely strong private sector initiative with a platform necessary for microenterprise development. The estimated budget under this option would be (x 000):

Estimated Budget under Full Funding

Year	Promotions	Grants	IESC T/A	Annual
1996	$ 800	$1,500	$ 225	$ 2,525
1997	800	1,500	225	2,525
1998	800	1,500	225	2,525
1999	800	1,500	225	2,525
2000	225	750	225	1,200
Total	$3,425	$6,750	$1,125	$11,300

Add: Contingency and Evaluation & Audit:	$ 700
Total New TIPS Budget, 1996-2000:	$12,000
Actual New Funds less 1996 Recapture:	$10,800

5.1.2 Retain TIPS but Refocus Activities

Because USAID is faced with changes in foreign assistance policies, TIPS would remain a private enterprise project and continue to provide subgrants under its existing mandate, but its focus would be altered. This falls short of a "redesign" effort, but does "reposition" TIPS by emphasizing efforts to reach more microenterprise clients, commit more resources to environmental technology development, and target more effectively the economically and socially disadvantaged. Consequently, TIPS could, for instance, be held accountable for an earmarked program for helping women and enterprises that generate jobs for less-skilled persons.

This could be accomplished through incentive grants, structuring all "normal subgrants" at a 50% participation rate, but for those that address special interests, a premium of 67% or more. It could also be accomplished by working with special interest groups (such as the Rural Women's Bank) to make grants to help provide leverage necessary to qualify for loans. Thus, loans would follow credit guidelines for facility and asset underwriting while grants would be used, as they are now, for non-asset-based activities. The combination would provide much more extensive assistance to microenterprise entrepreneurs and women who have the greatest difficulty qualifying for any form of commercial financing. A percentage of grant money could be allocated to these client groups thereby creating a forced distribution in subgrant allocations and close accountability for serving people who are among the most severely economically disadvantaged.

Essentially, this would be a "shift" in objectives requiring TIPS to focus less (if any) on export-oriented enterprises, retain a profile with aid for industrial clients, and allocate more to domestic microenterprises and minority owned (economically disadvantaged) clients. The danger, however, is that TIPS would lose its strength of high leverage in economic activity to partially address special interest groups. It would also require an enhanced monitoring system and an expanded staff capable of new venture planning, microenterprise start-up activities, and loan packaging.

How much emphasis would be placed on economically disadvantaged, environmental, and microenterprise interests is arbitrary, but assume that promotional activities and subgrants can be line-budgeted. Using the budget estimates noted above for 1996-2000, TIPS would contain three distinct subgrant elements -- Industrial, Microenterprise, and Environmental. The budget in 5.1.1 above would be retained, but under **Grants**, there would be three budget categories with the following allocations (x 000):

Year	SME/Industrial	Microenterprise	Environmental
1996	$ 800	$ 400	$ 300
1997	$ 800	$ 400	$ 300
1998	$ 800	$ 400	$ 300
1999	$ 800	$ 400	$ 300
2000	$ 400	$ 200	$ 150
Total	$ 3,600	$ 1,800	$ 1,350

This profile would hold TIPS accountable for utilizing grants in each sector. Coincidentally, it would not change substantially in terms of the environmental title as roughly 25% of existing grant activity is assistance for environmental activities (safety, quality testing, and environmental equipment procurement). It would require a determined effort for assistance in microenterprise activities, which would, by definition, include assistance for the economically disadvantaged. However, USAID and TIPS would have to remain somewhat flexible in allocating these budgeted funds because the thrust of grant activities depends on demand-driven applications. Consequently, if demand fluctuates among grant categories or changes over time, TIPS should have the discretion to approve grants without restrictive line-item budgets. Category budgeting is therefore a means of providing general guidelines for assistance, not inflexible limits on client services.

5.1.3 Retain TIPS but Adjust Funding

The scenario developed under 5.1.1 could be substantially supported at a lower funding level to relieve pressure on USAID/Sri Lanka, yet retain the project and its benefits. There is a floor funding level at which TIPS must be funded to be practical. This floor cannot be precisely determined, but it is in the area of about $7.5 million for a shortened project life of four years. This estimate is based on the pattern of current year activities that would pare down promotional and subgrant activities (somewhat below 1994 allocations) to approximately $2 million annually during 1996-1998, with a reduced-budget exit year in 1999.

This would effectively add three years to the existing project as the 1996 carryover is recaptured when the new project is implemented. Thus, TIPS would expire at the end of the century, be replaced by a new project, or be repositioned as policy changes might dictate. At the $7.5 million funding level, TIPS would be less active than it is now, and activities would require more careful screening.

A four-year planning period would be the likely minimum project life required. Experience with grant activities show that the average length of activity, from the initial client's application to activity completion, is about 14 months; many run for 18 months before completion. Because it is essential to have at least one year follow-up monitoring after completion, a client will be involved with an assistance activity for a period between 24 months and 28 months. Some that have add-on activities and second or third round assistance remain involved much longer. Therefore, activities during the final year of the project may be curtailed (no new clients) but assistance support will be required with careful monitoring to ensure that activities are fulfilled and performance can be sustained.

Estimated Budget under "Floor" Funding

Year	Promotions	Grants	IESC T/A	Annual
1996	$ 600	$1,200	$ 200	$ 2,000
1997	600	1,200	200	2,000
1998	600	1,200	200	2,000
1999	200	400	200	800
Total	$2,000	$4,000	$ 800	$ 6,800
Add: Contingency and Evaluation & Audit:				$ 700
Total New TIPS Budget, 1996-1999:				$ 7,500
Actual New Funds less 1996 Recapture:				$ 6,300

This alternative is a "bare bones" approach, but it is feasible for the shorter project life. It assumes that total new allocations required would be far less than designing and underwriting a new private sector initiative for several reasons: (1) project infrastructure would be in place without added capital start-up costs; (2) carry-forward funds projected for 1996 of about $1.2 million would be used for active project endeavors rather than final-year gatekeeping; and (3) slight adjustments in budgets resulting from reconciling management and fewer promotional activities would reduce overhead.

5.2 Redefine TIPS under USAID and IESC

Identify USAID priorities and redefine TIPS within that framework, but with its core content intact. Based on changes in foreign aid priorities and the administration's focus on microenterprise development, minority and humanitarian programs, environmental concerns, and social considerations, TIPS would be "redefined", not merely repositioned. TIPS would subsequently embrace new activities and require IESC to hire staff with expertise to meet new operational objectives. There are two options to consider: *New Component Program Design* and *Directed Services Design*.

5.2.1 New Component Program Design

Under this option, TIPS would address development for industrial enterprises, microenterprises, environmental technology, and human resources. However, these could be captured through activities of program components similar to existing ones with the addition of loan programs or special funding support that might arise for activities related to the environment and to assist the economically disadvantaged. The project components would be:

- **Promotional Program.** A program of activities structured on existing criteria to generate awareness and demand for assistance, self-reliant client participation in subgrants or loans, and self-development through educational and outreach endeavors.

- **Grants Program.** A system of subgrants involving clients in risk-sharing activities similar to the existing program but either funded at a lower level or structured for a larger grant share (50/50) by clients. The rationale for a pared grant system rests with the ability to either provide support from other USAID projects or to package activities with direct loans and guarantees through USAID credit initiatives.

- **Financial Assistance Program.** Coordinate through TIPS commercial loans and guarantees through the Loan Portfolio Guarantee program, direct loans and guarantees through the Enhanced Credit program, and client access to venture capital, loans, or financial assistance available commercially or through donor organizations. TIPS would coordinate, not administer applications or service loans and guarantees.

- **Technical Assistance Program.** Consolidate technical assistance under the TIPS project management together with client records and volunteer assignments, monitoring, and accountability.

Funding for a component-based program would be quite similar to the estimated budgets presented under the options in 5.1 above. Assumptions of "floor funding" requirements and project life would equally apply. However, a significant increase would be needed to staff the financial assistance component, enhance the monitoring system, and coordinate a more complex integrated assistance effort. Although the grant funding may be pared, support at the floor level may be insufficient to support a new financial component.

The annual cost of maintaining a financial assistance program would include approximately $50,000 for personnel, $100,000 for activities required in due diligence and risk/credit analyses, and $25,000 for monitoring. The monitoring system and operations would be restructured to ensure thorough accounting for client activities, requiring significant first-year sunk costs in equipment and training. Assume this cost to be $100,000. Also assume that costs for promotional activities in support of financial assistance will be absorbed in the promotion budget, not an added cost to the new financial assistance component. If these assumptions and project expectations for microenterprise and human resource development are reasonable, then the following budget may provide a baseline at full funding (x 000):

Estimated Budget under Component Design

Year	Promotions	Grants	Finance	IESC T/A	Annual
1996	$ 800	$1,500	$ 275	$ 225	$ 2,800
1997	800	1,500	175	225	2,700
1998	800	1,500	175	225	2,700
1999	800	1,500	175	225	2,700
2000	225	750	175	225	1,375
Total	$3,425	$6,750	$ 975	$1,125	$12,275

Add: Contingency and Evaluation & Audit:	$ 700
Total New TIPS Budget, 1996-2000:	$12,975
Actual New Funds less 1996 Recapture:	$11,775

5.2.2 Directed Services Design

Under this option, the program components noted above would exist as funding categories, but TIPS' activities would be structured on "directed" services that reflect USAID priorities. Accountability would be based on a project structured on the following:

- **Private Enterprise Industrial Development.** Using the integrated approach to development with the components noted in 5.2.1 above, TIPS would assist private enterprise clients through combined grants, loans and guarantees, educational support, research, and the array of IESC network services available. In effect, this would be a directed service similar to that provided by TIPS now with additional assistance tools of LPG, ECP, and other USAID instruments.

- **Microenterprise Development.** TIPS would proyide integrated support for microenterprise development, utilizing grants, loans and guarantees, promotional tools, and network services. This would require separate and new component funding in addition to feasible levels of funding for the other component programs. When possible, leverage of assistance would be used for group projects and cooperative funding for people in the economically disadvantaged minorities. For example, groups of family "contractors" that work for toy companies could be consolidated and trained, perhaps even assisted with equipment loans to provide a dozen or more families in proximity with similar support. Groups of individual contract growers providing spices might be assisted with new methods and supplies. Contractors that make simple electronic diodes or wiring assemblies could be provided aid for tools and training. At the individual level, direct grants, loans, and guarantees would assist those that meet USAID guidelines for risks and sustainability.

- **Environmental Technology Development.** Through tied grants and matching loans (perhaps accessing other donors such as the World bank), TIPS could address environmental technology for small scale industry and projects not requiring infrastructure. Specific allocations would be budgeted for these efforts. Environmental efforts could be approached on two levels -- individual and industry. At the individual level, clients could be assisted with specific business proposals. At the industry level, TIPS could provide consulting, educational assistance, and incentive grants and credit support to address major environmental problems, thus leveraging technology for widespread dissemination.

- **Human Resource Development.** Rather than focus on individual problems of the poor, TIPS could generate leverage by establishing cooperative programs with universities, training centers, and vocational schools for skills training. By utilizing IESC network contacts, volunteers or specialists could be brought to Sri Lanka for skills such as tool-and-die fabrication, machine tool operation, and electronic assembly. These are generic skills that can transfer between industries or companies thus improving opportunities for the least skilled and most economic disadvantaged persons. Unusual skills, such as jewelry fabrication or special printing, which are often proprietary to a few companies could be supported through activity grants or loans, perhaps using existing company employees assisted with training methods and resources.

This alternative is far more complicated than others. The project budget and monitoring system would require new program components with "activity" categories of assistance. The four primary components would be emphasized within the project according to the following weights: **Private Enterprise Industrial Development = 50%, Microenterprise Development = 20%, Environmental Development = 15%,** and **Human Resource Development = 15%.** Each of these would have activity budgets, and using the assumptions under 5.2.1 above, these activities would have the following weights: *promotions = 28%, grants = 55%, financial assistance = 8%*, and *technical assistance = 9%*. Each component in the estimated budget below assumes a reallocation according to these percentages under "full funding", with a notation of special first-year funding for substantial modifications to the monitoring system (x 000):

Estimated Budget under Directed Services

Year	Ind. Dev.	Micro. Dev.	Env. Dev.	HR. Dev.	Annual
1996	$1,400	$ 600	$ 400	$ 400	$ 2,800
1997	1,400	600	400	400	2,800
1998	1,400	600	400	400	2,800
1999	1,400	600	400	400	2,800
2000	500	200	150	150	1,000
Total	$6,100	$2,600	$1,750	$1,750	$12,200

Add: Contingency and Evaluation & Audit:	$ 700
First-year Monitoring System Costs:	100
Total New TIPS Budget, 1996-2000:	$13,000
Actual New Funds less 1996 Recapture:	$11,800

5.3 Reposition TIPS under a New Bilateral Donor

Retain the core elements of TIPS as it exists now with appropriate adjustments in management structure (as in 5.1 above), but transfer the core project to a new donor, such as the World Bank. This option assumes that IESC would remain involved, thus eliminating potential donors such as the British or Canadian counterparts to IESC. The rationale for this is that BESO and CESO lack networks, access to ABLE support, and integrated databases comparable to IESC, and neither BESO or CESO could replicate the IESC integrated design. Both organizations also have significantly different funding constraints and strategic mandates for assistance that do not emphasize private enterprise development as defined by USAID under the TIPS project. Of course, this assumes that the World Bank would be interested in such an option.

This does not exclude the World Bank or the Asian Development Bank, but neither organization is positioned to support an integrated program based on grants. They typically deal at the GSL ministerial level and do not become involved in project management. However, they have significant resources and several funds set up for specific grant activity, such as the World Bank environmental fund. One possibility is to reposition TIPS through GSL in such a way that GSL would generate donor underwriting through an earmarked loan, then allocate funds to TIPS for grants and related activities. Consequently, GSL would absorb the cost of TIPS in its general foreign debt. GSL would, in effect, make a block grant to TIPS while maintaining strategic governance in concert with the donor. Operational management would remain at a distance, and TIPS would retain its beneficial profile of services.

Depending on the nature of funding and expectations for TIPS, it may require changing from a project focused on subgrant activity to one that processes loans or loan guarantees. TIPS, then, would be working with a loan portfolio versus a grant portfolio with a segment of grant allocation for underwriting TIPS as an agent for these activities. Unfortunately, TIPS would no longer by "TIPS" as we know it, and the project would require staff with expertise in valuation matters, commercial loan processing (or at least similar applications), and servicing client accounts.

This would not preclude TIPS from retaining its private enterprise development mandate, but would assume replacement of grant activities with various financing instruments. Such an effort could also attract cooperation from other national donors and earmarked funds for regional development. IESC could remain as contractor, depending on donor preferences, but under this option IESC would have to establish financial management capabilities. Also, USAID would probably want to reorganize the Technical Assistance (TA) program as an independent development activity.

Funding estimates are not relevant to considering this option as USAID would simply transfer the project after negotiating disposition of assets. The agency would want TIPS to arrange a smooth transition to ensure continuity of client activities and responsibilities for existing commitments.

5.4 Reposition TIPS as a Government Agency Function

Transfer the TIPS project to GSL funding and control. This is not a remote option considering the bilateral agreement for development assistance between the United States and Sri Lanka. It is also feasible because there is a strong interest (indeed a public affirmation) that the government of Sri Lanka will ensure that TIPS is continued. The Prime Minister has said firmly in a speech to the Press Club in Washington, D.C., that TIPS has been such a successful endeavor that he is in favor of significant expansion and a sense of permanence for the project in his country's development efforts. When speaking at the opening of the 1994 American Trade Fair in Colombo, the Prime Minister once again applauded TIPS for its success and promised that it would continue as a major channel for U.S.-Sri Lankan trade development. It is also important to note that the Central Bank strongly supports continuation of TIPS, and interviews with local constituents during this assignment indicate that GSL will mount its own TIPS project if, for some reason, USAID does not continue as the donor.

Consequently, political protocol would dictate that USAID make a gift of TIPS as a turnkey project, transferring entirely the project, and perhaps its systems and assets, to the government of Sri Lanka. As a new function under GSL, TIPS would most likely be managed and staffed by Sri Lankan nationals, not IESC employees. Consequently, the new GSL agency function would not enjoy the advantages that TIPS has now, such as international networks, access to executive volunteers or technical assistance, and market access to technology. The new organization could develop expertise in client services and grants, and certainly could establish the means to provide the equivalent of financial and consulting services, but would lose the primary conduits to foreign markets and official U.S. development assistance.

What the new agency would do is not clear, but the presumption is that GSL would want to try to retain the core program components and secure funding through its multilateral assistance donors. Although this option is feasible, it is unlikely to meet GSL's expectations for development. Also, the new agency function would probably suffer some loss in credibility as a government activity. The existing reputation of TIPS as a politically nonaligned and independent, demand-driven organization would be seriously weakened if positioned under government control. From USAID's perspective, the existing project would be quietly ended with the least publicity possible, and GSL would simply create the new agency function with USAID's help. However, the best intentions and cooperation by USAID and GSL are unlikely to succeed in replicating the project as it now exists.

5.5 Establish TIPS as a For-Profit Enterprise

Take TIPS private by helping current staff and managers interested in this option to continue as a domestic organization. Managers at TIPS have put forward a memorandum indicating an interest in becoming a private consulting company if USAID cannot extend its project support. This could be a "big bang" effort at the end of the current profit life, or "staged" with one or more transition periods. For example, TIPS could be wound down thrcugh a caretaker exit strategy, replaced by a "seed" grant or loan backed either by USAID or though multilateral financing for 2-3 years while a new company is being created, and then a new enterprise legally formed.

The major problem with this option is lack of effective demand for a limited range of fee-based services. Based on discussions with several TIPS clients and local consulting firms, a private consultancy would not be able to deliver the same advisory services or provide access to grants or credit channels. Unless the new enterprise could demonstrate networked linkages and support through contacts with foreign trade commissions for access to markets, the managers would have only their expertise to sell. Clients are unlikely to buy that expertise, except perhaps for selected services such as advice on trade show promotions, new venture planning, and application procedures for approaching loan and grant agencies.

Fee structures would be localized, perhaps in the range of one-to-two thousand rupees per day, and it would be difficult to attract more than 100 billed days per year for the two or three primary managers. This conclusion is based on realistic experience by well-established development contractors and consultants who typically spend approximately 40% of their time sourcing clients and preparing proposals, 20% on administration (office functions, staffing, consultant recruiting), and 40% on billable activities. Even at the high end of the market, domestic consultants in Sri Lanka bill at Rs 2,000 per day, and assuming 100 days billed, annual income per consultant would approach Rs 200,000 (US$ 4,200 gross). A quick estimate of overhead costs and staff salaries suggests that net income per consultant would be, at maximum, no more than Rs 60,000 (US$ 1,260). It is more likely to be far less.

The venture would not be able to replicate TIPS activities and would not survive without substantial non-fee support. As it floundered, a rub-off effect would occur, harming USAID's reputation for development assistance by association. The managers, of course, have every right to go out on their own to form a consulting venture, but any connection with USAID or the former TIPS project would be disadvantageous to everyone. Furthermore, because the new firm would want to focus on client activities that generate the highest income possible, it would not serve development assistance objectives. It would not address microenterprise development or problems associated with economically disadvantaged groups, and it would have no reason to consider humanitarian or human resource development activities except, perhaps, through training and management development programs. Consequently, USAID would have no justifiable reason to help the enterprise through its start-up period.

5.6 Establish TIPS as a Not-for-Profit Association

Retain the concept of TIPS but organize its services for fee-based services as a not-for-profit enterprise. Conceptually, TIPS would function much like a chamber of commerce but with a strong mandate for private sector development, supported through a system of grants from every national donor interested in participating, and enhanced through multilateral loans. TIPS would be a legal entity, independent of government or any particular donor control, yet have a board of trustees represented by those constituents.

The new organization would draw its primary funding from periodic grant allocations from donors under a cooperative agreement whereby each country would commit something on the order of $250,000 annually. If there were four granting agencies, the enterprise would have a core funding of $1 million, and if this could be matched with multilateral loans, a total of $2 million could be made available. Consequently, the new TIPS would not rely on fee-based services for the livelihood of managers and staff, and could therefore target assistance to any company, to microenterprises, or to individuals regardless of their ability to pay. This removes the major barrier to development under a for-profit option, and it opens the door for donors to support a wide range of assistance programs with minimal concern for conflicts of interest or political maneuvering implicit in a for-profit company or government agency.

Because the new TIPS would not be a grant-issuing enterprise, the core funding and loans would ensure program sustainability. Also, because it is a not-for-profit, independent enterprise guided by a constituent board of trustees, it could retain the credibility and program integrity of the existing project. It would be managed entirely as a Sri Lankan enterprise with a director appointed by the constituent board, and although GSL may be directly involved at the board level, there would be no direct link to GSL or any particular donor. TIPS would be apolitical and nonaligned with respect to any donor nation.

Operationally, TIPS would function much differently than it does now. Direct grants would not exist except through special programs such as the World Bank's environmental fund or USAID's US-AEP initiative. TIPS would not be involved in administering these grants but could act on behalf of clients to help gain access to grants or to prepare feasibility studies for grant applications; TIPS would become a cooperative conduit for any donor with assistance funds and any client seeking help for funding. This would not preclude the possibility that TIPS could be empowered by donors to help make grants targeted to rural development, women's enterprises, educational institutions, or microenterprises.

The new TIPS could also act in an agency role for financial support through credit initiatives by donors, commercial loan guarantee programs, venture capital associations, and access to formal capital markets. In this regard, TIPS would not become involved in lending or client qualification, but in helping clients effectively structure proposals and plan new ventures. It would also serve to disseminate information about financial assistance to the public through sponsored seminars, publications, and programs such as small business workshops, technology demonstrations, and promotional activities.

The core components and advantages of TIPS, as it stands now, could be maintained under the new association. There is no reason why IESC, BESO, and CESO networks could not be accessed through the association with activities supported through the annual grant and loan funding. Cost-sharing activities with clients could continue, perhaps expand with credit access, enriching the concept of technical assistance. There is no reason why network support for marketing or technology sourcing could not be promoted through constituent donors from Europe, Asia, and North America as long as TIPS did not become an advocate for any special interest group. And there is no reason why TIPS could not initiate programs in cooperation with GSL or quasi-public organizations such as the Ceylon Chamber of Commerce to establish business incubators, trade development programs, or skills training institutes.

The new association could spearhead educational programs or cooperative non-fee consulting services such as those provided through the U.S. Small Business Institute (SBI). The SBI, funded through the U.S. Small Business Administration, contracts with universities to provide consulting services to small businesses by using student teams managed by faculty members. The student teams, for example, prepare business plans, do marketing research, establish accounting systems, and provide reports on product development, technology, distribution, trade, finance, and management. In turn, the SBA pays the university a set stipend (currently about $1,500) which is used to give the managing faculty member a small honorarium, cover university costs for administering the SBI program, and support field expenses for student teams and research.

From USAID's perspective, the agency would initiate the association and become the enabling force to bring together the other donors as participants with equal status in founding the new TIPS. USAID would have to create a well defined feasibility plan for this alternative, complete with initial start-up funding requirements, program components, and management responsibilities. In effect, USAID would write a proposed charter and commit seed grants for its implementation. Consequently, USAID would remain involved in a TIPS-like private sector development activity and benefit from an association that could channel development funds, open access to credit programs, and pursue targeted assistance to microenterprises, environmental initiatives, and economically disadvantaged segments of the population.

On the downside, this type of association would only succeed if the participating donors could find a common ground for cooperative funding, and at the same time, agree on the association's objectives, program components, and management. In addition, the Government of Sri Lanka would have to have a prominent role in formulating the association's development priorities. In order to bring these constituents together, the effort would be akin to establishing a micro-model of the United Nations. USAID cannot simply say that it sounds like a good idea, assume that it can be done, and then let the existing TIPS project quietly end. There would be significant negotiations and contract terms to settle with detailed program development. This would take considerable time and effort, and if the new association did not materialize, or was only established with marginal support, USAID might be charged with an embarrassing faux pas. The agency would also be left without a viable private sector development program, and both USAID and GSL would have lost momentum currently enjoyed with a successful TIPS project.

6.0 STRATEGIC PROPOSAL OR EXIT ALTERNATIVE

6.1 Preferred Strategy for TIPS

The preferred strategy is to redefine TIPS under a **Directed Services Project**, the option described in 5.2.2, and fully funded at $13 million for the period 1996 through 2000. This is the strongest alternative and has the advantage of directing assistance to program priorities under current foreign policy mandates. Although the directed services option is described in detail earlier, a summary of its attributes is provided here.

The Project Paper and subsequent Cooperative Agreement with IESC would be modified to accommodate revised objectives for sustainable development assistance. Specifically, TIPS would provide assistance to encourage broad-based economic development, while protecting the environment and promoting humanitarian efforts through directed services for industrial and commercial enterprises, microenterprises, environmental initiatives, and human resource endeavors aimed at the economically disadvantaged. To these ends, TIPS would provide services through the following service components:

- **Private Enterprise Industrial Development.** TIPS would assist private enterprise clients through combined grants, loans and guarantees, educational support, research, and available IESC network services for technology, improved trade, and domestic enterprise development.
- **Microenterprise Development.** TIPS would provide integrated support for microenterprise development, utilizing grants, loans and guarantees, promotional tools, and network services to encourage new, small ventures capable of sustained benefits for the ventures themselves or the individuals who can become better skilled and more capable of achieving economic prosperity through self-determination.
- **Environmental Technology Development.** TIPS would address environmental problems by providing grants, loans, or loan guarantees for technology and training at the enterprise and industry levels, thus providing the means and the incentives for clients to pursue environmental programs, initiatives that improve safety, and endeavors that reduce the exploitation of natural resources.
- **Human Resource Development.** TIPS would establish cooperative programs with universities, training centers, and vocational schools for skills training by utilizing IESC volunteers or commercial specialists, and by sponsoring activities that help people and companies develop skills, jobs, and new enterprises capable of long term growth.

In order for USAID to implement this choice, the project would be approved to begin January 1, 1996, and the existing TIPS project terminated December 31, 1995. The project would be fully funded at $13 million, although carryforward funds from TIPS for 1996 (estimated at $1.2 million) would be recaptured, thus requiring an estimated net new commitment of $11.8 million.

Negotiations between IESC and USAID would require agreement on a separately funded new monitoring and evaluation system capable of tracking the activities and results of directed services and the more complicated requirements for financial assistance. The resulting Cooperative Agreement with IESC would resolve management authority and organization of the IESC/TIPS project in Sri Lanka, and articulate the relative weight and subsequent accountability for performance within each service component. USAID must also involve GSL/MIST constituents as appropriate under the bilateral agreement.

Prior to August 1994, USAID and IESC must agree on organizational changes with a suitable executive staff capable of managing TIPS through the transition and into the year 2000. This will ensure a smooth transition and protect client interests and their activities while also encouraging TIPS to begin redirecting efforts toward new program priorities. Monitoring system modifications should begin in 1995, well in advance of project implementation, to establish a capable system before activities begin to take place. And finally, USAID should articulate criteria on which project performance will be judged, thus orchestrating operational objectives with the redesign of the Project Paper. Measurable impact should be specified at the outset.

6.2 Implications for Other Alternatives

If the preferred strategy is implemented, the remaining alternatives are ruled out as discreet choices. Nevertheless, potential new activities have emerged from studying the alternatives, and several important assumptions have surfaced that will influence the new project.

New activities include ways to leverage funds and to package assistance for clients. Specifically, the not-for-profit option highlighted the potential for bringing together other donors and multilateral support. The preferred TIPS strategy does not exclude these possibilities on an informal basis, and a more pervasive integration of development efforts should be pursued at the donor level utilizing the advantages of the TIPS platform. Access to credit and grants from other agencies will increase leverage. In addition, TIPS should pursue cooperative development programs with universities and various skills training institutions, thus leveraging assistance to reach more people with direct support for employable skills or new venture initiatives. Also, because TIPS is constrained by its urban location and small staff, some effort must be made to reach a broader base of clientele. This might be accomplished through cooperative efforts with other agencies, with universities, or through expanded staffing for extension offices.

In terms of packaging assistance, and in light of budget constraints, reduction of the grants program, or outright replacement of grants with credit instruments, was considered. Under the preferred strategy, some changes could be incorporated to enhance assistance packaging. For example, cost-sharing grants could be established at 50% for both clients and TIPS. No attempt would be made to "wean" clients toward a 0% grant, but maintained at 50%. Instead, loans or guarantees would become preferred methods of assistance because, by definition, if clients have the capability for greater cost-sharing, they will have improved their risk profile as a lendable entity. Meanwhile, targeted clients among women and the economically disadvantaged could be approved for "premium" grants with less cost-sharing (or perhaps 100% grants). These could also take the form of "repayable grants," given with the understanding of being repaid as grants, not loans, thus bearing no interest or charges. If the grantee defaults, the grant allocation is simply written down. But a certain percentage of grants will be repaid thus further leveraging assistance funds.

The Small Business Institute (SBI) initiative could be an additional program activity sponsored through TIPS. It may not be appropriate to design it into the project, but it could be a growth option as the new project begins solidifies. Fee-based services, although troublesome to administer as noted under the for-profit alternative, may be feasible for many TA activities whereby consultants other than volunteers are brought in for specific tasks subject to client agreements. Some cost sharing could be provided through TIPS to reduce the expenses of bringing in fee-based consultants, but clients would be responsible for market rates, thus expanding the network of TIPS and recapturing money that has in the past been absorbed by IESC/TA or TIPS.

Several assumptions that surfaced are important to note. When we considered the alternative of transferring TIPS to the World Bank, the question was whether the World Bank (or any other multilateral agency) would be interested in TIPS. It is safe to say that anyone looking closely at the project's results would be interested, but not to become involved in management or in a program that could be influenced by domestic politics. Also, because the World Bank and ADB have recently launched new development efforts or are considering programs such as the Ceylon Chamber of Commerce training institute, there is a strong commitment to enhancing private sector development. USAID and TIPS should seek ways to integrate these interests through activity packaging, information networking, and cooperative referral programs. As stated earlier, there is no reason why TIPS should be exempt from working with other donors as a not-for-profit association, so there is no rationale for a USAID-backed TIPS from doing the same; donors should not be in competition, but complement one another.

Another important assumption is that the Government of Sri Lanka has publicly committed itself to continuing TIPS. If necessary, this would occur through a GSL agency. Unfortunately, this would seriously weaken TIPS and perhaps create an adverse situation for both USAID and the GSL. Yet, USAID must recognize that if the agency decides to "jump off the tiger now," GSL will try to "jump on itself." Both parties could become victims, and neither have the means to "shoot the animal." TIPS, or some project like it, will most likely go forward regardless of the consequences.

6.3 An Exit Strategy

Each of the alternatives considered is a form of exiting the current project. However, the preferred choice of directed services exits by providing an enhanced project with greater potential for development assistance. The second choice would be the "new component" alternative under 5.2.1 in which existing program components are supplemented by a financial assistance function, thus enriching access to development funds and integrating the various project components. It would also require changes in monitoring and staffing, and would need sensitive definitions for activities concerned with microenterprise, environmental, and human resource development.

The third and fourth options assume that TIPS can be essentially retained as it is, thus replicating the existing project for another period of time or reducing funding levels to comply with budget constraints. These choices are the easiest to consider because the project would require only fine tuning in terms of its management and monitoring systems. The size the budget allocation and the project period are arbitrary, and between the extremes of full funding and "bare bones" support, there is a continuum of possible support levels. If a fully funded "directed services" option (or new component option) cannot be supported by USAID, the least troublesome and least costly option would be to fine tune TIPS at the best budget level possible above the floor funding.

The not-for-profit association option has tremendous merit, but it would be very difficult to implement in Sri Lanka without significant cooperation from other donors and a well-articulated feasibility plan. The plan would require extensive design efforts and perhaps many months to complete with the inherent risk of being blocked or killed by uncooperative parties or through political pressures. If it was successfully launched, it would have to begin as a rather small enterprise with limited capabilities, then evolve as donor support and program services began to solidify. This option, however, presents an interesting possibility for exiting TIPS in 2000. If it is considered as a possible exit strategy at the outset, when TIPS is redesigned and the project is implemented, then USAID would have four years to develop the new feasibility plan and align donors without risking its presence in private sector development. This is, in fact, a recommendation for an exit strategy assuming TIPS is continued through 1999 or 2000.

If TIPS is not continued under one of the feasible alternatives, there is no choice other than finding a way to end the current project. This must be done with a sense of "damage control" to bow out gracefully without risk to USAID's reputation as a development agency, and equally important, without putting at risk existing TIPS clients. Because funding is expected to be fully allocated by the summer of 1995, and considering the pattern of disbursements and time required for activities to be completed, the project will be a shell by early 1996. Client activities after that time would involve monitoring, making disbursements, and simply answering inquiries through referrals.

If a suitable replacement for the TIPS CEO can be appointed, and if the remaining managers and staff stay with TIPS through the end of the project, then the exit may be relatively smooth. However, this is unlikely for several reasons. First, the TIPS CEO replacement in this situation would be in a gatekeeping role, and consequently the position would not be very attractive to an executive of CEO calibre; a junior person might appear on the scene, or perhaps an executive with no real interest in the project, and the entire credibility of the initiative would be at risk. Second, current managers and staff would have little reason to stay through the end of the project; personal and career interests would certainly give them reasons to consider other employment. Third, the gatekeeping role coupled with a lame-duck staff and a monitoring system that is inefficient could lead to significant problems of client control, diligence in disbursements, and accountability. And fourth, with the approaching end to TIPS, GSL constituents would certainly not wait to launch a replacement program. USAID would be seem as jumping off the tiger, and GSL would try to mount it. Consequently, a "smooth" exit under these circumstances seems remote, and the public relations fall out could be rather unpleasant for USAID and the government of Sri Lanka.

7.0 CONCLUSIONS

The TIPS project has had a remarkable record of success, demonstrating significant leverage of assistance funding for a strong ratio of benefits to project costs. It is unique and respected within the development community and by its clientele. Although a new project design is recommended, the nucleus of TIPS and its philosophy of private sector development remain unchanged. Some modifications are necessary to focus attention to foreign assistance priorities, yet TIPS has often addressed these priorities without a formal mandate. Specifically, TIPS' clients include a significant number of small enterprises and new venture, and the project's record for assisting women and for pursuing environmental activities is realistic. Also, by assisting clients with employment opportunities in low-skill occupations, a majority of those employed through grantee organizations have come from a population of economically disadvantaged persons. Employment benefits, particularly for women and marginally employable persons, have also been significant, but hidden from official data through cottage industry contracting.

It is also reasonable to argue that there have been many unmeasurable benefits from TIPS activities. Through promotional activities, seminars, workshops, trade show activities, industry visits, and public engagements, market concepts of a free enterprise system have been introduced to more than 6,000 Sri Lanka participants. Strictly from a perspective of grant clients, TIPS has been involved with more than a thousand companies representing more than 32,000 employees. Many of these people have become keenly aware of the TIPS project and how their companies have benefitted from assistance. Although we cannot account for attitude changes, it is an intuitively sound conclusion that many managers and workers have learned more about free enterprise, trade, new technology, new work methods, market mechanisms, and the constituent benefits of an open democratic economy.

This report emphasized the importance of sustainable development to USAID and to U.S. Foreign Assistance policy initiatives. The performance of TIPS and its impressive results for improved sales, increased employment, enhanced technology, and substantially improved value-added output are not short-term consequences of temporary assistance. They represent structural changes in client organizations that are crucial for sustained growth, and, consequently, TIPS has fulfilled its role as a catalyst of change that can perpetuate that growth. Although it is unlikely that an exponential rate of growth can be maintained among TIPS' clients, even more modest results far exceed nominal growth rates in Sri Lanka. It is also important to emphasize that private sector industrial development is expected to be the engine of growth for Sri Lanka, and TIPS is unique in its ability to provide precisely the kinds of services needed during the foreseeable future.

In the event that USAID chooses to no longer support TIPS, thus terminating the project when activities cease, it must accept several risks: The current project will be difficult to close gracefully; GSL may seek to replicate TIPS through a government agency that could create an awkward situation with doubtable benefits; and USAID Sri Lanka will be challenged to replace TIPS with an equally viable project that is both cost-effective and effective as an instrument for sustainable development.

In conclusion, it is in the best interests of everyone concerned that TIPS be continued under the most beneficial project design. Recommendations for project design changes will redirect TIPS in constructive ways to enhance grant activities and assistance packaging. If the recommendations are implemented, the project will have a broader scope of services and a stronger selection of development tools. USAID will benefit by having a low-risk project with high-leverage results that fully address the major objectives of sustainable development and the strategic goals of U.S. Foreign Assistance.

APPENDIX I -- INTERVIEWS AND VISITS

Patrick Amarasinghe, President of the Federation of Chambers of Commerce & Industry, Colombo, Sri Lanka

M. Denzil Aponso, Managing Director, Simplex International (Pvt) Ltd.

Keith D. Bernard, Director of Monitoring & Evaluation, T.I.P.S./Sri Lanka

David A. Cohen, Mission Director, U.S.A.I.D./Sri Lanka

Sujeewa de Alwis, Director of Project Development, T.I.P.S./Sri Lanka

Dinesha de Silva, Private Sector Development, U.S.A.I.D./Sri Lanka

William S. Foerderer, Private Enterprise Officer, U.S.A.I.D./Sri Lanka

Amitha Gamage, Managing Partner, Amaran Gems and Lapidaries

Gary W. Heinke, Director, Institute for Environmental Studies, Asian Region, University of Science & Technology, Hong Kong

Dr. G. N. Jayakuru, Director, UN HIV/AIDS Program, World Health Organization, Sri Lanka

Sanath C. Jayanetti, UNDP/UNIDO Project, Ministry of Industry, Science and Technology

Chullante G. Jayasuriya, Secretary-General, The Ceylon Chamber of Commerce.

Amarananda S. Jayawardena, Deputy Governor, the Central Bank of Sri Lanka

Saman Kelegama, Economist, Institute of Policy Studies, Sri Lanka

Mumtaz Khan, Division Manager, Asia, International Finance Corporation, World Bank, Washington DC

W. D. Lakshman, Dean, Faculty of Graduate Studies, National Director, UC-ISS Co-operation Project, University of Colombo

Jon D. Lindborg, Private Enterprise Officer, U.S.A.I.D./Sri Lanka

Lorne G. Olsen, Chief Executive Officer, T.I.P.S./Sri Lanka

L.P. Douglas Pemasiri, Director, Department of Commerce, Sir Lanka

Moksevi Prelis, Chairman, National Institute of Business Management

Wimal Rupasinghe, Managing Director, Srinko Enterprises (Pvt) Ltd.

Luxman Siriwardena, Director/Investment Division, Ministry of Industry, Science and Technology

Dennis M. Smyth, Loan Portfolio Guarantee Program Consultant, Coopers & Lybrand, for U.S.A.I.D.

Quintus Suriaratchie, Senior Director, Technical Assistance Program, I.E.S.C./Sri Lanka

Nissanka Weerasekera, Private Enterprise Officer, U.S.A.I.D./Sri Lanka

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