Mid-Term Evaluation
Feasibility Studies Cost-Sharing Program

Evaluation Report No. 3

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Bureau For Private Enterprise
U.S. Agency for International Development
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MID-TERM EVALUATION OF THE
FEASIBILITY STUDIES COST-SHARING PROGRAM

Submitted to

Office of Policy and Program Review
Bureau for Private Enterprise
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by

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FEASIBILITY STUDIES COST SHARING PROGRAM

Executive Summary

Problem and Overview: As part of its program to promote the development of indigenous private for-profit enterprises in developing countries, the Bureau for Private Enterprise of AID offers partial funding for feasibility studies intended to provide the basis for investment and financing decisions.

The Feasibility Studies Cost Sharing Program seeks to bridge the "information gap" between conception and actual investment in a business, based on the concept that a feasibility study should put a local entrepreneur in a better position to secure U.S. joint venture partners, outside financing, and further technical assistance.

U.S. Assistance: This experimental project (940-002.26) was initiated by the Bureau for Private Enterprise in September 1982. The program is administered from Washington to promote the formation of private, for-profit developing country businesses by providing 50 percent of the cost up to $50,000 for feasibility studies for potential business ventures in targeted sectors. The program has two principal objectives: (1) to serve as a loan origination mechanism for Bureau for Private Enterprise Office of Investments or other financial institutions; and (2) to develop a model feasibility study financing program, the concept of which would be replicated in individual countries and managed either by the respective USAID Mission or an appropriate in-country institution.

The authorized level of spending through September 30, 1986, is $1,350,000. To date approximately $810,000 has been committed to studies, all of which has been for agribusiness projects. Sixteen projects have been approved for feasibility funding in nine countries, including Costa Rica, Dominican Republic, Egypt, Kenya, Liberia, Malawi, Pakistan, Panama, and Zambia, as well as a regional project in the Caribbean.

Purpose of Evaluation: This evaluation, conducted during March-May 1985, represents the first formal review of the feasibility studies program, although numerous internal memoranda, trip reports and periodic status reports have documented the experience for individual cases and overall program operations. The present review was conducted to provide the Bureau for Private Enterprise management with an outside, objective analysis of the progress and problems of

this program and to provide guidance to the Bureau on corrections and adjustments in the project design and management to improve project implementation and results. The focus of the review during April 1985 was on Pakistan, Costa Rica and Malawi since nine of the 16 approved studies were in these countries.

Findings:

1. The Feasibility Studies Cost Sharing Program has financed feasibility studies as it was designed to do. The management structure and procedures were adequate for the size of the program administered. Over 300 requests were answered on a timely basis and over 75 files were opened. Correspondence was exchanged in 42 cases. Seventeen studies were approved and 16 actually were carried out.

2. Permanent financing has not taken place in any of the approved projects. Of the 16 approved projects, seven are known to have been abandoned by the sponsors.

3. Administration of the program from Washington hindered communication with developing country entrepreneurs and opened the door for consultant-driven studies. The eligibility criteria were not always clear to applicants nor to the USAID personnel handling private sector initiatives. Communications with the field were uncertain and character and management verification were difficult.

4. The program operated in relative isolation from local financial institutions. No completed feasibility study was taken to a local bank by the Bureau for Private Enterprise. Prior commitments by financial institutions were usually weak or missing altogether.

Project Design and Policy Implications: The program's experience demonstrates that administration from Washington was a key constraint to the success of the program and is an inappropriate organizational design for a program that targets developing country entrepreneurs. Inadequate knowledge of local conditions, delayed communications and uncertain coordination inevitably led to investment performance below expectations.

The project design was suited more to the investment style of donors and other governmental organizations than the needs of the private sector. In the redesign of this and similar programs, the information needs and procedures used in the private sector need to be more carefully considered.

Conclusions and Recommendations:

1. Conclusion: The Bureau for Private Enterprise Feasibility Study Cost Sharing Program, in its present form, is not reaching its intended market (developing country entrepreneurs) with a product that contributes significantly toward securing investment financing in business ventures.

Recommendation: The program should be restructured to be administered in targeted developing countries.

Recommendation: Emphasis should be shifted away from comprehensive and expensive feasibility studies and directed toward smaller incremental studies.

2. Conclusion: The PRE Feasibility Studies Cost Sharing Program in its present form is not consistent with established business practices and therefore does not meet the needs of private sector clients.

Recommendation: The program should be decentralized and administered by intermediate financial institutions in each country.

Recommendation: Loan origination for the Bureau for Private Enterprise Office of Investments should not be considered a prime objective of the Feasibility Studies Cost Sharing Program.

3. Conclusion: There is a real demand for feasibility study and investment brokerage assistance, such as the Feasibility Studies Cost Sharing Program was intended to supply, and this demand is otherwise not being met.

Recommendation: USAID missions should play a direct role in designing feasibility study programs tailored to country conditions and overall development strategy.

Recommendation: Participating intermediate financial institutions should receive technical assistance to support expanded investment banking activities.

4. Conclusion: The Feasibility Study Cost Sharing Program is not ready to be replicated and needs further development on a pilot scale.

Recommendation: The program should be continued as an experiment in two or three countries with active private sectors.

Recommendation: The interest of the intermediate financial institution in maximizing profits should be used as a mechanism for allocating funds among projects and also to wean the intermediate financial institution from continued financial support under the program.

Recommendation: Alternative fee structures and cost sharing procedures should be considered as a replacement for the refundable grant concept now being used.

PROGRAM IDENTIFICATION DATA

1. COUNTRY: Worldwide

2. PROJECT TITLE: FEASIBILITY STUDIES COST SHARING PROGRAM

3. PROJECT NUMBER: 940-0002.26

4. PROJECT DATES:

   a. First Project Agreement: September 1982

   b. Final Obligation: Ongoing project

   c. Project Activity Completion Date: September 30, 1986

5. PROJECT FUNDING:

   a. A.I.D. Bilateral Funding: $1,350,000 grant

   b. Local Currency Matching Loan Funds: None

   c. Other Major Donors: None

   d. Host Country Counterpart Funds: None

Total Funding	Loan:	None
	Grant:	$1,350,000

6. MODE OF IMPLEMENTATION: Resources Support Services Agreement with USDA Graduate School Under PRE Oversight

7. PROJECT DESIGN: Bureau For Private Enterprise

8. RESPONSIBLE OFFICIALS:

   a. Bureau for Private Enterprise: Neal Peden Assistant Administrator

   b. Program Manager: Bill Kedrock, USDA Graduate School

   c. Mission Director(s): Donor Lion, Pakistan 1982-85

      Dan Chaij, Costa Rica 1982-85

9. PREVIOUS EVALUATION AND REVIEWS: None

10. COST OF PRESENT EVALUATION:

    a. Direct Hire: N/A
    b. Contract: $64,360
    c. Other: N/A

TOTAL $64,360

11. DATE OF PRESENT EVALUATION: March 1 - May 15, 1985

12. HOST COUNTRY EXCHANGE RATES: N/A

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I. BACKGROUND OF FEASIBILITY STUDIES COST SHARING PROGRAM

Introduction

This report assesses the achievements of the Private Enterprise Bureau's Feasibility Studies Cost Sharing Program (FSCSP) and recommends a revised course of action for the future, based on a study carried out by Robert R. Nathan Associates between March and May 1985 at the request of the AID Private Enterprise Bureau (PRE). The study team reviewed the program files and other available information, completed field investigations in Pakistan and Costa Rica, and interviewed personnel from two Malawi-based enterprises. The field work provided direct contacts with nine of the fifteen enterprises participating in the feasibility studies program.

In the course of the work in Pakistan and Costa Rica, the team also carried out extensive discussions with representatives of local and off-shore financial institutions, to gain insights into the investment situation in their respective countries and to get preliminary reactions to the alternative program strategy recommended in this report.

The team wishes to thank the staff of the Private Enterprise Bureau, particularly the evaluation officer and the FSCSP program manager, for their assistance in completing this report, which would not have been possible without their full cooperation and active support at all stages of our investigations. We would also like to express our appreciation of the support provided by USAID/Islamabad and USAID/San Jose, as well as the participants in the program themselves, all of whom very generously contributed their time to this effort.

Feasibility Studies Program Summary

The Feasibility Studies Cost Sharing Program was initiated by the Agency for International Development's Private Enterprise Bureau (PRE), with the joint aims of testing an approach to investment promotion in LDCs and developing fundable projects for the Bureau's investment program and other lenders. As of mid-1985, approximately $810,000 of the initial $1 million funding has been expended.

The program was implemented by the Private Enterprise Bureau, with contract assistance from the U.S. Department of Agriculture Graduate School under a RSSA agreement. For the past two years, USDA has provided a full-time manager in addition to general management support.

As currently structured, the program provides partial funding for feasibility studies in support of investments by developing country entrepreneurs, generally in association with U.S. partners. The program funds half of the total study cost, up to $50,000, with reimbursement only in the event that the investment goes forward. Applications are accepted from the investors themselves, from consultants acting as their agents, and on a referral basis from the Bureau's investment program and AID missions. The funding and overall activity level of the first three complete years of the program are summarized in Table I-1.

As of March 1985, the program had received over 300 inquiries, leading to continued discussions with 75 entrepreneurs. Of these, 42 led to formal applications for feasibility studies funding. Sixteen applications were approved, 15 were disapproved, and 11 were dropped without formal disapproval for various reasons (insufficient information provided, inappropriate project size, etc.). Information on the current status of approved studies is provided in Tables I-2 and I-3. Tables I-4 and I-5 summarize the disposition of dropped and disapproved projects.

Of the 16 approved studies, 14 have been completed, one was dropped when preliminary investigations indicated the project was not technically feasible, and one study is still underway. To date, no study has resulted in permanent investment, although in seven cases the investors still intend to go forward with the project if financial and other barriers can be overcome. In the remaining seven cases, the investors have apparently decided not to proceed with the project, either because it does not appear profitable or because other problems cannot be resolved.

Table I-1. Status of Projects with PRE/FSCSP Cofinanced Feasibility Studies as of April 1985

				Found not feasible		Feasible but abandoned		Still active				
Number	Country	Brief description	Study received	Technical reason	Market or profit	Investor(s) withdrew	Reason	Seeking investors F or L[a]	Financing located	Under construction	In operation	Answered FSCSP's 3/85 inquiry
1	Egypt	Poultry/egg	6/7/83		X							Yes
2	Pakistan	Livestock and dairy[b]	6/14/83						X			Yes
3	Costa Rica	Fresh vegetables[b]	11/16/83			X	Too costly					
4	Caribbean	Venture capital fund	7/15/83			X	Too risky					
5	Costa Rica	Frozen produce[b]	7/16/83			X	Wrong site					
6	Pakistan	Shrimp farming[b]	10/4/83					F				
7	Pakistan	Horticulture[b]	6/5/84			X	c					Yes
8	Dominican	Sow breeding	4/4/84					F				Yes
9	Malawi	Row crop[b]	2/3/84					F & L				Yes
10	Malawi	Livestock[b]	3/2/84					F & L				Yes
11	Costa Rica	Dried spices[b]	8/24/84		X							
12	Kenya	Tomato paste	8/16/84									Yes
13	Zambia	Irrigated farming	11/5/84						X			Yes
14	Costa Rica	Coffee by-products[b]	?					F & L				Yes
15	Liberia	Shrimp farming	?	X								Yes
16	Panama	Rice hull particle board	not complete									
Total				1	2	4		5	2	0	0	11

a. F = Foreign investors (foreign currency); L = local investors.
b. Interviewed by RRNA evaluation team.
c. Scale too large; needs infrastructure and investment in related sectors; U.S. investor withdrew.

Table I-2. Analysis of Proposals Approved for PRE/FSCSP From August 1982 to March 1985

Number	Country	Brief description	Date applied	Date approved	Months elasped	Study due	Study received	Accepted for payment	Review period in months	PRE amount in dollars
1	Egypt	Poultry/egg	8/5/82	9/30/82	2	3/28/83	6/7/83	?	?	44,617
2	Pakistan	Livestock and dairy	9/82	9/27/82	1	6/30/83	6/14/83	?	?	50,000
3	Costa Rica	Fresh vegetables	9/30/82	2/15/83	4.5	4/15/83	11/16/83	?	?	30,000
4	Caribbean	Venture corporation capital fund	4/21/83	5/27/83	1	6/30/83	7/15/83	8/15/83	1	50,000
5	Costa Rica	Frozen produce	4/8/83	6/10/83	2	9/30/83	7/16/83	12/2/83	1	17,000
6	Pakistan	Shrimp farming	3/26/83	7/6/83	1.5	9/30/83	10/4/83	10/14/83	0.5	33,725
7	Pakistan	Horticulture	6/27/83	8/4/83	1.5	10/31/83	6/5/84	7/2/84	1	50,000
8	Dominican Republic	Sow breeding	6/24/83	8/4/83	1.5	11/30/83	4/4/84	4/30/84	1	11,480
9	Malawi	Row crop	5/26/83	9/29/83	4	1/31/84	2/3/84	2/16/84	1.5	50,000
10	Malawi	Livestock	5/26/83	9/29/83	4	1/31/84	3/2/84	3/20/84	1	50,000
11	Costa Rica	Dried spices	12/23/83	2/28/84	2	7/1/84	8/24/84	9/26/84	1	50,000
12	Kenya	Tomato paste	2/17/84	3/20/84	1	7/2/84	8/16/84	10/17/84	2	50,000
13	Zambia	Irrigated farming	2/9/84	3/21/84	2	7/6/84	11/5/84	8/12/84	1	45,722
14	Costa Rica	Coffee by-products	2/6/84	5/17/84	4	8/30/84	11/30/84	12/20/84	1	20,600
15	Liberia	Shrimp farming	4/30/84	7/6/84	2	12/30/84	2/25/85	2/25/85	0	41,125
16	Panama	Rice hull particle board	3/23/84	7/16/84	4	11/30/84	(due 6/85)	--	--	48,500

Table I-3. Analysis of Proposals for PRE/FSCSP Participation that Were Disapproved and Dropped From October 1982 to March 1985

Number	Country	Brief description	Date of initial contact	Date disapproved	Approximate months elapsed	Reason
			Proposals disapproved			
1	Caribbean	Fisheries	6/6/83	6/22/83	1	No local investors (R)
2	Costa Rica	Blood products	9/11/83	6/22/84	9	Mission not in favor; partners at odds (M)
3	Indonesia	Animal waste to energy	1/19/84	5/8/84	4	Mission doubts management's technical expertise (M)
4	Jamaica	Animal husbandry	12/2/83	6/25/84	7	After initial PRE/FSCSP approval, no local currency raised, investors withdrew (R)
5	Jamaica	Sports resort	10/82	10/82	1	No investors; not development priority (R)
6	Philippines	Musa fuel pellets	5/21/83	7/12/83	2	GOP was sponsor, no private investor
7	Liberia	Banking	?	11/7/83	?	Mission questioned character of investors
8	Costa Rica	Logging	7/15/83	8/30/83	1	No need for feasibility study
9	Belize	Oil refinery	9/14/83	9/22/83	0	No local investors
10	Madagascar	Edible oil	12/13/83	1/17/84	1	Mission judged project inconsistent with current development efforts (M)
11	Somalia	Aquaculture	9/13/83	10/6/83	1	No investors; need suport study; no mission comment (M)
12	Tanzania	Edible sunflower oil	11/2/83	11/8/83	0	"620 q" (R)
13	Thailand	Animal husbandry	2/9/84	3/1/84	1	Scope of study too broad; not oriented to specific project ($)
14	Jamaica	Tomato paste	5/7/84	12/10/84	8	Agent partner is U.K. not U.S. (R)
15	Zimbabwe	Leasing agricultural equipment	5/9/84	7/18/84	2	Investor not putting up cash, only "in-kind" equity. No leasing expert in scope of work (R)

(continued)

Table I-3 continued

Number	Country	Brief description	Date of initial contact	Date disapproved	Approximate months elapsed	Reason
			Proposals dropped			
1	Haiti	Pasta	11/7/83	Dropped	?	Sponsor informed project would be too small for PRE financing (less than $1MM) (R)
2	Jamaica	Lime	10/26/83	Dropped	?	(1) Inadequate proposal, need more detail; (2) Mission funded (M)
3	Pakistan	Fruit canning	10/20/83	6/16/83	8	(1) Sponsors did not provide pre-feasibility study or financial information and did not agree to refund PRE contribution; (2) conflicts with another project (R)
4	Somalia	Agro-industry	5/4/84	5/8/84	0	Project too large (R)
5	India	Photo voltaic cells	4/18/84	4/26/84	0	Study already done (R)
6	Pakistan	Date processing			?	Study already done (R)
7	Equitorial Guinea	Tourism	12/3/84	1/3/85	1	Tourism not priority sector (M)
8	Lusaka	Agricultural production	6/4/84	6/22/84	1	PRE/FSCSP Fund availability uncertain (R)
9	Ecuador	Shrimp farming	12/9/83	Dropped	?	Sponsor did not identify investors (R)
10	Morocco	Fisheries	7/19/84	Dropped	?	N.E. Bureau assumed (M)
11	Costa Rica	Papain	11/8/83	2/85	3	Referred to Bureau for Commercialization of New Technology

Note: R = AID/PRE/WASH comment; M = USAID/Mission comment.

Table I-4. Analysis of Proposals for PRE/FSCSP Participation that Were Disapproved or Dropped Between October 1982 and March 1985

Category	Disapproved	Dropped	Total
Total proposals	15	11	26
Proposals disapproved by PRE/ Internal Review Committee	4	--	4
Negative comment from:			
- Mission	4	3	7
- PRE/W	12	7	19
General nature of reason given for not participating[a]			
Documentation insufficient	--	2	2
No local private sector investors	6	1	7
Management experience weak	3	--	3
Mangement's character questionable	1	--	1
Conflict with:			
- USAID regulation	1	--	1
- PRE policy	3	2	5
- Mission/country development plans	4	1	5
Referred to other USAID funding	1	2	3
PRE budget constraints	--	2	2
Study already completed	--	2	2
Project or scope too large	--	2	2

a. Total reasons exceed the number of proposals because of multiple reasons for disapproval or dropping.

Source: Project Manager's Files and Status Reports.

Table I-5. Eight PRE/FSCSP Applications Reviewed by the PRE Internal Review Committee Between October 1982 and March 1985

Number	Date	Country	Description	Action
1	7/18/84	Zimbabwe	Agricultural Equipment Leasing	Rejected
2[a]	2-4-85	Costa Rica	Dollar Component Feasibility Study Financing	Rejected
3	12-10-84	Jamaica	Tomato Paste	Rejected
4	6-29-84	Liberia	Shrimp Farming	Approved client terminated[b]
5	3-13-84	Kenya	Tomato Paste	Approved
6	3-13-84	Zambia	Irrigated Farm Complex	Approved
7	2-21-84	Costa Rica	Horticulture Development	Approved
8	2-27-84	Jamaica	Dairy and Beef Cattle Operators (Divestiture)	Approved, then withdrawn[c]

a. Mission roll out proposal, not a direct applicant for PRE/FSCSP funds.
b. Approved given contingent upon technical test for water salinity. Tests results were negative; project not feasible.
c. Approval given and subsequently withdrawn when original local investor group could not raise local currency portion of study costs.

All of the approved studies are in the agribusiness sector, with both agricultural production and processing projects represented. No feasibility studies were funded for intermediate financial institutions, health projects, or other areas identified as agency priorities. The projects were located in 10 countries, with nine concentrated in three countries: Pakistan (4), Costa Rica (3), and Malawi (2). Of the nine projects investigated, five were oriented towards the export market, while four were intended to produce primarily for the domestic market. Additional details on the projects investigated are presented in Appendix A.

The program has not succeeded in generating investment opportunities for the Private Enterprise Bureau. Only two projects not initially referred to the feasibility studies program by the investment program approached AID for project funding after the feasibility study was completed; at this time neither has been approved.

To date, none of the Agency's missions has initiated a program modelled on the feasibility studies program. Direct assistance was provided to programs under development in Costa Rica and Jamaica, however, and other missions appear to have benefited indirectly from the Bureau's experience.

The evaluation team's examination of program management indicates that the program was generally well managed, despite apparent shortcomings in the areas of internal control, monitoring, and documentation. The problems experienced can be traced directly to the program's location in Washington, rather than in an institutional setting closer to the locus of investment decisions in the field. The resulting distance from the center of action impeded clear and rapid communication with the investors, prevented program management from obtaining information needed for decisions, and made the program too dependent on U.S.-based consultants. This overall conclusion is discussed in detail in Section II of this report, which evaluates the current program.

The Consultants further conclude that, based on the experience to date, the program should not be continued in its current form and should be restructured. Consequently, the Consultants have not proposed specific changes in the existing management structure, but have instead focused on a proposed approach to restructuring the program, as discussed in Section III.

II. EVALUATION OF CURRENT PROGRAM

This section examines the mechanics of the program's operations, with particular emphasis on management concerns. As requested by the client, specific findings are presented regarding difficulties experienced by program management and the entrepreneurs they sought to assist. However, the Consultants wish to emphasize their conclusion that these difficulties cannot be repaired by tinkering with the program machinery. The existing machinery produces feasibility studies, but has not and is not likely to produce investments on a cost-effective basis.

The evaluation of the current program is organized into four sections as follows:

A. Management

B. Feasibility Study Content

C. Integration with Bureau for Private Enterprise Programming

D. Program Marketing

The management section addresses ten main concerns that both shed light on the current program and suggest areas of concern for successor programs: (1) eligibility criteria; (2) the $50,000 ceiling on individual studies; (3) application procedures; (4) screening procedures; (5) staff time requirements; (6) reliance on U.S. consultants; (7) the role of USDA Graduate School; (8) the operation of the Bureau's Internal Review Committee; (9) internal control and reporting; and (10) the total cost of the program.

A. Management

Eligibility Criteria

Eligibility requirements for the PRE/FSCSP are unclear and ambiguous to PRE and USAID Mission staff as well as to applicants. In practice, this ambiguity has not hindered the program significantly, although it has resulted in misunderstandings and wasted effort, both within PRE and between PRE and some applicants. In practice, PRE/FSCSP has operated like a private bank credit committee with veto power over applicants. For the most part, applicants have accepted the uncertainty of dealing with PRE on a trial-and-error basis, learning whether they are eligible by whether they are refused.

USAID's restrictions are considerable, and it is difficult to communicate them all in advance to an applicant. In addition, the internal review committee has in some cases added criteria that were never formally expressed even as internal policy (i.e., applicants allied with U.S. consulting firms are to be preferred over others).

The ambiguity in the FSCSP criteria is a product of two conflicting ideas: (1) the premise that there is a typical developing country entrepreneur who needs a feasibility study; (2) efforts to serve multiple constituencies, such as the host country private sector, AID/PRE Office of Investments, USAID and the U.S. private sector.

Mutually Exclusive Criteria

AID operates under the ambiguity that it should target its resources to: (A) individuals and entities that can make a significant contribution to economic development (i.e., the powerful, energetic, and motivated recipients); and (B) individuals and entities that do not already have ready access to resources (i.e., the needy, deprived, less powerful recipients). Entrepreneurs could be found in either group, but entrepreneurs in Group A are capable, in large part, of operating without AID assistance. They are also capable of combining AID assistance with other resources and they are more likely to achieve success than entrepreneurs in Group B. Entrepreneurs in Group B can have initiative, skill, and modest amounts of capital, but they will not be able to leverage AID assistance with access to other resources. The FSCSP has not explicitly made a decision about the type of entrepreneur the program seeks to serve.

If PRE's mode of operation is to provide partially financed studies for serious developing country entrepreneurs who are capable of arranging project financing, a strict set of creditworthiness and business management criteria are needed. Certain of the FSCSP's criteria point in this direction. However, such entrepreneurs are likely to be less interested in complying with FSCSP constraints. Such entrepreneurs may, for example, prefer a feasibility study very limited in scope in contrast to the FSCSP's omnibus format. In addition, local entrepreneurs may not wish to use U.S. consultants.

If PRE's purpose is to provide seed capital to small- or medium-sized entrepreneurs who are taking the first step toward operationalizng a business idea, the program's eligibility criteria can and should be less restrictive. Such applicants will also be more likely to accept AID restrictions. They are also more likely to fail in raising equity and will more likely look mainly to PRE's Office of Investments for their project investment needs. Such entrepreneurs would be more likely to need a comprehensive feasibility study, business plan, and even a business advisory service. However, in dealing with these more risky situations, AID and the entrepreneur should proceed in an incremental, stepwise fashion rather than launching into a program that consumes their own scarce capital in an effort to qualify for PRE funds.

OPIC's Eligibility Criteria

The Overseas Private Investment Corporation (OPIC) manages a feasibility cost-sharing program oriented toward U.S. investors considering projects overseas. OPIC uses three eligibility criteria that make its selection process much more restrictive than PRE's, but also more likely to result in substantive investment action. The OPIC program is open to U.S. principals that have an adequate net worth and an established management record in the proposed business.

OPIC will deal only with principals, not with consultants. Principals must be able to demonstrate an ability to finance about one-third of the total project cost from internal sources. OPIC therefore routinely rejects promoters or developers or "new concept" projects, even though the individuals involved might well qualify as using criteria other than net worth.

Eligibility and Selection
Criteria, Some Recommendations

The FSCSP has to adopt credit- and management-oriented criteria, such as net worth of principals. The provision for reconnaissance studies and procedure of allowing the principal investor to control the scope of work used by OPIC appear to have merit.

The FSCSP should allow itself the option of a higher percentage participation in cases where a well-defined technical uncertainty, overshadowing other feasibility issues, must be resolved. The FSCSP should also allow for studies of a more limited scope.

The $50,000 Ceiling

The $50,000 ceiling on FSCSP participation in a feasibility study does not constitute a difficulty for the FSCSP. The amount is, unfortunately, large enough to attract the interest of small- to medium-sized U.S. consulting firms, thus swelling the inquiries that the program must handle.

The combination of the ceiling amount with an emphasis on doing a comprehensive feasibility study has a tendency to inflate the level of effort in certain cases beyond that needed to determine reasonable feasibility for a business person. The $50,000 ceiling should be maintained but not emphasized as the obvious or preferred size of study.

Guidelines

By requiring or preferring a comprehensive scope, the FSCSP guidelines reinforce the program's and the principal's reliance on professional consultants, and may increase the cost and complexity of the investigation beyond that required for a prudent investment decision.

The FSCSP should be more flexible in its approach to feasibility study content, especially where the investor will not seek Bureau for Private Enterprise financing or can demonstrate a capacity to secure financing on his/her own. Such flexibility of scope will be easier to achieve as PRE begins to deal directly with investor principals.

The appropriate content of a feasibility study depends in large part on whom it is written for. The FSCSP guidelines for content are presumably structured in part so that a properly done study could be presented to PRE/Investments.

Comprehensive guidelines would also be in order if the entrepreneur is really a project promoter/developer who is not capable of taking a major equity position in the project and will have to solicit equity participation as well as debt financing from sources not intimately familiar with his/her background, experience, markets, site, or process.

Experienced investors/entrepreneurs seldom face the full range of obstacles that a start-up promoter faces. During the project investigation stage, they are not inclined to undertake a study that covers anything except what they regard as essential or critical information.

Serious business people would also prefer to approach the feasibility determination process one step at a time. Interestingly, the FSCSP program encouraged one applicant to undertake a water salinity test for a shrimp farming project at his own expense. FSCSP offered to cover the costs of additional feasibility investigations that would be required if the salinity test proved the process technically feasible. The water was not saline enough and no further investigations were made. No FSCSP grant was made, yet FSCSP goals were served and the program administrator achieved the program purposes using PRE funds to maximum leverage.

A Go/No-Go Decision

The PRE guidelines require more information than most serious host country entrepreneurs with business and management experience would need to make a go/no-go decision. The type of funding source which the feasibility studies are suited for is government funding of some kind.

Standard Application

Some of the processing delays, internal legal worries and effort expended on disapproved or dropped proposals could have been avoided by using a standard application form. The critical missing element, however, an in-country evaluation of the applicant's creditworthiness and managerial capability, is not something that can be readily established by a form sent out from and returned to Washington. Such a form would help to reduce some of the delays and misunderstandings that have arisen in the application process. The existing application and approval process is presented in a flow chart in Appendix C.

Screening Process

The applicant screening process has been the most difficult aspect of the FSCSP experiment to administer from Washington. The Washington Project Manager has been in a position to screen out obviously ineligible inquiries from U.S. groups with no ties to a foreign investor. Screening inappropriate overseas inquiries, however, has proved difficult and has consumed a major portion of the Washington staff effort without producing useful results.

Mission Role in Screening

The Washington office has generally cabled and relied on the USAID mission for critical information regarding (1) the development impact of projects proposed for study, (2) creditworthiness and management experience of the applicant, and (3) accuracy of prefeasibility projections.

The missions, for their part, have responded to most requests for information. In some instances, the missions have informed PRE that they are not in a position to assess creditworthiness. PRE has also relied on Dunn and Bradstreet credit checks and in one instance on the Foreign Commercial Service's ability to evaluate host country businesses and business people.

In practice, the missions have veto power over applications. Negative or lukewarm mission comments have accounted for 7 of the 26 projects disapproved or dropped over the three-year course of the program. In those instances where the mission did not respond with useful information, FSCSP was left dangling, unable to progress with the screening and evaluation process.

Screening Some Recommendations

A program based on referrals from private sector banks can rely on the banks' capacity to ascertain creditworthiness, business experience, level of commitment to the project, and risk exposure of investors. The mission should still be involved to respond to legal and policy issues regarding eligibility and compatibility with host country development programs.

The structural safeguards built into the program -- (1) applicant must have host country investor, (2) 50 percent ceiling on participation, (3) repayment obligations -- have been effective in screening out most of the non-serious applicants. These mechanisms are not foolproof, however, as is discussed in the section on internal control.

Staff Time

Essentially the program has operated for two years with only one full-time staff position. Overall staff time on the application process has not been excessive. Despite some examples of wasted effort on decision reversals, most applications have been handled with minimum staff time.

Multiple Actors

The system of allowing the U.S. consultant to act as agent, combined with the use of USDA Graduate School, results in a voluminous amount of "copy to" correspondence. The sponsor and the mission are copied on all correspondence to the agent. The agent and the mission are copied on all correspondence to the sponsor, etc. Given the nature of the contracting process and the critical role played by the mission, this multiplication of communications is unavoidable, although the necessity for verbatim transmissions is sometimes questionable.

The only example of unnecessary staff time is that spent in Washington trying to assess the character and business experience of an applicant based only on his/her mailed-in submissions -- documents that were in many cases prepared by the U.S. consultant rather than the applicant.

Staff Time - Some Options

Staff time could be leveraged by using the credit and management of in-country institutions, either intermediate financial institutions or the Foreign Commercial Service, to do the evaluations of FSCSP applicants.

Reliance on U.S. Consultants

The FSCSP relies too heavily on U.S. consultants for its stated objectives. However, given its centralized Washington, D.C. management, these U.S. consultants provide the necessary liaison between PRE management and the developing country entrepreneurs that the FSCSP aims to serve.

The preponderance of inquiries the FSCSP receives come from U.S. sources, and the majority from U.S. consulting firms. Most of the application process is handled between

FSCSP and the U.S. firm acting as an agent for the foreign entrepreneur. The USDA Graduate School never contracts with the foreign entrepreneur, only the U.S. consultant. After accepting the study, PRE authorizes the Graduate School to pay the agreed-upon reimbursement directly to the U.S. consultant. The foreign entrepreneur never sees the funds. The foreign entrepreneur is supposed to sign the conditional reimbursement agreement. Several telexes signifying agreements are in the files of completed studies. In practice, the U.S. consultant's signature as agent for the foreign entrepreneur is accepted, even without formal power of attorney.

"Consultant-Driven" Studies

The project manager of the FSCSP program is concerned over the role consultants play in the process, estimating that 80 to 90 percent of the projects are the result of consultant initiative, even in some cases where the initial inquiry came from overseas. RRNA's findings indicate that the majority of disapproved, dropped, and even approved FSCSP studies can be classified as "consultant driven." The consultant either conceived the project or controlled the scope of work to serve purposes not necessarily shared by the foreign entrepreneur.

This finding should come as no surprise, nor should it be considered as an indictment of the program. PRE/FSCSP had very few avenues through which to contract host country entrepreneurs. Private sector consultants, some with USAID backgrounds and USAID contacts, also have contacts with individuals in the private sectors of foreign countries. The OPIC program has a policy of dealing only with principals and refusing to deal with consultants. OPIC's target audience is the U.S. private sector which OPIC can reach directly through advertising. The policy excluding consultants reduces OPIC's workload and simplifies its screening process.

If PRE had operated with a similar policy of excluding consultants, however, it is doubtful that as many feasibility studies could have been co-financed.

Market and logistical difficulties keep a Washington-based FSCSP from contacting and working with foreign entrepreneurs. In addition, the burden of prefeasibility information submittals and the requirement that the feasibility study be comprehensive in scope have dissuaded foreign entrepreneurs from attempting to deal directly with the FSCSP program.

It is conceivable that a workable program could be devised around the fact that many U.S. citizens have contacts with foreign country private sector enterprises, utilizing these contacts as a means of channeling AID resources to worthwhile private sector projects. However, the FSCSP is not structured for this. For the sake of its own integrity, it must come to grips with the fact that the program is having more success attracting U.S. consultants rather than entrepreneurs and investors in the private sectors of foreign countries.

Role of USDA

A discussion of the USDA Graduate School's role in the FSCSP may be pointless in view of a recent Government Accounting Office ruling that the USDA Graduate School will not in the future be allowed to enter into new PASA and RSSA contracts since it is not an agency of the U.S. Government directly receiving appropriated funds. During interviews, the director of the USDA Graduate School International Program indicated that the International Program Office will continue to offer its contracting services. However, this will be in competition with private sector service firms.

The USDA Graduate School's role in administering studies rarely extended beyond formalizing the contract and executing the disbursement. The USDA contract administrator admits that the overhead rate was more than sufficient compensation for services rendered to PRE/FSCSP. USDA Graduate School's main costs appear to be handling the contracting provisions and answering inquiries.

Internal Review Committee

The Internal Review Committee, which is made up of senior staff of PRE, the PRE Office of Investments legal counsel and the FSCSP Project Manager, is an evolutionary feature of the FSCSP of relatively recent origin. There have only been seven full sessions of the Internal Review Committee in the three years of FSCSP operations. Of the 26 studies disapproved or dropped, the Internal Review Committee met in session to discuss only four of them. Of the 16 studies financed, the Internal Review Committee met in session to approve only three.

Members of the Internal Review Committee understand their role as a sort of credit committee meeting to approve loans or actions to be taken on specific applications. No minutes are taken, however, and no individuals are expected to sign off on a loan. Discussion is informal, though informed. The most frequent action taken is simply to request more information, to table or postpone action until the information is received.

Bureau for Private Enterprise Investments and the FSCSP

The fact that the Internal Review Committee has not evolved into a more organized, systematic approval body reflects both good and bad features of the program's history. On the positive side, the absence of a regular formal review committee is evidence that the program is small and the relationship so close so that the Program Manager can usually approach Bureau for Private Enterprise Office of Investments staff directly and get a timely reaction to an FSCSP application without having to resort to the formality and costs of scheduling a committee meeting.

On the negative side, two weaknesses evident in the program design also help explain why the Internal Review Committee has not evolved or progressed:

(1) The committee generally has little or no direct knowledge of the applicant/investor/sponsor. Thus, even though it sits as a form of credit committee, it is really reviewing the paperwork and correspondence assembled by the program administrator. Members meet as critics of the proposal based on their reading and not inconsiderable skills as project judges. In most cases, however, they lack the very information they need to make a judgment about investing in a particular feasibility study. No one in the meeting usually knows the person or company who is supposed to (a) contribute one-half or more of the study funds and (b) then be able to finance the project.

(2) Bureau for Private Enterprise Office of Investments is committed to and busy with its own loan portfolio as a first priority. Officers have only limited time to devote to a serious review of FSCSP applicants.

For a variety of reasons, PRE/I usually does not look to FSCSP as a source of potential loan applicants. Even when PRE/I faces a situation in which one of its potential loan candidates requires a feasibility study, PRE/I does not always use the FSCSP. PRE/I has an allocated pool of feasibility study grant funds that it has authority to incorporate into one of its loan agreements if the project needs further study.

Three of the 16 FSCSP participants have also applied to PRE/I for loans. Thirteen did not apply, four because the feasibility study resulted in negative findings, and nine because the investors were not interested in PRE financing. Four of the PRE feasibility studies should be considered referrals/approvals, i.e., applicants who were rapidly approved for FSCSP funds after referral from PRE/I to FSCSP.

Although there is some value to a program that will co-finance a study for an entrepreneur, the funds invested in the FSCSP lack impact in isolation. The FSCSP should develop or cultivate links to private sector financial institutions and view PRE/I as another source of finance.

Internal Reporting

The internal reporting system developed by FSCSP management over the past two years is adequate for the purpose of tracking inquiries and producing summary reports on the status of projects.

There is a need for more "market-oriented" reporting. FSCSP reports on the countries from which inquiries are received. More useful would be a report indicating the number of requests by country, showing not only the subject country for the study (including categories for multiple countries) but also indicating the source (i.e., how did you learn of the program?) of the inquiry.

The program's internal control system does not provide the Bureau with sufficient control over the use of program funds to ensure that program policies are followed, that the funds are not misused, and that the studies produced are technically sound and meet the needs of the investors. Program management is wholly reliant on reports provided by the consultants for key information on:

The total cost of the study, both estimated and final;

- The contribution made by the local entrepreneur; and

- The initial scope of work and the justification for diverging from it during the study, if and when divergences occur.

The opportunities for abuse of this system are readily apparent. Nonetheless, the Consultants did not find evidence that AID funds have in fact been misused (as, for example, by consultants claiming expenses that they did not in fact incur). In some cases, however, it appears that program guidelines have not been followed. For example, not all local investors appear to have contributed 50 percent of the studies' costs. In several instances, the technical quality of the final report and its adherence to the agreed upon scope of work have been deficient, but the current system does not provide a means for the Agency to withhold payment or reduce the amount reimbursed in either of these situations. Although the reimbursement provisions have not been put to the test, because no investments have gone forward, there is reason to doubt that the Agency has the information system and legal standing to enforce the repayment requirement.

These defects cannot be corrected unless the program is moved to the field, so that management can deal directly with principals, rather than consultants, and so that independent verification of study effort and results obtained can be made.

It is evident, however, that serious consideration should be given to internal and external control measures in any redesign effort, to reduce the potential for abuse in the future.

Achievement vs. Objectives

The program needs a regular "Achievement vs. Objectives" Report that compares targets for the planning period with results achieved. A rather detailed set of quantifiable goals was drawn up for the FSCSP, but no reports comparing goals to accomplishments have been issued. Table II-1 uses the goals stated in the program manager's July 1984 memorandum to build a Goals vs. Achievements chart.

Table II-1. AID/PRE/FSCSP Measurable Program Objectives: Goals vs. Achievements

Measurable program objectives	Target	Actual by 4/85	Percent of target
1.0 Participation in feasibility studies by number and type			
1.1 Total	20	16	75
1.2 Financial intermediaries	6	1	17
1.3 Health and medical	2	0	0
2.0 Geographic reach of program			
2.1 Countries with PRE studies	10	10	100
2.2 Countries visited	4	2[a]	50
3.0 Program brochure			
3.1 Print new trifold	2,000	2,000	100
3.2 Sent to missions	150	150	100
3.3 Sent to U.S. businesses	?	0	0
3.4 Hand-outs	?	?	?
3.5 French translation	1	0	0
3.6 Spanish translation	1	0	0
4.0 Investments following from FSCSP			
4.1 75 percent within 2 years	11	1	18
4.2 PRE/I participation 30 percent	5	1	17
4.3 Repayment received or expected; 75 percent	11	0	0
5.0 Correspondence management			
5.1 Cables and letter inquiries received	?	>400	
5.2 Items replied to in less than 10 days	All	?	
5.3 Information packets sent to missions	10	10	100
6.0 Application management			
6.1 Total applications handled	?	31[b]	--
6.2 Completed applications (CA) handled	?	20[c]	--
6.3 CAs as % of total	?	63	--
6.4 CAs decided upon within 14 days of receipt	20	0	0
6.5 CAs decided upon within 60 days of receipt	20	17	85
6.6 Standardized application designed	1	1	100

(continued)

Measurable program objectives	Target	Actual by 4/85	Percent of target
7.0 Follow-up management			
7.1 Total studies received	15	15	100
7.2 Payment notifications within 15 days of receipt of study	15	1	7
7.3 Payment notifications within 30 days of receipt of study	15	8	53
7.4 Follow-up mail out on investments	15	15	100
7.5 Replies received	15	8	.53
8.0 General			
8.1 Standardization of correspondence agreements and notices	80%	80%	100
8.2 Computerization of files	--	50%	--
8.3 Management reports (2/year)	5	2	60

a. The PRE/FSCSP manager visited Costa Rica and Jamaica to discuss country specific feasibility study programs. Some applicants have been visited by PRE/I officers and applicants have also visited Washington.

b. Approvals (16) plus disapprovals (15).

c. Approvals (16) plus disapprovals by IRC (4).

Total Cost Per Study

In addition to the recognizable costs included as part of the feasibility study, the costs for several other parties should be considered: (1) PRE representatives overseas, (2) the investor's costs which most likely will equal or exceed those of FSCSP, (3) the cost of the time of PRE/I officers who serve on the Internal Review Committee and also assist the FSCSP program manager. The easily traceable costs of the PRE program amount to $780,000 through the end of FY 1984. This figure does not include the salary costs of anyone other than the program manager, however, and it also does not include the cost of telephone calls or cables.

B. Feasibility Study Content

The content guidelines for the acceptable feasibility studies have been somewhat confusing to participants. In the early brochures, the Investment Opportunity Proposal is mentioned as the definitive guideline, but "IOP guidelines" were not made available to all applicants.

The guidelines that were eventually provided applicants emphasize that the FSCSP program expects studies that undertake a broad, comprehensive investigation, rather than a focused, stepwise feasibility analysis. This procedure would be appropriate if the feasibility analysis were being done for either (1) USAID or a government agency or (2) investors not yet known, and perhaps not at all familiar with the country, market, or process proposed. It is less suited to the needs of an investor who has a well-developed project concept and/or specific investors in mind.

Just as there is no unique, singular definition of an entrepreneur, neither is there a clear-cut definition of a feasibility study. Defining a feasibility study as a study which enables an investor to make a go/no-go decision is useful conceptually, but clearly the range of information that must be marshalled for such decisions will vary, depending on the particulars of the project and the investor in question.

In contrast to the FSCSP tendency to require a broad scope feasibility study, OPIC leaves the determination of the scope in the hands of the investor/principal. While requiring that the applicant specify the critical information to be obtained, OPIC does not usually urge the principal to expand the scope of his/her investigations. They are more likely, however, to question the amount of funding requested in relation to the proposed work. This procedure makes the applicant/investor responsible for identifying the critical information needed for a decision. While the scope of the study may not be suitable for PRE, AID, World Bank, or Wall Street sources of financing, it is not clear that FSCSP should restrict itself only to developing country investors who agree to undertake studies of such extent and quality.

C. Integration with Bureau for Private Enterprise Programming

The program is so small that flexibility is more important than an allocation formula. Until or unless a program involving intermediate financial institutions is in place, the entire feasibility study program should be handled and budgeted as "another arrow in the quiver" of PRE Investments. Running it as a separate program disconnected from further financing could create ill will among some study grant recipients who do not understand the duality of the program.

D. Program Marketing

No formal market survey has been done of the program, nor was one attempted by RRNA as part of this evaluation. Some preliminary conclusions regarding marketing may be drawn from the review of program experience to date. Despite a respectable geographic spread of inquiries, the initiative behind the inquiry has usually come from a U.S. consulting firm.

Marketing efforts of the FSCSP have been limited to:

- Printing and mailing brochures to missions,
- Sending information cables to missions;
- Attending development conferences; and
- Contacting other development associations.

Given the budget and staffing of the program, this level of marketing has been sufficient.

It should be recognized, however, that this is not a strong marketing program. It has not succeeded, for instance, in reaching the program's principal target, the host country entrepreneur.

The cost of a marketing program designed to reach the entrepreneur in more than one country would be prohibitive if undertaken from scratch. Any such program should avail itself if at all possible of the various international networks in the foreign offices already established.

PRE is correct to assume that intermediate financial institutions offer a useful marketing network as well as a managerial network. More importantly, the few selected private sector financial institutions questioned by RRNA in Pakistan and Costa Rica indicated an interest in associating with the PRE program -- if it represented a potential source of investment funds.

III. RECOMMENDED STRATEGY FOR A RESTRUCTURED FEASIBILITY STUDIES PROGRAM

A. Summary of Conclusions and Recommendations Regarding Future Programming

The principle conclusions of the evaluation and the recommendations that flow from them are as follows:

- Conclusion One: Support to the feasibility study process serves a useful role in promoting investment, but only when this support is integrated with investor search, project financing, and other assistance.

  - Recommendation: The agency should continue to support the identification of profitable private sector investments in developing countries by providing financial and other assistance to feasibility studies, but the program should be restructured to tie it more closely into the investment process.

- Conclusion Two: Washington-based management has proved an insurmountable barrier to effective program implementation, impeding clear communication with investors, fostering an undesirable dependency on consultants, and preventing a valid test of program replicability within the agency.

  - Recommendation: If the agency decides to continue testing of the feasibility studies concept, the program should be redesigned to transfer primary implementation responsibility to private intermediate financial institutions in selected developing countries and to limit the Bureau's role to supporting the intermediate financial institutions by providing program funding, training for intermediate financial institutions personnel, and assistance in establishing contact with off-shore sources of debt and equity financing.

- <u>Conclusion Three</u>: Comprehensive feasibility studies of the type promoted by the program are not consistent with prevailing business practice, do not serve the needs of the developing country investor clientele, and rarely prove useful in recruiting potential partners.

    - <u>Recommendation</u>: The restructured feasibility studies program should give program managers and entrepreneurs maximum flexibility in determining the questions to be answered and the level of effort needed to address them; in particular, the structure should permit entrepreneurs to enter the process at an earlier point in project development and determine project feasibility in an incremental manner, with program support at key points in this process, rather than attempting to provide all of the information needed to permit a final "go-no go" determination.

To implement these recommendations, three main changes ~urrent program structure are required:

<u>Transfer program implementation responsibility</u> to intermediate financial institutions in two or three developing countries selected for further testing of a revised program concept.

2. <u>Establish a program of support to participating intermediate financial institutions</u>, preferably in close cooperation with U.S. private sector organizations, which would improve intermediate financial institution capacity to carry out the investment banking function effectively, including both determination of project feasibility and identification of investors.

? <u>Redefine application and screening procedures</u> to give intermediate financial institution management personnel maximum flexibility in meeting investor needs, structuring the program so that it is possible to rely on in-built incentives to encourage sound management of the fund, rather than on complex or rigid procedures.

The remainder of this section discusses these points further, and provides a more detailed examination of the alternative approach recommended for the Bureau's feasibility studies program in the future. The discussion is organized in three sections. The first section analyzes the project identification and feasibility study process, as carried out by private sector firms and financial institutions, and discusses how the Private Enterprise Bureau program could be restructured to follow this pattern. The second section illustrates how this basic concept could be put into practice by establishing a self-financing feasibility studies program based in selected intermediate financial institutions and an investment banking support program based in a U.S. private sector organization. The final section provides a checklist of design issues that must be addressed to implement the proposed restructuring.

B. Recommended Program Approach

Refocusing Objectives

The stated objective of the Feasibility Cost Sharing Program is to serve as a "loan origination mechanism" for PRE financing or financing from other (undefined) sources. The intention was that the program be run on an experimental basis from Washington and later transferred to individual countries, either to the USAID/Mission or to an appropriate local institution.

As a "loan origination mechanism" for PRE, the system has been inefficient. For this purpose, it has been more expensive and less effective than it would have been to pay finders' fees to investment bankers. It would also have been more effective to advertise the PRE investment program and augment in-house capacity to prepare project papers. We recommend that "loan origination" <u>not be considered a prime objective</u> although projects originating in the program should continue to be reviewed for possible PRE financing.

If "PRE loan origination" were of major importance, there is a question as to why so few funded feasibility studies have been financed. With the volume of "prefeasibility" information that has been requested, an efficient screening process should have resulted in at least 15 percent to 20 percent of the feasibility studies being accepted for PRE financing.

The evidence suggests that the origination of investment opportunities for non-PRE funding has dominated the program. This aspect of the program has also been ineffective since the objectives have been vague. The beneficiaries of the grants (the "sponsors") are defined as "those private businesspeople who will become investors in the project should the feasibility analysis demonstrate its commercial viability." However, the feasibility studies have clearly not been in their own countries. The tacit goal has been to raise funds from external sources. A businessman in Costa Rica does not need a document written in English that reviews the political and economic climate of his own country in order to make an investment decision.

Worthwhile, economically attractive LDC projects may go unfunded due to a lack of local capital. Local entrepreneurs are often unable to make effective use of international capital markets, even when the investment climate of the LDC is relatively attractive. Generally, the entrepreneur can find no one to fill the role of international investment banker:

- Of the myriad sources of financing, which one should be approached for a given project?

- Who will vouch for the capability of the LDC entrepreneur and the feasibility of the project, making the proper introductions to potential sources of financing?

- Who will help the local entrepreneur document the investment proposal in such a way as to be acceptable to the foreign investor?

In designing the FSCSP, it is assumed that the "sponsor" (the local entrepreneur) would be able to act as his own investment banker. However, this is realistic only if the program were to be restricted to projects already entirely financed, pending only the results of a feasibility study.

We suggest refocusing the program objectives toward providing assistance to entrepreneurs in selected countries in raising capital abroad for worthwhile developmental projects. To increase the likelihood of success, the program should include features that will supply the missing investment banking functions. The sources of financing should explicitly include capital markets outside the United States.

The Role of the Feasibility Study

There is no standard feasibility study. The value of a study is linked to the interests of a specific investor. Feasibility studies play a role in capital formation, but their importance should not be overestimated.

The position papers which justified the establishment of the program, present the "feasibility study" as valuable per se, an element in short supply in international financial markets. Even a study that demonstrates non-feasibility was considered an asset. Moreover, the characteristics of an investment justification paper acceptable to PRE were assumed to be of similar value to other investors.

In order to address this matter clearly, we need to define the following terms:

<u>Business Plan</u>. This is a document which outlines the proposed line of development of a business. Based on certain <u>assumptions</u> as to the market, economic conditions, and productive capabilities, results are forecast in the form of generally understood financial statements. On reading a business plan, an investor is able to determine if the proposed activity is compatible with his "portfolio parameters." He is also unable to judge, based on his business experience, if the results appear "feasible" given the stated assumptions. A business plan is usually prepared by the entrepreneur, although professional assistance may be needed to put it in terms and language that would be acceptable to the investor. A business plan, may represent a substantial investment of the entrepreneur's time, but cash expenditure should be modest. Since the ability to draw up a business plan is an elementary test of managerial ability, many professional private-sector investors would look askance at a plan that was not prepared by the management team.

<u>Reconnaissance Mission</u>. This is a visit by an investor to the entrepreneur's area of activity in order to meet with the principals, key managers, local bankers, suppliers, customers, government officials, and others. The visit may include the proposed facilities, competitors, and similar enterprises. A professional investor can often make an informed decision from a business plan and reconnaissance mission alone. The major costs of a reconnaissance mission are the investor's time, travel and lodging. A typical mission will occupy one or two people for a week.

<u>Restricted Feasibility Study</u>. This is an <u>expert opinion</u>, prepared by a specialist <u>accredited by the investor</u>, attesting to the validity of a <u>key assumption</u> in the business plan. A business plan will contain many assumptions. Most will be accepted (or rejected) by the investor without special verification, based on experience. Others may be resolved by a reconnaissance mission. Only a few questions justify the expense of outside expert opinion. Depending upon the nature of the question, the cost of a feasibility study may range from a few thousand dollars to millions. Common sense indicates that if the cost of the feasibility study is large with respect to the size of the proposed investment, it may be quicker and cheaper to start the venture on a pilot basis in order to test the feasibility of the concept.

<u>Background Paper</u>. This is a document, usually compiled through library research, which presents supplementary information relevant to an investment situation. Typical subject matter might be the economic condition of a country, a political history, or a description of sectoral development. Also in this category are descriptions of non-proprietary industrial or agricultural processes.

<u>Impact Paper</u>. A document which purports to describe the effect of a specific endeavor on the economic or physical environment. Primarily of interest to government organizations, the impact paper ordinarily attempts to justify a venture in terms of political objectives of interest to specific groups.

<u>Investment Justification Paper</u>. This is a document which is used to justify an investment "for the record." It may contain features of the business plan, a reconnaissance mission report, restricted feasibility studies, background papers, and impact papers. This document is of interest primarily to governmental and parastatal financial agencies.

<u>Investment Prospectus</u>. This is a document used to promote an investment. It may contain features of a business plan and background paper. A prospectus is written carefully so as to avoid exaggerated claims and to disclose fully the important facts and assumptions. If the prospectus is aimed at a wide audience, legal assistance may be required in drafting. This type of document is widely used to syndicate special projects. The value of a prospectus in raising capital is relative to the reputation of the sponsor of the project.

The type of study contemplated by the PRE cost sharing program resembles the investment justification paper defined above and is tailored to the specific interests of the PRE investment area.

The tacit objective of the FSCSP is to assist the LDC entrepreneur in raising funds from any source. Although PRE retains the right to participate in the project, the entrepreneur is not given an early declaration of interest or commitment. Feasibility studies have been funded without certifying that the topics addressed were relevant to a specific serious investor. The failure to clearly identify the potential investor at an early stage is a major reason the project has been ineffective.

<u>The Investment Review Process in the Private Sector</u>

Unless PRE is willing to fund a project entirely or assist in finding other government financing, the requirements of private sector investment institutions are of fundamental importance.

The early identification of the source of the financing is vital for an efficient feasibility cost sharing program. Few investors will require the complete range of studies and papers in order to reach a decision. The typical private sector investment decision for a new project goes through these stages:

- Portfolio Suitability: Investors and project lenders usually specialize. They are looking for projects that meet some predetermined criteria. The perusal of a well-presented business plan is sufficient for an investor to quickly determine whether a project meets these criteria. Rarely will professional investors stray from their "portfolio parameters."

- Management Capability: Given a project that matches the profile for a portfolio, the investor next judges the capability of the managers. This ordinarily involves interviewing, checking references, and evaluating experience. Many investors will not bother with proposals unless the promoters are introduced by someone whose judgment they respect. The sophisticated investor knows that without proper management, other features of a project are irrelevant. A marginally attractive project with excellent management is preferable to an excellent project (perhaps elaborated by skillful consultants) but run by poor managers. In order to save time, the appraisal of management capability comes early in the process.

- "Seat of the Pants" Evaluation: The next step in project evaluation is to form a preliminary impression as to whether the concept "makes sense." The professional investor will be influenced by his experience with similar projects, the results of a quick reconnaissance mission and informal consultation with experts to whom he has easy access. Most investors will eliminate over 95 percent of all projects presented on the basis of portfolio suitability, management capabilities, and seat-of-the-pants evaluation.

- Restricted Feasibility Studies: Once an investor feel that there is a high probability of proceeding with a project, he may wish to test some key assumptions in the business plan in order to reduce the risk. The decision whether to use expert opinion and testing or to fund a pilot operation will depend upon the nature of the question and amounts involved. The private sector investor is apt to be more skeptical of the value of "feasibility study" than his public sector counterpart. PRE cost-sharing of studies at this stage may be a critical element in arranging financing for a project.

. <u>Formal Investment Papers</u>: Once the investment decision is reached by the leading investor, subsidiary investment papers may be drawn up to satisfy others participating in the process: background and impact papers, investment justification papers, and investment prospectus. The lead investor will only prepare those documents which are necessary in the given situation.

A major difference between public and private sector investment decisions is the importance given the qualifications of management. If the government decides to build a hydroelectric project, it assumes that management can be found to implement the plan. In private investment, the entrepreneur-owners and management are usually the same people, and not easily changed once the financing is given. Therefore management is the first consideration.

The PRE Feasibility Cost Sharing Program ignores this process in ways that reduce efficiency substantially:

. Only the full-scale investment justification paper is considered eligible for cost sharing.

. Studies are financed without prior linkage to an investor. There is no assurance that a particular investor will find these studies relevant or even credible.

  - Assumptions which the investor may believe need testing may be given little attention, while other points with which he would agree off-hand may be validated in depth.

- Due to the delay in finding an investor after a report is completed, the material may be become outdated. With high inflation and rapidly changing economic scenarios, a report that is not constantly revised becomes of less value.

- The reputation and credibility of the experts attesting to the feasibility of key issues may be unknown or even refuted.

• The emphasis has been on the project rather than the entrepreneur. No serious background check is made. In some cases, projects with manifestly incompetent management were kept in the pipeline instead of being eliminated quickly. Consideration of one project was allowed to continue while consultants switched "sponsors."

By matching the different kinds of studies against the steps in the private investment process, it is possible to avoid unwarranted funding of complete studies:

Investment step	Type of study needed	Cost
Portfolio suitability	Business plan	Low
Management capability and seat-of-the-pants evaluation	Reconnaissance mission	Low
Restricted feasibility study	Restricted feasibility study	Medium-high
Formal investment papers	Background paper Impact paper Justification Prospectus	Medium-high

This analysis suggests a solution to the problem of how to provide assistance to the LDC entrepreneur who has not yet located an investor. The low cost business plan and reconnaissance mission may be used to find potential financing. Then the more expensive studies may be funded, tailored to the needs of a specific investor.

Eligibility Criteria

Since the purpose of the Feasibility Study Cost Sharing Program is to aid LDC entrepreneurs in raising capital, either from the PRE portfolio or from other sources, it would make sense to weed out those proposals that appear to have little chance of ever attracting financing, no matter how attractive an investment paper may be developed.

There are two criteria that quickly focus on this issue:

- Management Qualifications: Who are the "sponsors?" What proof can they offer of managerial ability? Are they reputable? How committed are they to this project? Do they have the necessary technical qualifications? Would they impress a prospective investor?

- Investor Qualifications: Who are the proposed investors? To what degree have they already investigated the project? Do they have access to the financial resources needed? What is their opinion of the project and its management? What questions would they like to see answered in a feasibility study? If no investors are indicated, what evidence do the sponsors give that they have the ability to broker their own project?

Applicants are asked to indicate the expected source of financing. If PRE is not to finance the project, it must be assumed that the feasibility report will be of interest primarily to the indicated financiers. Common sense would dictate that these be contacted in order to ascertain the type of study they require and the seriousness of the investors.

Due to the public sector political emphasis on the "project," the relevant practical considerations of whether the sponsors are capable managers with a chance of attracting financing are largely not given proper attention. It is unlikely that the program can overcome this bias if administered directly by PRE or the USAID missions. The difficulty of meeting these politically oriented project requirements while still qualifying as attractive private sector investments tends to make the program ineffective as long as it is administered directly within the government. This does not mean that there are no economically sound projects that match the political goals, only that there is a bias against eliminating projects that are politically attractive but not economically sound. This bias, when combined with the pressure that budgeted funds be spent, creates an environment not conducive to efficient direct administration of the FSCSP.

Fortunately, the PRE priorities include prominently the development of intermediate financial institutions. By administering the Feasibility Study Cost Sharing Program indirectly through selected LDC financial institutions, there is an opportunity to make a positive, long-term contribution to private enterprise development.

Suggested Principles for Reorganizing the Program

The feasibility study program fills a valid role in assisting LDC entrepreneurs in raising capital for worthwhile projects. In order to make the program more effective, the following principles are recommended:

> The program should be administered directly by intermediate financial institutions in each country.
>
> - PRE's cumbersome contracting procedures may be avoided by giving yearly grants to qualified institutions. The need to employ the USDA Graduate School as a contracting agent is eliminated, saving 25 percent of program resources while closing a loophole in the system.
>
> - The intermediate financial institution is easily accessible to the local entrepreneur, eliminating the need and cost of the U.S. representative. This also reduces the likelihood of "consultant-driven" projects.

- The intermediate financial institution is insulated against the "project" orientation of the public sector and is more likely to identify opportunities on the basis of economic merit.

- The intermediate financial institution is in a better position to interview and evaluate the capabilities of the entrepreneurs at an early stage.

. The more expensive feasibility studies should be financed only when the source of the funds is clearly identified. These studies should meet the requirements of the financier. There should be reasonable grounds to believe that this financier is serious. One simple test would be to insist that investors with obvious resources be willing to spend the time to make a reconnaissance mission.

. Rather than finance the omnibus study, the program should be directed to partial funding of business plans, reconnaissance missions, and restricted feasibility studies, with successive go/no-go decisions along the way. These steps should be:

  - The business plan -- a 10 to 15 page document designed to acquaint the potential financier with the nature of the project and qualifications of the entrepreneurs. This would be used to locate investors with compatible "portfolio parameters."

  - The reconnaissance mission -- partial cost reimbursement to an overseas financier to visit the country, talk with the entrepreneurial group, and investigate other aspects of the project at first hand. This would serve to qualify serious investors.

  - The restricted feasibility study -- partial cost reimbursement to a financier who requires expert opinion on some critical aspect of the business plan and who has already made the reconnaissance mission and demonstrates a real interest

- Proposals should be initiated at the USAID mission. In order to avoid politically unacceptable funding (or funding of projects that may be illegal), the USAID/Mission should start the process by giving a selected LDC entrepreneur a letter of introduction to the intermediate financial institution official. (The intermediate financial institution would be able to use grant funds only for projects so introduced and would refer walk-in inquiries to the Mission before proceeding.)

- Provide the intermediate financial institutions with "investment banking" support, under a general program administered from Washington. This support program would include:

  - Training the intermediate financial institution officials to assist entrepreneurs in preparing business plans in a form appropriate for sophisticated international investors.

  - Providing direct intelligence as to major international portfolio investors that may consider proposals from that country.

  - Providing assistance in developing personal contacts between the intermediate financial institution officials and the major international portfolio investors interested in their country.

- Jse the intermediate financial institution's interest in maximizing profits as the mechanism for allocating funds among the projects that are indicated by the USAID/Mission.

- Substitute the concept of a "grant-line" to the intermediate financial institution for the "refundable grant" to the sponsor. This "grant-line" would be a draw-down facility, reviewed annually, that the intermediate financial institution could use to assist

Mission approved project-sponsors in drafting business plans, and in sharing the costs of reconnaissance missions and in funding restricted feasibility studies. The grants would not be refundable. However, the intermediate financial institution would agree to split fees received for arranging financing for these projects.

- Retain in the USAID/Mission, as part of the support program for intermediate financial institutions, a restricted FSCSP to provide supplemental funding for those exceptional projects that require assistance beyond the possibilities of the intermediate financial institution "grant-lines." These funds would be requested by the intermediate financial institutions and would be allocated at the discretion of the USAID/Mission.

C. Illustrative Program Outline

The proposed program would have two main components:

- A feasibility studies fund implemented through intermediate financial institutions in developing countries; and

- An investment banking support program implemented in cooperation with a U.S. private sector organization.

The following discussion illustrates how these basic concepts might be translated into progr ms suitable for AID funding and implementation. We believe that the approach presented here is sound and should be explored further, using this program outline as a point of departure in exploring alternatives and developing a final program design.

Suggestions for IFI Administration of the Program

Certain intermediate financial institutions in the host countries should be selected to administer the FSCSP. The intermediate financial institutions will usually require the support of a special program designed to develop their international investment banking capabilities (see below).

The following criteria may be used in selecting intermediate financial institution's for this program:

- The intermediate financial institution should be located in a LDC with an investment climate conducive to foreign private investment. The local government should fully support the program.

- The intermediate financial institution should already have a satisfactory relationship with USAID, preferably as a channel for loans to the private sector.

- At least some of the managers of the intermediate financial institution should be "deal-oriented" and interested in developing an investment banking capability.

- The intermediate financial institution should present at least one employee who would be available for special training under the PRE sponsored investment banking support program. This employee:

  - Should speak and write fluent English, preferably with training in business administration overseas;

  - Should have analytical qualifications that are well above average and have a personality that would contribute to successful contacts with professional foreign investors; and

  - Might be a management trainee, without heavy administrative responsibilities.

- The managers of the intermediate financial institution should have adequate sophistication in international affairs to deal effectively with foreign investors. They should also have access to local government and business leaders.

- The business reputation of the intermediate financial institution must be impeccable.

Having selected the intermediate financial institution, the employee that will administer the program should be sent for a two week training session sponsored by PRE (see below). The USAID/Mission must be fully supportive of the program, having approved the intermediate financial institution and the employee indicated. The "grant-line" administered by the intermediate financial institution might be drawn down as follows:

Purpose	Reimbursement
Drafting of business plan	$ 1,000
Reconnaissance mission	3,000
Restricted feasibility study	10,000

The maximum draw-down per sponsored project would be $14,000 (one business plan, one reconnaissance mission, and one restricted feasibility study). The overall grant-line per year would be initially $50,000 per intermediate financial institution. This amount would be revised yearly. The participation of the entrepreneur or the investor in these programs would be at the discretion of the intermediate financial institution.

The use of these funds would be as follows:

Drafting of business plan	Cost-sharing with intermediate financial institution of the salary of the program administrator
Reconnaissance mission	Reimbursement of travel expenses and local lodgings for a foreign investor interested in an approved project
Restricted feasibility study	Consultant fees. Expert opinion requested by a foreign investor that has already made a reconnaissance mission. (Does not require U.S. consultants.)

The intermediate financial institution would charge the sponsor a fee of 6 percent on the funds arranged. For projects with PRE cost-sharing, half of this fee would be paid to PRE. In other words, if the intermediate financial institution were able to arrange $1.7 million in financing, the $50,000 grant-line would have been reimbursed.

The intermediate financial institution program administrator would not be obligated to provide assistance for every project presented by the USAID/Mission. In fact, the function of the intermediate financial institution is to filter out those projects with little chance of going forward. The "grant-line" is only $50,000 in order to force the intermediate financial institution to be selective in an attempt to maximize its profits. A typical successful case might go as follows:

> Mr. X is an entrepreneur in a LDC in which the FSCS program is active. He is committed to expanding his agribusiness and requires $1.5 million in equity financing that is not available on the local market. The USAID/Mission hears of this project and believes that this type of endeavor should be supported. The Mission chief gives a letter of introduction to the intermediate financial institution FSCSP administrator.
>
> The intermediate financial institution official meets with the entrepreneur and has a positive impression of the proposal. He makes a background check on the entrepreneur. As the reports are highly favorable, the intermediate financial institution official meets with the entrepreneur's associates and visits the facilities. He is impressed by the thought and planning that have gone into the project.
>
> From the PRE investment banking support, the intermediate financial institution official knows of several foreign sources that may be interested in this project (a regional development bank, a London portfolio investor, and PRE itself). He decides to help the entrepreneur by redrafting the business plan in terms that will be acceptable to these investors. Using skills learned at business school and the orientation given by the PRE support training, he prepares a 15 page paper in English that concisely presents the plan and relevant financial projections. The intermediate

financial institution recovers $1,000 from the "grant-line" for this effort. (No prior approval is required. The intermediate financial institution only need submit copies of the business plan to the USAID/Mission and PRE in Washington.)

The intermediate financial institution official knows of two foreign investors that may be interested in this project. He has met a senior official of one of these sources as part of the PRE program. He sends a copy of the plan to the investor's office in London, along with a personal note.

In two weeks he receives a telex expressing interest in the project. Believing this official to be serious, he phones and offers to pay the plane fare and hotel if the investor can take the time for a brief visit to meet with the entrepreneur. The investor accepts, agreeing to fly down and spend a few days a month hence. These expenses are reimbursed from the "grant-line."

When the investor arrives, the intermediate financial institution official meets him at the airport and takes him to a hotel. He arranges for a dinner with the entrepreneur and his associates. The next day he takes the investor to visit the project site, as well as competing enterprises. He arranges for the investor to meet with a government agricultural official.

Before returning to London, there is a meeting to summarize preliminary findings. The investor says that based on his experience with similar projects in other countries, he believes the endeavor is feasible. However, confirmation of the soil by an expert known in the London market would be required.

After the investor returns to London, the intermediate financial institution official discusses the problem of the soil test with the entrepreneur, who does not believe the expense of a London expert is necessary. He says a local expert could do the job for only $2,000, whereas a foreign expert would cost $10,000. However, since they both feel that the investor is interested, an agreement is made whereby the entrepreneur and the intermediate financial institution (with the "grant-line" funds) will each pay $5,000 towards the cost of this study.

The London expert turns in a favorable report and after six months of talks and negotiations, the investor arranges the $1.5 million needed to start the project. The intermediate financial institution fee for its services is $90,000, which is split with PRE.

The final accounting for the PRE involvement in this project is:

Fee sharing	$45,000	Fee sharing	$45,000
Business plan	(1,000)	Business plan	1,000
Reconnaissance	(3,000)		
Expert opinion	(5,000)		
Net	$36,000	Net	$46,000

Of course PRE has other expenses with the investment banking support program, while the intermediate financial institution has the salary and overhead of the FSCSP administrator.

This hypothetical case serves to illustrate the principle of the self-administered "grant-line." The intermediate financial institution official is able to draw on this line at any time, without prior approval. However, in order to <u>maximize</u> the intermediate financial institution profits, he must make some rather difficult decisions:

- Will this entrepreneur be able to attract investors? What is the risk of "burning out" a good investment contact by presenting an inappropriate situation.

- How serious is the investor? Is it worthwhile to risk the scarce grant-line funds to pay for the reconnaissance mission?

- Will this deal go through to the end? Is the requirement for the London expert valid, or is it a "put off?" Would this opinion be useful to any other potential investors?

In order to qualify for reimbursement for the reconnaissance mission, the intermediate financial institution official would be required to prepare a brief memorandum covering the results of the visit. A copy of the restricted feasibility study would also need to be submitted.

The maximum that an intermediate financial institution could receive directly from the grant-line would be $50,000. This is the equivalent of 50 business plans (assuming that USAID sent 50 presentation letters). However, by only preparing business plans, the IFI would severely reduce the chance of receiving the larger contingency fees which might be promoted by using cost-sharing funds for reconnaissance missions and restricted feasibility studies.

The amounts suggested are meant to represent a reasonable incentive for the IFI to participate in the program, without leading to abuses with the grant-line. A $500,000 annual budget could fund programs in ten countries, not including the central investment banking support to the IFI's. This should be sufficient to produce from 150 to 200 business plans, a rich source of possible loans for PRE.

The Suggested Investment Banking Support Program

There are essentially three sources of investment funds for LDCs:

- Official development agencies (World Bank, AID, regional and national development banks, IFC, etc.);
- Private direct investors (major multinational corporations); and
- Private portfolio investors (private developmental funds).

The first two sources are of major importance to LDCs. Private portfolio investors probably account for less than 5 percent of the total LDC investment funds.

Official development institutions tend to invest for political reasons, in accordance with a priori determination as to the type of investment that is considered useful for development.

Private direct investors usually enter LDCs as part of a larger corporate strategy to control markets, to assure sources of supply, or to obtain low-cost production. They prefer to manage their own investments or work together with other direct similar investors.

Private portfolio investors tend to favor countries with attractive "investment climates," thereby eliminating many LDCs. However, some private portfolio funds are available for development or to establish advanced positions in potential markets.

In addition to the sources of investment funds, there are thousands of financial institutions, such as commercial banks, that provide short- and medium-term commercial financing. These may provide long-term financing as a collateral activity.

Each financial or investment institution has specific "portfolio parameters." The parameters of a specific institution are seldom obvious from its name.

Most people in the financial world have a very restrictive knowledge of sources of financing outside their particular speciality. In LDCs, the entrepreneur who has ru.. through the local sources of funding, faces a difficult (and expensive) task if foreign investors are to be approached directly. Furthermore, few (if any) investment bankers are available to bridge the gap.

The investment banking function requires:

- A detailed knowledge of the sources of investment for a specific market; and
- Access to the decision makers.

Most people in the financial world have little time to develop investment banking activities, even though these may yield substantial fees. The delay and uncertainty in making a deal relegates this function to a role secondary to financial services with more dependable income. Only the largest, developed financial markets permit major investment banking activity on a regular basis.

Nevertheless, it is the investment banking function that is critical in LDCs, especially for projects without local funding.

Three things are necessary to create investment banking activity:

- Investment Intelligence: The names and "portfolio parameters" of major professional investors interested in the country;

- Personal rapport must be developed between the person that is to be the investment banker and the more active investors which have been identified;

- Funding must be available to develop and present project proposals in a form useful to the investors.

The latter requirement fits in with the FSCSP. By creating a PRE program to support the first two needs, the effectiveness of the program may be substantially enhanced.

An Investment Intelligence program should achieve the following results:

- A data bank should be built and maintained containing information on major external private and public institutional sources of financing for selected LDC countries.

- For each source, the following information would be recorded:

    - Name, address, and communication information;

    - Portfolio parameters; and

    - Eligibility criteria and screening methods.

- The type of institutions covered for the selected markets would be:

    - Investment bankers;

    - Portfolio and fund managers;

    - Trustees of private funds;

    - Private development banks;

- Foundations;
- Official development banks (world, regional, national);
- Long-term financing sections of major commercial banks;
- Insurance companies with external portfolios; and
- Private syndicates.

. The data bank would issue a quarterly report to investors to gather support for its service to elicit additional sources.

This program should be managed under private contract.

The second step in developing the investment banking function would be to select the IFIs and IFI officials who were to participate in the program. The officials would then be sent to a special two-week course, managed under contract in the United States, that would cover the following topics:

. How to screen proposed projects;

. How to evaluate management of LDC projects;

. How to write a business plan that will be acceptable to professional investors;

. How to approach investors and develop rapport;

. Effective use of the USAID "grant-line;" and

. How to follow-up on negotiations.

Once the IFI officials have been trained, an "Investors Conference" would be financed in selected markets, based on the names developed by the investors intelligence program. The purpose of these conferences would be to introduce the IFI officials to the major professional investors with an interest in their countries. For example, a conference might be held in London to bring together the IFI officials with key LDC investor's in that market.

The maximum "leverage" from the program would come from a successful investment banking support program. Since this program aims at developing IFI capabilities to raise funds from all external sources, including external dollars in Europe and Asia as well as LDC private sector development cooperation from other friendly countries.

D. Major Design Issues

The Consultants recommend that the following issues be given priority in determining the feasibility of continued PRE programming in this area and in finalizing the design of such programming:

1. Integration with other PRE investment promotion and investment funding activities. While the internal requirements of the PRE investment program may make it desirable to continue funding for feasibility studies as part of this program, development of a mission-replicable feasibility studies program requires a separate test of an LDC-based strategy. Incorporation of such a pilot program into a broader PRE-supported investment promotion program should also be considered.

2. Program financing, including leveraged participation of the IFIs and investor repayment. The program's funding and fee structure should be designed to encourage IFI's to supplement PRE funds from their own resources and to direct support to projects most likely to go forward quickly to investment. Repayment provisions should be designed to weed out investors who are not serious or whose proposals are unlikely to go forward in the near future. At the same time, they should not impose an unreasonable monitoring or administrative burden on either AID or the participating IFI.

3. Criteria for selection of countries and IFIs for pilot testing. What criteria are most likely to result in placement of the program in a private sector lending institution capable of expanding its role in investment banking and serving a dynamic investment community?

4. PRE role in program implementation and support. What role should PRE personnel play in implementing the program, given the limitations on PRE resources, mission and IFI preferences, and the needs of the program itself?

5. Level of funding. What is the total financial requirement for a test of the program concept and what is the division of this requirement among feasibility study funding, program management support to the IFIs, and investment banking support?

IV. CONCLUSIONS AND RECOMMENDATIONS

Although the FSCSP has contributed to legitimate and worthy development objectives, it is the team's opinion that the scarce resources available to the FSCSP are not achieving their intended purposes. It is recommended that the resources would be better employed and leveraged by establishing and maintaining a system that reaches entrepreneurs in developing countries through intermediate financial institutions operating in those countries.

Conclusions

- The PRE/FSCSP is not reaching its intended audience, developing country entrepreneurs/investors, with a product that significantly advances their efforts to arrange or secure project financing.

- The PRE/FSCSP as currently structured is not suitable for replication or roll out to USAID/missions.

- The PRE/FSCSP has proven limited usefulness as a loan origination mechanism to PRE/I.

- In concept and operation, the FSCSP fails to distinguish among the project interest of the entrepreneur, the investor, and the consultant to the project.

- The FSCSP is dependent on the consultant to the project and has too little contact with the entrepreneur and other project investors.

- The FSCSP is not integrated into the private sector financial community and its procedural assumptions regarding the role and importance of feasibility studies do not correspond to the procedures and assumptions of private sector sources of project financing.

- A feasibility study co-financing program, in isolation from other financial services and products, lacks strong appeal to entrepreneurs and investors -- and makes little sense as in and of itself.

- The FSCSP has attracted a number of consulting firms with interests in the program that differ significantly from those of the committed entrepreneur/investor that the FSCSP wishes to serve.

- There appears to be a real demand by developing country entrepreneurs and developing country investors for professional services and risk capital at the prefeasibility study stage of projects as well as at the feasibility study stage.

The shortcomings of the FSCSP can be attributed to design problems and resource constraints that handicap the FSCSP efforts rather than to faulty administration or operation of the program. The principal disadvantages of the FSCSP are its isolation from the entrepreneur and local financial institititions as a result of location in Washington.

Isolation has also led the FSCSP to act as if the consultant, the entrepreneur, and the potential investor in a project have similar outlooks and similar interests in the type of feasibility study that the FSCSP will co-finance.

Their outlook and interests are, of course, quite different, and any entrepreneur would be well-advised to identify and involve his other investors (debt or equity) before undertaking a comprehensive and expensive feasibility study.

Location in Washington, D.C. has made it difficult for the FSCSP to judge the (1) character, experience, and creditworthiness of the entrepreneur; (2) the particular merits of the project; and (3) the financing and implementation obstacles that the project will face.

Lack of contact with other financial institutions offering services has meant that the FSCSP has not been able to offer entrepreneurs a continuing relationship nor refer them to entities that could become financial partners.

Recommendations

Based on the findings developed in the evaluation of the current program, the Consultants recommend that the FSCSP be restructured to bring it more closely into line with prevailing business practice and the needs of LDC investors. The restructuring proposal involves five alterations to the existing design, that can be implemented as a package, or in part, although maximum effectiveness would be realized by implementing all five.

The five major actions recommended as elements of the proposed restructuring are as follows:

1. Transfer the program overseas;

2. Relocate the feasibility program in a local, private sector bank, an investment bank if possible;

3. Establish clearer and more flexible application procedures and repayment requirements;

4. Establish a U.S.-based support system -- also located in the private sector -- to assist the participating intermediate financial institutions with foreign investor search and other pre-investment needs; and

5. Continue the new FSCSP as an experiment but limit the new program to two or three countries with active private sectors and involved missions for the next phase of testing.

Relocate the program overseas. The current location in Washington effectively prevents the program managers from functioning to maximum effect. In this location, they cannot establish the close ties to potential investors that are necessary to provide adequate support to investment start-up, nor do they have ready access to the information needed to judge the merit of proposed business ventures and to determine the issues that must be resolved in order to go forward. In addition, the Washington location promotes consultant-driven initiatives and tends to distort the consultant-client relationship.

Tie the program to investment financing. While support for feasibility studies is a necessary component of investment promotion, it is rarely sufficient by itself to make investment possible. Moreover, it is highly desirable to identify the source of both debt and equity financing as early as possible in the pre-investment phase, so that investor concerns can be addressed by the study and so that investment can proceed rapidly once the venture is found to be feasible. Equity partners may also bring expertise or market access that materially affects the feasibility of a venture, thus making it impossible to accurately determine its profitability until they are identified. The feasibility studies program should help the investor to establish the long-term relationship with a financial institution that is needed to build and sustain a sound business venture.

Recommendation: The feasibility studies program should be managed by financial institutions located in the developing countries. The personnel responsible for the program within these institutions should have the authority to allocate feasibility funds on the basis of the information provided by the investor and should be encouraged to use the funds to promote investments for which their parent institution will provide debt or equity financing.

- The preferred location for the program is a locally owned private sector investment bank established in the target country. Loan officers from this institution would receive the training and other support needed to enable them to add the feasibility studies program to their existing package of assistance for investors.

- Other feasible locations for the program include an off-shore or joint venture bank operating in the country, a development finance corporation with public sector or mixed ownership, and a newly established investment bank.

- The least desirable location for the program is within a public sector investment promotion office that does not provide investment financing. Location within AID is regarded as not feasible.

Establish clear and flexible procedures. The procedures for identification and screening of applicants, management of the program, and repayment must meet three criteria: (1) they must be clear and consistent; (2) they must be consistent with standard business practice; and (3) they must be workable. The current set of procedures does not fully meet any of these criteria. The lack of clear, businesslike, workable criteria has been a major factor in limiting the accomplishments of the program to date.

- Identification and screening of applicants: It is recommended that the current system of relying on self-identification and referrals from the USAIDs should continue. This procedure would be more effective, however, if it were based in the field, as recommended above. The screening procedure, however, should place greater reliance on the business reputation of the investors and their commitment to equity participation, rather than evidence regarding the proposed investment itself. This shift in screening procedures could only be implemented if the program administration were shifted to the field, since it is nearly impossible to obtain or verify this information in Washington.

- Allocation of feasibility study cost-sharing funds: The financial institution administering the program and the investors themselves are in the best position to determine the need for additional information in order for the investment to go forward. A predetermined list of issues cannot be developed that meets the needs of all investments and, in addition, implies a need for a comprehensive study, which in fact is rarely appropriate for the types of investments being assisted. Consequently, it is recommended that the financial institution have considerable latitude in determining the scope and content of studies funded. A recommended set of criteria should be developed covering the types of investments, investor qualifications, and the permissible content of the feasibility study, but the financial institutions should be permitted to make adjustments to these criteria to reflect local conditions and their own portfolio structure.

Level of funding provided: The desire of intermediate financial institutions to maximize profits should be used as an allocative mechanism to determine which studies should be funded at what level.

Allocations can be made on a case-by-case basis with preference given to small grants of less than $10,000 to meet the foreign exchange cost of expert assistance in specific areas. If necessary, several smaller grants could be given sequentially, in order to provide continued assistance as the project concept progresses, but large, one-time allocations would be avoided.

Repayment provisions: It is difficult or impossible to establish a single timetable that fits all projects and equally difficult to monitor investment activities after AID-assisted activities have been completed. Several options are available for repayment. The recommended option involves requiring a local financial institition to share brokering and finance fees [see Appendix D]. This is attractive since it rewards financial instititions which successfully complete deals. Monitoring is relatively easy and the incentive for the intermediate financial institution is to become independent of the program as soon as possible.

Another option is to provide assistance for doing feasibility work on a 50 percent loan and 50 percent grant basis. The loan would be forgiven if the project goes forward with financing arranged by the intermediate financial institition within a prescribed time period.

Establish a system linking the program to off-shore investors. The evaluation found that both local investors and local financial institutions have great difficulty in identifying potential sources of hard-currency financing -- both debt and equity -- and that assistance in resolving feasibility issues is rarely effective without a linkage to specific sources of finance. Two (and possibly three) of the seven investments examined in detail are currently stalled because of the need for additional equity investors.

Recommendation: PRE/Washington should establish a capacity to support projects in the feasibility studies program by assisting them to identify off-shore sources of financing, particularly equity capital. This capacity could be implemented directly by PRE, but could probably be performed more efficiently by the private sector.

- Develop an informal investment referral network linking PRE to investment sources other than investment banks. Such a network would identify investors actively interested in investments in developing countries, determine the sectors and countries that are consistent with their portfolios, and assist feasibility study program clients to make connection with appropriate members of the network. Participation in the network would not obligate investors to finance any (much less all) investments identified.

- Develop an investment brokerage capability by forming a committee of established investment brokers willing to assist AID in syndicating promising investments identified through the feasibility studies program. Members of the committee would serve on a part-time fee basis and would review proposals submitted by participating LDC-based financial institutions (not by missions or individual investors). Individual members would have the option of taking on the responsibility of syndicating one or more projects, on a case-by-case basis.

Continue testing of the feasibility studies program. The program as currently designed has demonstrated that there is a demand for assistance in investment start-up and that private sector investments can be identified that promote AID's goals. However, the program as designed does not provide a replicable model that can be applied by AID missions or other donors, nor should it be continued by PRE in its current form. Continued testing is necessary to develop and test a program concept based on LDC financial institutions.

Recommendation: The feasibility studies program should be continued, but action should be taken immediately to refocus the program on intermediate financial institutions in developing countries, and to pilot test the concept in two or three countries. Selection of countries should be based on: (1) presence of a private sector investment bank or other suitable institution willing to sponsor the program; (2) positive investment climate in the country; (3) PRE priority; and (4) mission interest.

APPENDIX A. SUMMARY OF CASES REVIEWED

Malawi

Two cases were reviewed in Malawi, both involving efforts to privatize a parastatal commercial farming operation. The parastatal, whose operations consist of livestock and row crop operations, went into receivership in early 1980 because of operating losses and lack of access to further capital. It had originally grown out of an official national youth movement and some of the losing enterprises were maintained for political rather than financial purposes. An international accounting firm was appointed as the receiver to oversee the process of reorganization.

Through a U.S.-based investor and financial advisor, private investors with extensive agricultural background in cattle ranching, row crop farming and tree farming were attracted to the possibility of participating in a reorganized farming operation using the parastatal's facilities. Following a reconnaissance visit, application was made to the FSCSP for partial funding for two in-depth studies of the financial potential of livestock and row crop operations.

The feasibility studies were done with the substantial participation of the potential private U.S. investors. Investors from Israel, South Africa and Europe had also expressed interest in the project. The CDC and AID both were quite interested in participation in the project. However, the investors saw no point in restructuring the parastatal unless they were satisfied that worthwhile successor operations were likely to result. Thus the feasibility studies had to be done first to verify the potential for a profitable investment.

AID arranged a $2 million bridge loan to keep the farms operating while restructuring and investments were being arranged. This AID participation provided assurance to local banks which then agreed to extend additional credits.

The interest of AID has been intense since this situation presents an opportunity to assist the successful privatization of a parastatal organization. This would serve as a model for similar efforts in Africa. The prospects are very good that PRE/I will participate in the long-term financing of reorganized private operations.

This case is one in which the FSCSP functioned smoothly as a loan origination vehicle for the PRE/I portfolio. In addition, other serious investors were identified prior to conducting the feasibility studies. The principals played significant roles in actually doing the feasibility study. In contrast to other situations with FSCSP involvement, this combination assured that questions of concern to prospective investors were addressed during the feasibility studies.

In the opinion of the receiver for the enterprise, the involvement of the FSCSP and PRE/I in this situation as official arms of the U.S. Government provided incentive for the Government of Malawi to approve a greater degree of divestiture. The point was stressed that a private merchant bank would not have the same degree of leverage as would the U.S. Government in such a situation, even though both might be playing the same brokering role. This was especially evident when decisions had to be made concerning whether the Government would relinquish nominal or effective control of parastatal operations.

Pakistan

Since the inception of the FSCSP, 11 identifiable inquiries have been received from Pakistan. These led to three completed studies: one in shrimp farming, one in horticultural production and processing, and one in dairy production and processing. AID has committed $133,725 as a cost-sharing portion for these studies.

The Shrimp Farming Project

Project development began when a Pakistani company with interests in shrimp farming contracted with a U.S.-based firm specializing in aquacultural production to do a feasibility study for a shrimp farm in Pakistan and to provide technical assistance and management during construction and initial operations. This relationship was cemented when the U.S. consultant was able to bring partial funding for the feasibility study portion of the contract and reported good prospects for loan financing of the entire project as a result of contacts with PRE's Office of Investments. The consultants had been competing with a French firm for the overall contract. The Pakistani firm initially approached PRE/Investments as a loan applicant, and both the Pakistani and the American firm viewed the FSCSP as a means of obtaining access to PRE/Investments funding. The Pakistani firm felt its referral to the FSCSP was a first step in qualifying for a PRE/Investments loan.

Initial application for FSCSP funding came in May 1983 and the feasibility study was completed by mid-September 1983. Study acceptance and reimbursement of $33,725 was made in October. Formal application for $375,000 debt financing was made to PRE/Investments at the time of submission of the feasibility study in September. On November 8 the application for PRE/Investments debt financing was turned down because "...the limited size of our investment staff has forced us to concentrate only on larger loans...." The decision was appealed and the denial reaffirmed by PRE/Investments citing inadequate management and experience.

The Pakistani and American firms had applied to the Agricultural Development Bank of Pakistan for a local currency loan, on the assumption that AID would provide the foreign currency. When PRE/Investments turned down the request, the total finance package of $2.6 million unravelled. The two firms are in the process of restructuring and cutting the scale of the project. Local currency financing has apparently been approved, but the foreign currency portion is still not in place. Total project size is now around $800,000, with a foreign currency component of $235,000. Three phases of the feasibility study were needed to get to this point. AID/PRE shared in the cost of the most expensive of these. The study financed by FSCSP would not have been undertaken at the time since the American firm indicated it would do a study of this size only in response to the needs of a lender. The U.S. firm felt that this study was in response to the needs of PRE/Investments prior to financing.

Neither the U.S. nor the Pakistani firm was aware that the decisions on the feasibility studies program and project investments are made out of different sections of PRE. They were confused by the changes in personnel and location, and felt misled when project financing was rejected. Both groups indicated they would not have undertaken the feasibility study unless they had located financing, nor would they have done it through PRE had they not viewed it as necessary to get PRE/Investments funding. Their perception was that, given the positive atmosphere of conversations with Office of Investments staff, funding would be assured if the technical and economic feasibility were borne out. The negative impacts on entrepreneurs as a result of poor coordination with PRE need to be considered.

Horticultural Production and Processing

The initiative for this project apparently came from an Honorary Consul of Pakistan in the United States, who attracted a major U.S. agribusiness firm to the possibility of horticultural exports from Baluchistan to the Middle East. A vice president of the firm and former AID Mission Director visited Pakistan and conferred with USAID regarding the FSCSP. He was referred to the Agricultural Development Bank of Pakistan and in turn to representatives of a family that is prominent in Baluchistan. The U.S. firm sought to combine its knowledge of horticulture operations and Mideast markets with the substantial presence in Baluchistan of the Pakistani partners. The Agricultural Development Bank recommended an investment in a specialty market such as almonds or pistachios.

The U.S. firm handled all of the contacts with AID and completely managed the feasibility study. The Pakistani partner did not take an active role in the study and made no direct investment in the study. A representative of the Pakistan partner termed himself a "catalyst" and apparently agreed to sponsor the study largely as a result of interest shown by the Agricultural Development Bank.

The scope of the resulting study was far-ranging and more of a horticultural sector study of Pakistan than an investment study. The U.S. firm concluded that project investment would not be feasible unless preceded by substantial infrastructure development, to establish grading, sorting, packing, storage, transportation, handling, quality control and cold chain facilities to handle perishables. The prospective size of an investment was more than could be handled by the Pakistani partners and even exceed the portfolio limits of the Agricultural Development Bank, so the entire project was put on indefinite hold.

Livestock and Dairy Farm

The project concept initiated with a major family-based investment group in Pakistan, who developed an interest in an integrated dairy production and processing project based on family land holdings in the Sind. The Pakistani group wanted an American consultant to do the feasibility study, because they felt U.S. climatic conditions paralleled those in Pakistan, that U.S. technology was state-of-the-art, and that a U.S. consultant would be able to attract U.S. companies as equity partners. A California-based firm was hired to do the study. This selection was partially based on the consultant's knowledge of the FSCSP and the PRE/Investments as a result of previous employment with AID in Pakistan. The consultant visits Pakistan periodically and was introduced to the Pakistani group through the National Development Finance Corporation and a local bank.

The prefeasibility study was done completely at the expense of the Pakistani group. The full feasibility study was done by a team assembled by the consultant and was financed 50 percent by FSCSP, 25 percent by the National Development Finance Corporation, and 25 percent by the Pakistani group. The completed study was accepted and approved by FSCSP. The National Development Finance Corporation has since done its own verification study of the feasibility study.

The project is being delayed by the need for a waiver of the land reform law by the Government of the Punjab. The law places a limit on the size of land holdings, and the Pakistani partner has applied for a 2,000-acre exemption for the livestock project. Representatives of the Pakistani group volunteered that one of the original factors in the decision to consider a dairy project was a special incentive provision of the law that grants exemptions from the land holding ceiling for livestock-based projects. The project is thus seen as a means of maintaining title to family lands that exceed the limit. In the view of the RRNA team, this is also a compelling reason to expect that the project will go forward.

Representatives of the Pakistani group felt that competent local consulting expertise was available at a much lower cost, and that it should be approved by AID for use in FSCSP. However, they feel that the recommendations of a foreign consultant would be more readily accepted by a Pakistani financial institution. One of the benefits of the

FSCSP is that participation by AID imparts prestige to studies in areas such as agribusiness which may otherwise be neglected by local lending institutions. Continued involvement of AID after the termination of the formal feasibility stage may help get government concessions, licenses, and approvals necessary if an investment is to take place. Involvement of local lending institutions at the feasibility study stage helps gain their commitment to participate as a lender.

The Pakistani entrepreneur voiced some general concern about financial disclosures that might be required under a revised FSCSP. The group was not required to submit any financial statements as a price of participation in the program. Because of the rate structure and incidence of the Pakistani tax code and the common practice of keeping separate records for tax purposes, investors would feel quite vulnerable to inquiries by the tax authorities if complete disclosure were required. Confidential bank reports and bank references would not be viewed as intrusive.

The Pakistani entrepreneur indicated that this particular project had such importance to the group that even if the FSCSP were not available, the feasibility study would have gone forward with other sources of funds.

Date Processing

A rather ironic development in Pakistan is that in a case wherein an investment was made as a result of the FSCSP, the investor failed to qualify for the program because of an apparent confusion regarding application procedures. A food surveyor for a U.S.-based trading company visited Pakistan in 1983 to inspect some dates for purchase and import into the U.S. He saw an opportunity for setting up a profitable date processing facility and approached the local PRE representative for assistance. Since the FSCSP was new and there was no standard application form, some confusion developed on the procedures for applying on the part of the USAID mission and the U.S. businessman.

The principals of the trading company were persuaded to do a feasibility study, since they felt that the worst that could happen was that the study would arrive at a negative conclusion and that AID would pick up half of the cost of the study. At best, they would have a profitable business investment opportunity on their hands. They went ahead with the feasibility study with the knowledge, but not the prior approval, of the USAID private sector office. At the completion of the study, an application was made to the FSCSP for reimbursement. The application was rejected, since the group did not have prior approval. The group subsequently found a Pakistani majority interest partner and invested in a date processing facility which is now nearing completion.

This case most clearly demonstrates the need for clarification of the eligibility requirements and for a clear and rapid acceptance process. This investor was inexperienced at working with government programs and is impatient with the eligibility requirements and time consumed in procedures. He is planning to expand the date processing facility and inquired into the OPIC feasibility study program. He observed that OPIC took three months to answer his letter, and that is more time than he planned on spending doing the actual feasibility study.

Another feature about this case is that the "consultant" who did the study was actually one of the principals. There was no divergence of interests between the consultant and the entrepreneur, and this helped to move rather quickly into investment.

Private Banking Sector

As part of an effort to identify alternatives and options to redesign and strengthen the FSCSP, interviews were conducted with intermediate financial institutions to determine what role these institutions could play in a decentralized FSCSP.

In Pakistan the local banks have all been nationalized and the only privately held banks are foreign-based. Strict lending limits are imposed by the Government of Pakistan as a means of holding down the money supply under IMF strictures. The 17 private banks are limited to an approximate 10 percent share of the lending market. Foreign-owned banks are also limited to three branches in the country, while five of the nationalized banks have 6,500 branches in the country.

One U.S.-based bank, for example, provides merchant banking services in underwriting capital offerings, syndication of loans to the Government of Pakistan and parastatal corporations, short-term notes, corporate finance, and advisory services. A second bank provides full commercial banking services, investment banking out of their Singapore branch, and syndication of large loans, while a third provides full commercial services specializing in short-term finance of international trade, syndication of loans to parastatals, and expertise in pharmaceuticals, rice, textiles, jute and engineering. A fourth bank interviewed by the evaluation team provides full commercial services and does limited brokering of overseas investment funds.

Because of the legal restrictions on interest rates and the ceiling on portfolio size in Pakistan, the private banks lend only in the more profitable short-term market. Many requests are received for longer-term project finance, but these requests are referred to the nationalized development banks.

All of the above-mentioned banks showed a polite to moderate interest in working with AID to originate loans either for overseas investors/lenders or for the PRE/Investment portfolio. A very keen interest was indicated by all if they could wholesale counterpart funds or some other foreign source funds without having the loan count against their respective lending limits. The waiver of the credit ceiling to permit the lender to make long-term loans is critical to the participation of financial institutions and success of any feasibility study program designed to increase investments in Pakistan.

The RRNA team recommends that USAID/Pakistan consider earmarking future ESF funds or PL480 funds to capitalize a private sector investment fund to be administered by the private financial institutions. As part of this package, USAID would have to require waivers from the Government of Pakistan that loans from such a fund would not impair the lending limit of the private banks either individually or collectively. The mechanics of capitalizing and administering such a fund require detailed study, but commodity import programs seem to be well-suited for this purpose.

Earmarking funds to be administered only by the private financial institutions to private sector entrepreneurs may provide some incentive to the Government of Pakistan to allow private indigenous financial institutions to develop. An example of a nascent Pakistani financial institution is an Islamic mutual trust which is being started by a Pakistani investment group to raise funds on behalf of project owners. It will operate under Islamic banking laws in a manner similar to that of a U.S. mutual fund, and will be able to provide financing on a long-term basis. Channeling funds through such a trust will provide a source of funds and a small measure of policy protection to permit growth of similar private financial institutions.

Pakistan is in the process of converting to Islamic banking, with July 1 as the deadline past which no interest-bearing deposits can be accepted. Strict Islamic practices prohibit the charging of interest, and this is to be reflected in the new banking procedures. The new procedures have been designed with the active collaboration of the banking community to assure a smooth transition. It should be noted, however, that this is the first time anywhere where the entire banking system is to be converted to Islamic banking principles.

The changeover should not directly affect any feasibility study loan/investment program that might be undertaken by USAID, because any foreign source funds will continue to draw interest as before. If a capital investment fund is to contain reflows or existing counterpart funds, these may be subject to Islamic banking practices. American banks are prohibited from making loans on a profit-and-loss-sharing basis, so they will continue to finance on a fixed return basis by using paper transactions of buying and selling goods at prices predetermined to yield a fixed return.

Conversion to Islamic banking has a potential for drastic changes in marketing and competitive practices. In Islamic banking, no predetermined fixed interest can be paid for funds on deposit. Depositors will share in the profits and losses of the bank according to a predetermined formula. The fortunate depositor in a profitable bank will receive a higher return on depositors' money, while depositors who place funds in an unprofitable bank may see an erosion of their capital. The potential exists for a rapid decapitalization of a bank which has suffered losses as depositors withdraw funds from less profitable banks to put into a more profitable bank. In essence, the profit-and-loss-sharing model for deposits amounts to decontrol of interest rates paid. The potential exists that a more efficient banking system will evolve as capital moves from the less efficient to the more efficient banks.

Costa Rica

Ten inquiries were identified in the files with specific emphasis on Costa Rica. Four completed feasibility studies have been done in dehydration of spices and vegetables, frozen vegetables, fresh cauliflower, and coffee byproducts.

Dehydration of Spices and Vegetables

A U.S.-based food storage company initially contacted an officer of a Costa Rican supermarket chain through personal contacts. The U.S. firm wanted to do a study of dehydration of vegetables and spices under the FSCSP, but, as a U.S. firm, was not eligible for FSCSP. It therefore proposed that the Costa Rican firm sponsor the study through a subsidiary.

The Costa Rican firm agreed to sponsor the study because, if feasible, the project would allow it to contract with farmers for their entire crop. Table-quality vegetables could be sold through the supermarket chain and industrial quality produce could be dehydrated for use in soups and other preparations. The Costa Rican partner did not understand at the time it agreed to sponsor the study that it would be obligated to repay the grant if an investment went forward. It made no commitment to provide any financial support to the study, but in fact provided scheduling and logistic support while the study was underway.

The Costa Rican firm indicated it was interested only in the smallest feasible size of equipment that was flexible and capable of handling short runs of vegetables, since the local markets are limited. The consultants, early in the study, found that only pineapple and bananas had sufficient surplus production to justify investment in dehydration equipment, but the Costa Rican firm was not interested in pursuing this option, since there is no domestic market for these products. However, the consultant continued the study and recommended a pilot phase to explore market possibilities at a cost of $2.4 million. The U.S. firm was not willing to make an investment of this size, and this option did not suit the marketing strategy of the Costa Rican firm, so the entire project was scrapped.

This case demonstrates the desirability of being more flexible in allowing incremental phases in feasibility studies. The originally conceived project was shown to be infeasible early in the process, yet a contract had been signed for a full feasibility study. As a result, a full feasibility study was done which focused on an irrelevant enterprise, much to the dismay of the Costa Rican sponsor. In this case, the sponsor was not a full partner in the study and was little more than a contracting convenience. This also highlights the importance of the entrepreneur/investor playing a major role in the feasibility study.

Coffee By-Products

The project under consideration is designed to process coffee wastes into usable products such as caffein, tannin, animal feeds, and pectin. The technology involved has not yet been commercially proven. The role played by the FSCSP in the development of this project is clouded, since the initiative for the feasibility study came through the PRE Investment program and bypassed the usual review procedures. At least six separate feasibility studies have been done on various aspects of this project over the last 16 years, and AID participated in the financing of only the most recent study. This study called into question some of the results which were obtained earlier in a study done by a U.S. consulting firm, which is also a subsidiary of a U.S. firm that hopes to supply equipment to the project, should it go forward. The future of this project is now in doubt and may require another study to determine whether the project should be restructured, scaled back, or abandoned.

This case demonstrates the role played by consultants in preparation of feasibility studies. A consultant renders an expert opinion on key issues in question in the business plan or project plan. To be of value, the consultant must be recognized as an expert by the investor. In this case, in an earlier feasibility study not funded by AID, an expert opinion was given by a consulting subsidiary of an equipment supplier. Even though the consultant is an expert, the conclusions may reflect the perspective of the equipment supplier and not necessarily the perspective of other investors or lenders. The subsequent study, which was partially funded by AID, showed a different interpretation of the prospects and more nearly reflected the interests of the sponsors.

Frozen Vegetables

An off-shore businessman with intermittent residence in Costa Rica applied to FSCSP for a study to determine the feasibility of locating a freeze processing plant in a free port on the Pacific Coast. The consultant recommended putting the plant in the free port and proposed a follow-on study for $250,000. A Costa Rican business partner who became involved after the study was commissioned hotly contested the conclusions. He maintained that the plant should be located on the Atlantic side instead of the Pacific side, since exports of frozen vegetables to the U.S. have easier market access to the East Coast rather than California. The prospective production areas were too far removed from the processing plant and were not proven agricultural areas. He further contested the need to locate in a free port, since almost all of the advantages of a free port location are also granted to export-oriented business ventures. The business affiliation fell apart, and the equipment is lying unused in a government warehouse.

Fresh Cauliflower

An American consultant with work experience in Costa Rica approached a Costa Rican lawyer about an investment opportunity in exporting fresh vegetables to the U.S. market. The lawyer syndicated a group of Costa Rican investors, who collectively raised $10,000 to pay part of the local costs of a feasibility study. The study, done in a professional manner, recommended setting up operations for exporting fresh cauliflower to the U.S. market.

The results of the study were favorably received, but the realization of the size of required investment cooled the ardor of the Costa Rican investors. Especially disconcerting was the proposal of the consultant for a 36-month management contract for $420,000. The investors felt they would be assuming all of the risks and the consultant would be getting "the sweetest slice of the pie." The project is now on hold, but could be revived at some future date.

The Costa Rican investors expressed a preference for the FSCSP to be administered from the local USAID office so they could play a more direct role instead of relying entirely on the consultant. They also felt that complete reliance on U.S. consultants made the feasibility study artificially expensive, since local consultants could have done the same job more cheaply.

APPENDIX B. OTHER DONOR APPROACHES TO FEASIBILITY STUDY FINANCING AND INVESTMENT PROMOTION

The findings presented in this section are based on an examination of other donor activities in the private sector, which was undertaken as part of a review of recent AID experience in private sector assistance. In this review, carried out by RRNA in late 1984, interviews were conducted with representatives of multilateral donors and bilateral donor agencies in France, Germany, Great Britain, and Canada, as well as other U.S. agencies active in promoting overseas investment, including Eximbank, OPIC, and TDP. Although the review did not focus specifically on feasibility studies, considerable information was generated that is relevant to this report. These are summarized below. Further details on individual donor programs may be found in *A Review of AID's Experience in Private Sector Development* (AID Program Evaluation Report No. 14).

The overall finding of the review of other agency experience in this area is that *assistance in evaluating project feasibility is a necessary and appropriate element in donor support to private investment in developing countries*. All of the donors contacted have at least one program to assist potential investors in carrying out feasibility studies. These programs typically finance 50-75 percent of the total feasibility study costs and the donor's contribution is reimbursable only in cases where the investment goes forward. Thus the programs are essentially identical to those of OPIC and TDP and very similar to PRE's FSCSP.

The experience of other donors with support to feasibility studies supports the conclusions of the FSCSP evaluation. Three points deserve special emphasis:

1. <u>Feasibility study assistance is most effective when it is part of an integrated program of support to overseas investment and when it is backed up by financial assistance to promising ventures</u>. The German DEG, in particular, has been successful in generating investment activity through its promotional activities, which include investment planning and legal information, partner identification and brokering, investment counselling, cooperation with trade groups, and advisory assistance to state institutions and local development banks (including those set up with DEG assistance).

2. <u>Feasibility study programs, like other activities in the investment area, are more effective when carried out in close cooperation with the actual investor and when they are supported by a sustained in-country presence</u>. OPIC, for example, will deal only with principals, a policy adopted to help in screening out proposals that lack adequate equity support. DEG's positive experience with its in-country investment advisors also suggests the importance of country-specific knowledge and regular personal contact in bringing the investment decision process to a successful conclusion. Over a ten-year period, DEG has assisted in the establishment of 90 new business ventures in Tunisia, working in cooperation with Tunisian investment authorities.

3. <u>Cooperation with in-country intermediate financial institutions increases the impact of feasibility study resources</u>. The World Bank, IMF, and DEG have been particularly active in promoting expanded investment activity through support to development finance companies and in assisting these organizations to take a more active role in seeking out and assisting local entrepreneurs. Experience with these institutions indicates, however, that they cannot cost-effectively provide services falling outside the scope of normal banking practice; other institutions should be

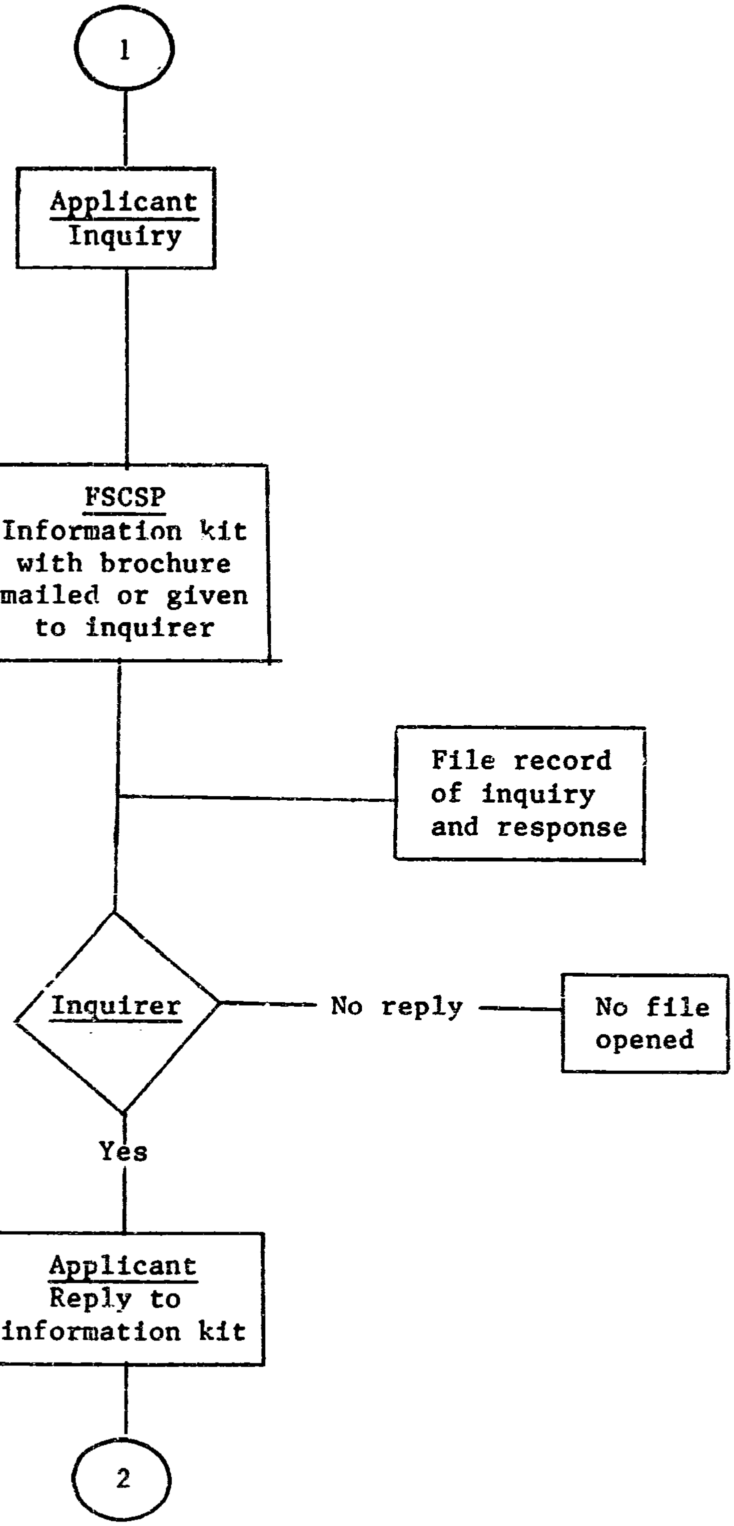
brought in to provide management training, accounting support, and other non-financial business services needed to complete the package of assistance to the entrepreneur.

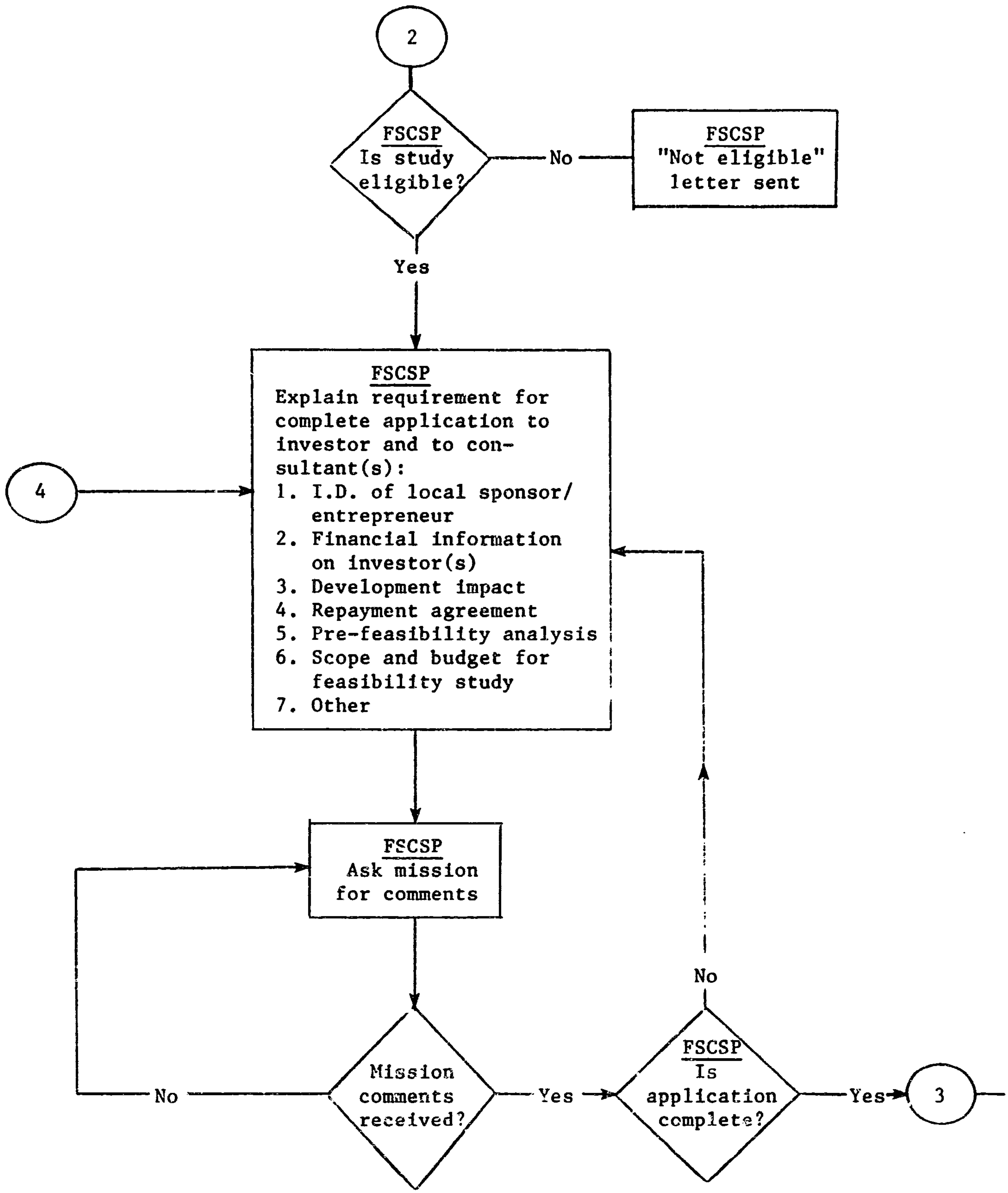
In sum, the experience of other donor agencies argues for an approach that would (1) continue and build on PRE's experiment with feasibility study financing; (2) incorporate this program more closely into an integrated program of investment promotion and packaging; and (3) increase reliance on in-country personnel and institutions to both identify and assist individual entrepreneurs, with support and coordination from the central office.

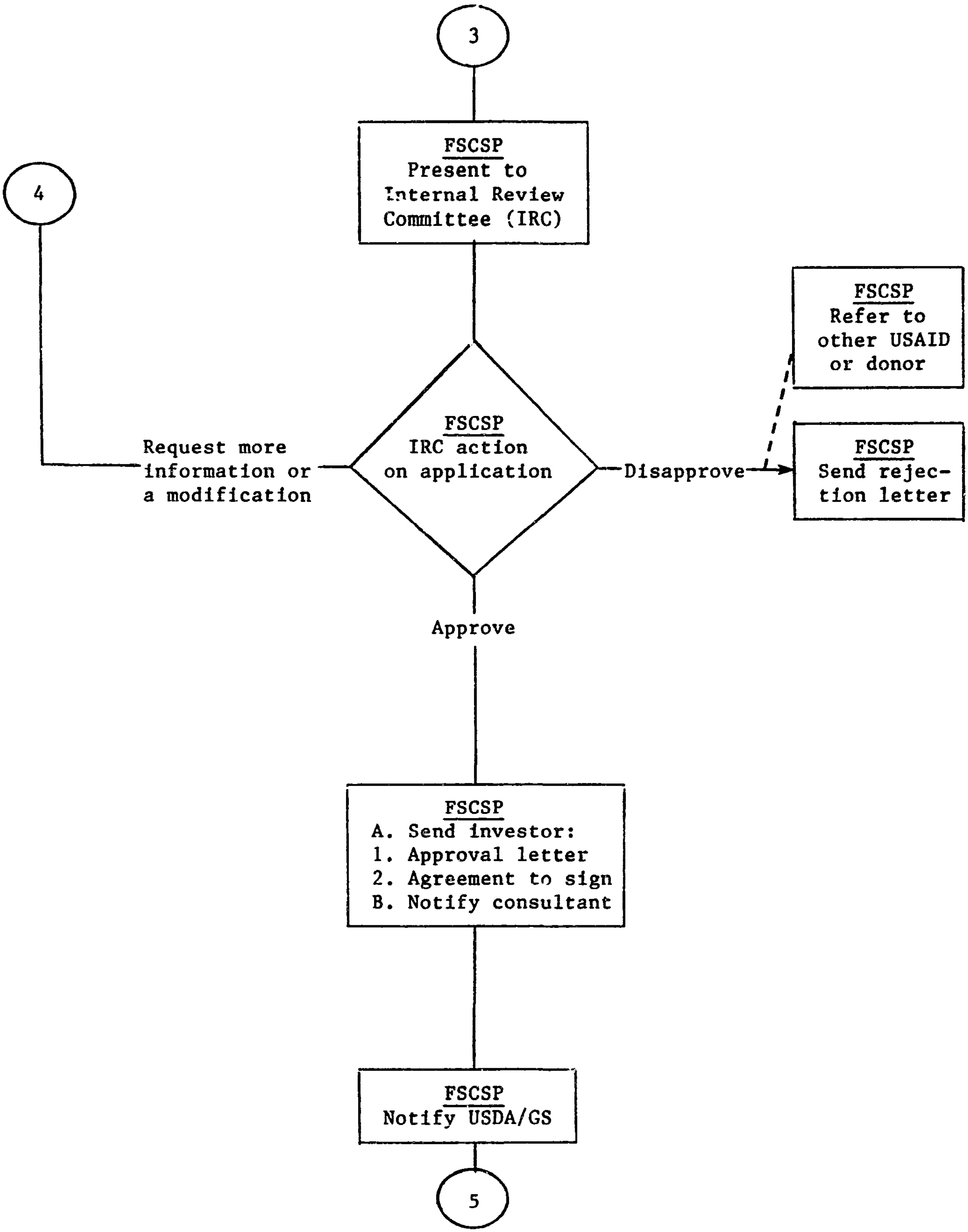
APPENDIX C.

FLOW CHART
of
PRE/Feasibility Study Cost Sharing Program

March 1985




2
FSCSP
Is study eligible?
No
FSCSP
"Not eligible" letter sent
Yes
FSCSP
Explain requirement for complete application to investor and to consultant(s):
1. I.D. of local sponsor/ entrepreneur
2. Financial information on investor(s)
3. Development impact
4. Repayment agreement
5. Pre-feasibility analysis
6. Scope and budget for feasibility study
7. Other
4
FSCSP
Ask mission for comments
Mission comments received?
No
Yes
FSCSP
Is application complete?
No
Yes
3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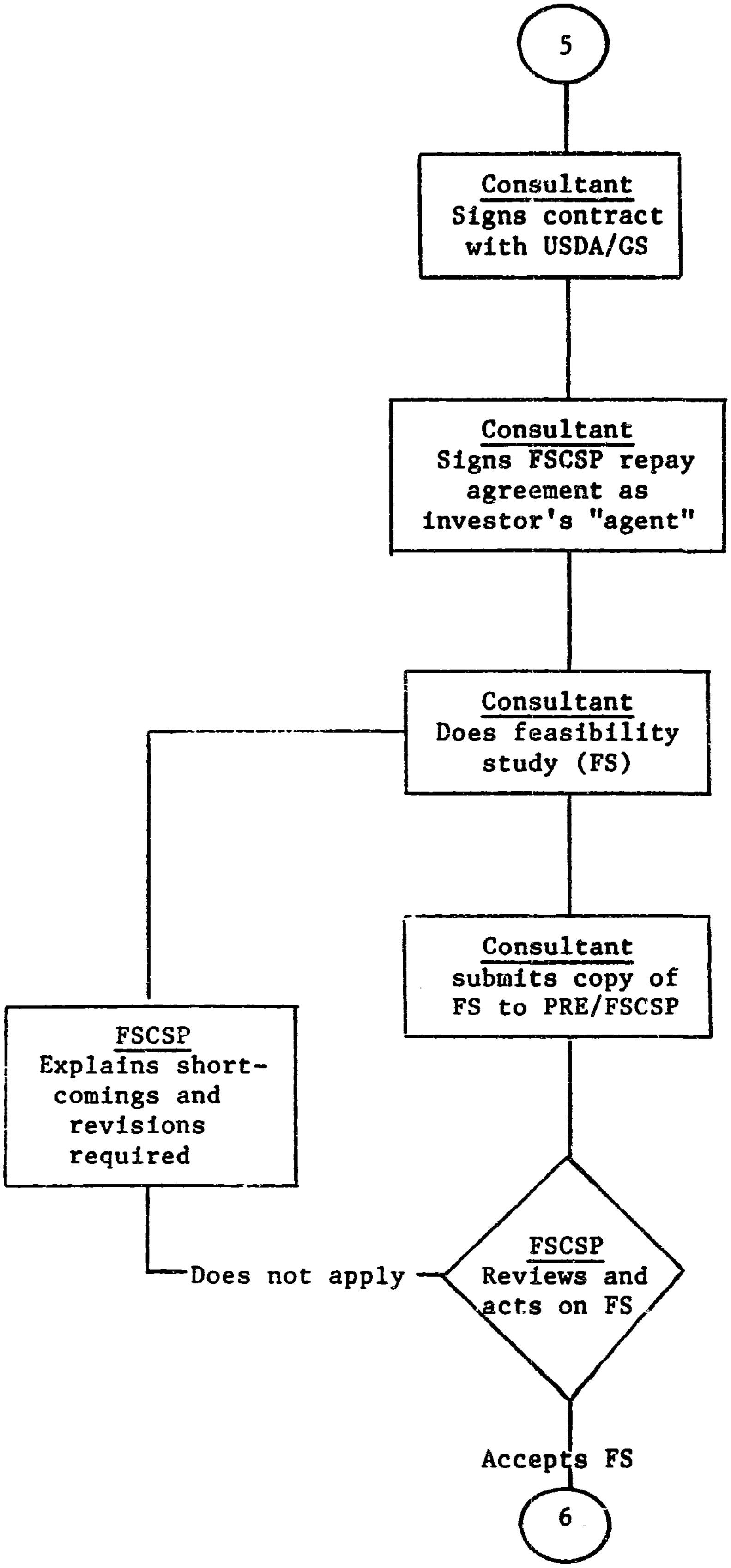
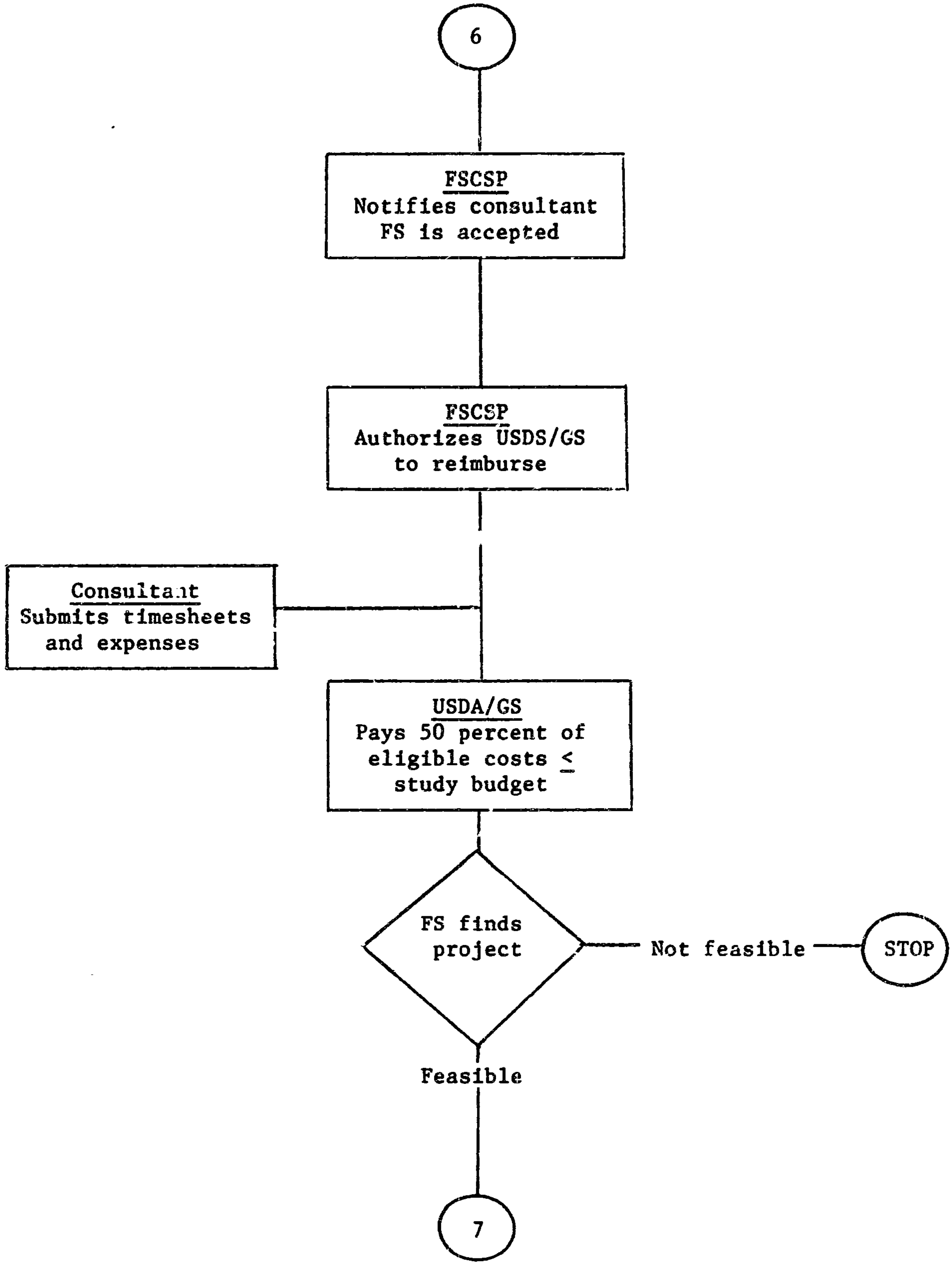
FSCSP
Present to
Internal Review
Committee (IRC)
4
FSCSP
Refer to
other USAID
or donor
FSCSP
IRC action
on application
Request more
information or
a modification
Disapprove
FSCSP
Send rejec-
tion letter
Approve
FSCSP
A. Send investor:
1. Approval letter
2. Agreement to sign
B. Notify consultant
FSCSP
Notify USDA/GS
5

40


5
Consultant
Signs contract with USDA/GS
Consultant
Signs FSCSP repay agreement as investor's "agent"
Consultant
Does feasibility study (FS)
Consultant
submits copy of FS to PRE/FSCSP
FSCSP
Explains short-comings and revisions required
FSCSP
Reviews and acts on FS
Does not apply
Accepts FS
6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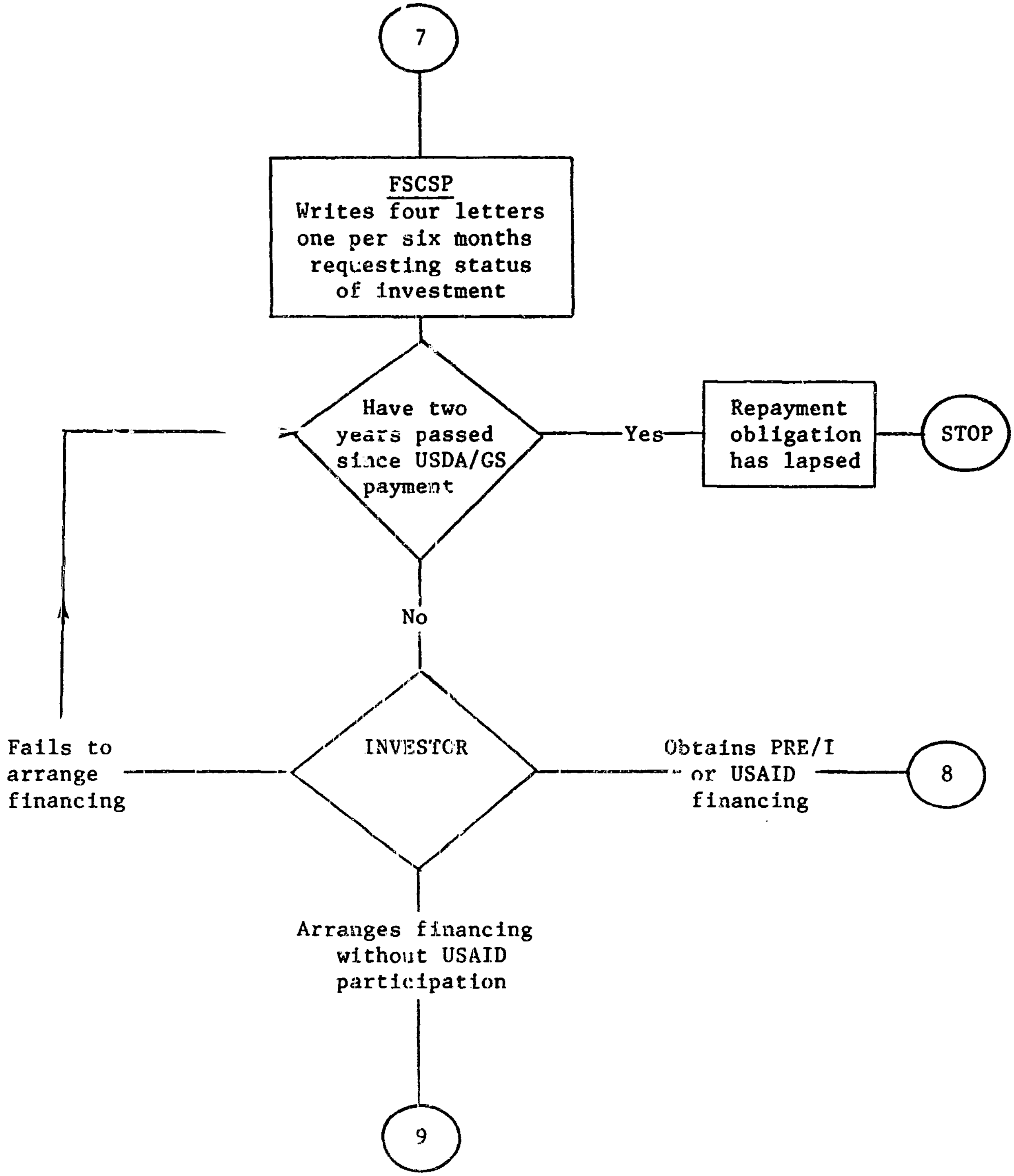
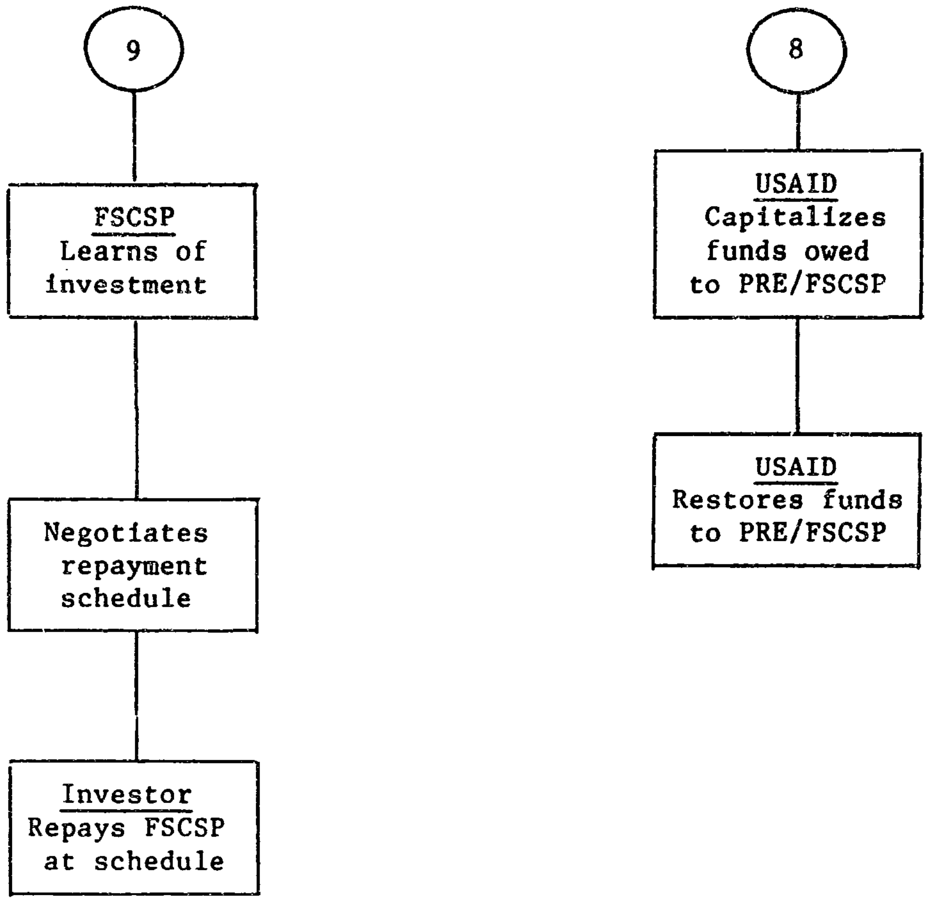
FSCSP
Notifies consultant
FS is accepted
FSCSP
Authorizes USDS/GS
to reimburse
Consultant
Submits timesheets
and expenses
USDA/GS
Pays 50 percent of
eligible costs ≤
study budget
FS finds
project
Not feasible
STOP
Feasible
7


7
FSCSP
Writes four letters one per six months requesting status of investment
Have two years passed since USDA/GS payment
Yes
Repayment obligation has lapsed
STOP
No
INVESTOR
Fails to arrange financing
Obtains PRE/I or USAID financing
8
Arranges financing without USAID participation
9


9
FSCSP
Learns of investment
Negotiates repayment schedule
Investor
Repays FSCSP at schedule
8
USAID
Capitalizes funds owed to PRE/FSCSP
USAID
Restores funds to PRE/FSCSP

APPENDIX D. SCOPE OF WORK

Background

The purpose of the Feasibility Studies Cost Sharing Program is to promote the formation of private, for-profit developing country businesses by providing financial assistance in the performance of feasibility studies for potential business ventures in targeted sectors. From its inception, the program had two principal objectives:

1. To serve as a loan origination mechanism either for PRE's potential financing, or from some other financial intermediary; and

2. To develop a model feasibility study financing program, the design of which would be replicated in individual countries and managed either by the respective USAID/Mission or an appropriate in-country institution.

The financial assistance offered under this new program provides partial funding for approved feasibility study proposals, and is referred to as "a refundable grant," with the project sponsor bearing the cost of the study up front. If the study is accepted by PRE, the sponsor is reimbursed for up to $50,000, or half the total cost of the study (whichever is less). The program has been operational since late FY 1982. To date, $1.35 million has been authorized for the program and $826,000 has actually been committed to studies or disbursed to sponsors of completed feasibility analyses. These have all been agriculture or agribusiness projects in AID assisted LDCs. We plan to expand the program to consider potential studies on health projects, housing projects, and intermediate financial institutions, including mortgage institutions.

To date, commitments have been made to 16 projects in 9 countries. Of the 16 approved proposals, 12 have been completed. Two of the 12 finished studies demonstrated nonviability of the ventures, while 10 completed analyses showed varying degrees of profitability. Of the 10 successfully completed studies, two have led to investments. The eight outstanding studies are in various stages of investment packaging.

This evaluation will provide PRE with the necessary information to make the management decisions outlined in Article II below.

ARTICLE I - TITLE

Mid-term Evaluation of the Feasibility Studies Cost Sharing Program

ARTICLE II - OBJECTIVE

The evaluation is being conducted to provide PRE management with an objective analysis of the progress and problems of this new and highly innovative program in achieving its objectives.

Management needs to determine:

(1) What, if any, design problems exist with the program both in terms of the management process utilized and the content of the studies;

(2) Recommendations on how the program could be redesigned to strengthen it and better articulate its objectives;

(3) What criteria to use for measuring success in the short-term since investments frequently have long gestation periods and how through management and redesign of the program we ensure that success; and

(4) Whether to continue future funding of the program and, if so, under what conditions and at what level.

ARTICLE III - STATEMENT OF WORK

PRE has selected 3 countries for review: Pakistan, Malawi and Costa Rica. These countries have the majority of the feasibility analyses completed to date. The evaluation will begin on or about January 14, 1985 and the field work will take approximately four weeks to perform.

Methodology and Procedures

Team members will spend approximately one and one-half weeks in Washington, D.C. reviewing project documentation including rejected proposals, such as the construction of low-cost housing in Jamaica, animal waste processing in Indonesia, the Maqboo Loop Housing Society in Pakistan and the edible oil processing project in Tanzania. They will also meet with appropriate PRE staff, interview U.S. applicants by phone, and meet with OPIC, IFC and TDP staff to review their feasibility programs, and interview staff at the USDA Graduate School.

At least five working days will be spent in each of the identified countries to interview USAID private sector officers and other appropriate Mission staff, local sponsors of the feasibility studies, and other pertinent individuals. The contractor will be expected to work, and be paid for, a six day work week.

The itinerary will be planned in consultation with the contractor and the respective USAIDs.

The evaluation report should address the following essential issues and questions:

A. Program Management

1. What are the eligibility criteria for feasibility study financing requests, and are the criteria clear to all parties? How can they be improved/made more clear?

2. Is the PRE funding process and eligible items for funding clear or confusing to local sponsors?

3. Is $50,000 on a shared cost basis an appropriate level for PRE to achieve its objectives under this program?

4. Should PRE develop a standard application form for this program, and if so what critical elements should it include?

5. Does PRE have an adequate process for screening and checking capabilities of sponsors and consultants and reasonableness of costs for feasibility studies? How might it be improved?

6. Is too little/too much staff time spent by PRE managing this program? How might this be improved?

7. Should the program continue to work with U.S. consultants identified by local sponsors? If not, what are the alternatives? If so, what should be the relationships and how do we market our program with theirs?

8. Does it make sense to continue to try to manage this program from Washington? If so, what improvements can be made to focus the program (e.g., geographic, sector, etc.) making it easier to manage?

9. What has been the role of the USDA Graduate School? Has it been effective from PRE's view? Should alternative methods for contracting be considered? If so, provide alternatives.

10. How effective has the PRE internal review committee been in screening projects and should its role continue? Has the proper material been presented to the committee from which reasoned decisions on potential PRE participation can be made. If so, what improvements can be made? If not, how should this function be performed?

11. What action can PRE take to improve internal reporting for management use?

12. Do the development benefits of FSCSP justify the budget and personnel costs associated with it? What are the approximate total costs per study?

B. Program Marketing

1. What action has been taken by PRE, to date, to market this program and has it been appropriate given the program's objectives and resources?

2. How can the feasibility program be designed and marketed in a way to help develop or expand LDC IFIs?

3. To what extent should the marketing strategy be altered to allow it an improved chance of helping the program meet its objectives?

C. Feasibility Study Content

1. Do the guidelines adequately detail the types of information/analyses which must be completed for a study to be acceptable? If not, what additional information needs to be included?

2. Do the completed analyses result in sufficient information for an investor (including PRE) to make a "go/no go" decision? If not, what improvements need to be made to assure that required analyses are complete?

D. Budget

1. How should PRE allocate funding for the program? For example, should the Bureau provide a percentage of the overall budget to the Investment Office specifically for loan origination and if so, should the same eligibility criteria and management process be utilized? Should a percentage be allocated for programs with interested USAID Missions? Should we provide small amounts of matching funds to financial institutions to disburse on our behalf? Provide recommendations.

2. Should PRE consider other co-financing mechanisms? If so, what are they?

Reporting Requirements

The report should specifically address:

1. Accomplishments vs. Objectives
   --achieved/not achieved
   --why/why not
   --unplanned achievements under the program
   --development impact (if any)

2. Lessons learned

3. Recommendations for redesign, if necessary

4. Sustainability

5. Format of the Report

   The report will contain the following sections:

   -- Executive Summary (guidelines attached).

   -- Basic project identification data facesheet (attached).

   -- Statement of Conclusions and Recommendations (short and succinct with topic identified by subhead corresponding to conclusions and worded, whenever possible, to specify who should take the recommended action);

   -- Body of Report (which includes a brief description of the project and which provides the information on which the conclusions and recommendations were based); and

   -- Appendices as necessary (including, minimally, the evaluation's scope of work and a description of the methodology used and, possibly, methodological recommendation for future evaluations).

6. Briefing

   The team will brief PRE/PPR staff in Washington, D.C., immediately following completion of the field work.

7. Submission of the Report

   Six copies of the draft report should be submitted to the PRE Evaluation Officer no later than 6 days following the briefing for PRE/PPR staff.

APPENDIX E. METHODOLOGY

The methodology used in this evaluation consisted of review of relevant documents and interviews with key participants. A Robert R. Nathan Associates, Inc. interdisciplinary evaluation team composed of an agribusiness specialist, an investment specialist, a policy evaluation specialist and an investment banking specialist started in March 1985. The team spent two weeks in Washington interviewing key personnel in AID Bureau for Private Enterprise Office of Policy and Program Review, the Bureau for Private Enterprise Office of Investments, the USDA Graduate School, the Overseas Private Investment Corporation, the Trade and Development Program, U.S. investors and U.S. consultants.

During the period in Washington an alternative program structure was designed which, in the opinion of the RRNA team, would better achieve the goals and objectives of the program. During the four weeks of site visits in Pakistan and Costa Rica, interviews and discussions included "field testing" of the applicability of the suggested restructuring of the FSCSP to local situations. This final report on the suggested restructuring contains much of the feedback obtained in the field.

During site visits in Pakistan and Costa Rica, interviews were conducted with USAID personnel, consultants, local bankers, local entrepreneurs, local investors, local legal counsel and local representatives of the International Executive Service Corps.

Two more weeks were spent in Washington synthesizing material and drafting the report. A debriefing meeting was held with the PRE Evaluation Officer and a discussion of the conclusions was held with top staff of PRE prior to submission of the final report.