

ASIAN DEVELOPMENT BANK

TAR: SRI 36357

TECHNICAL ASSISTANCE

TO THE

DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

FOR PREPARING THE

PRIVATE SECTOR DEVELOPMENT PROGRAM

(Subprogram II)

December 2003

CURRENCY EQUIVALENTS

(as of 4 December 2003)

Currency Unit	–	Sri Lanka rupee/s (SLRe/SLRs)
SLRe1.00	=	\$0.01
\$1.00	=	SLRs96.35

ABBREVIATIONS

ADB	–	Asian Development Bank
Code	–	Code of Best Practice in Corporate Governance for Public Enterprises
PSDP	–	Private Sector Development Program
SOE	–	state-owned enterprise
TA	–	technical assistance

NOTE

In this report, "\$" refers to US dollars.

This report was prepared by B. Ericsson.

I. INTRODUCTION

1. On 12 December 2000 the Asian Development Bank (ADB) approved (i) the Private Sector Development Program (PSDP) cluster; (ii) subprogram I of the PSDP comprising two loans amounting to \$85 million equivalent from the Asian Development Fund and \$15 million from ADB's ordinary capital resources; and (iii) technical assistance (TA) for Governance and Institutional Support for Private Sector Development.

2. Due to the uncertain security situation resulting from the civil war and the high level of public debt at the time of the design of the PSDP, caution was exercised to avoid adding pressure to the public budget or placing additional demands that could disrupt economic stability and growth. As a result, the PSDP was structured as a cluster with two subprograms: subprogram I and subprogram II. Depending on progress in implementing subprogram I, satisfactory macroeconomic management, and the Government of Sri Lanka's commitment to undertake proposed reforms, subprogram II would be processed for Board consideration.

3. PSDP subprogram I supports the creation of an enabling environment for private sector development by focusing on five broad areas: (i) sustaining and reinforcing the Government's privatization and public enterprise reform program, (ii) facilitating private sector entry and participation in infrastructure development, (iii) enhancing the market system by promoting fair competition and appropriate regulation of private sector activity, (iv) increasing labor market mobility while providing adequate protection to workers, and (v) improving private sector access to finance.

4. The first tranche of subprogram I was released upon loan effectiveness on 31 January 2001, the second on 19 December 2002, and the third and final tranche was released on 21 November 2003.

5. Due to the satisfactory progress in implementing subprogram I and (i) the improved security situation resulting from the second year of a cease-fire agreement after a 20-year civil war; (ii) improved economic growth and macroeconomic stability (real gross domestic product growth rate has been in the range of 5.5–6.0% since mid-2002); (iii) reduction in the fiscal deficit to budgeted 7.5% in 2003, compared with 8.9% in 2002 and 10.0% in 2001; and (iv) the Government's policy reforms introduced in subprogram I to stimulate private sector development, project preparatory technical assistance (TA) for subprogram II was included in the 2003 Country Strategy and Program. A Fact-Finding Mission was fielded to Colombo in August 2003 and reached understanding with the Government on the objectives, scope, financing plan, and implementation arrangements for the TA. The TA² is designed to build on ADB's earlier assistance and support efforts for further policy reforms to stimulate private sector development that were identified as critical areas in the Government's national development strategy, *Regaining Sri Lanka*.

II. ISSUES

6. The future growth of private sector development requires that follow-on initiatives should continue to adequately address major impediments to private sector participation.

¹ All 10 conditions for the third and final tranche release of subprogram I have been fully or substantially met. Program implementation is discussed in ADB, 2003. *Private Sector Development Program Progress Report: Release of Third Tranche*. Manila. (Loans 1800 and 1801-SRI).

² The TA first appeared in *ADB Business Opportunities* (Internet edition) on 19 March 2003.

7. **Capital Market.** Limited access to financing, particularly long-term financing, and the high cost of funds in the country hinder increased private sector activity. The financial system continues to be dominated by the banking sector and by state-owned institutions. The latter have a large presence in banking, insurance, and provident funds; they control over 60% of the total assets of financial institutions and utilize over 50% of the country's financial resources. Assets of institutional investors amount to approximately one third of the total assets of banks. Despite their large relative size, their impact on financial market development and innovation through new products have been negligible, mainly because they have been used as a captive source for funding primarily Government issued short-term debt.

8. There is a strong demand in the private sector for medium- and long-term debt financing, especially for home mortgage financing; but the housing sector has been crowded out of the market due until recently, to the lack of a government yield curve for various medium- and long-term maturities. Mortgage companies assume significant interest rate risk in their portfolios by mismatching long-term mortgage lending activities with short-term borrowings. Due to the limited availability of long-term debt to the private sector, mortgage rates are high, and housing construction and job creation are reduced.

9. **The Stock Market.** As a result of the cease-fire agreement in effect, the Colombo Stock Exchange has substantially increased its market capitalization and trading volume during the last 2 years. However, the number of products and services offered are still limited, especially in the management of investment risk for issuers and investors, and asset management.

10. **The Insurance Industry.** The working population in the country with access to insurance is extremely low (5% for life insurance and 7% for general insurance), and there is significant potential for growth of the insurance industry. However, almost all insurance companies lack financial strength and some companies may be in danger of technical insolvency. Additionally, the insurance industry does not have a strong regulator to supervise and monitor it and implement international best practice accounting standards.³

11. **State-Owned Enterprises and Government Assets.** The Government has made significant inroads in the sale of state-owned enterprises (SOEs). Since the approval of subprogram I, proceeds from the sale of assets are in excess of \$100 million. Yet, due to the fiscal burden resulting from the budget support to SOEs, the process of privatization must be accelerated and the inefficient operations of SOEs addressed.

12. **Commercialization of Government Owned Assets.** Many services that are presently or could be offered by the Government can be more efficiently provided through public-private partnerships or joint ventures. Government assets (e.g., land and other assets used by railway stations, major bus terminals, and postal complex, etc.), which are strategically located, could also be developed but the Government lacks the proper management and financial resources.

13. **Deregulation and Streamlining Regulations.** In its national strategy, *Regaining Sri Lanka*, the Government has identified barriers that reduce productivity and limit investment and economic growth. The Government's economic policies are gradually being reformed to create an environment that promotes economic growth. The Government's focus is on reforming the regulatory process pertaining to obtaining approvals for (i) goods to pass through ports and

³ Results from the TA ADB. 2000. *Technical Assistance to the Democratic Socialist Republic of Sri Lanka for Governance and Institutional Support for Private Sector Development* associated with Private Sector Development Program, subprogram I.

customs, and (ii) starting and operating businesses. To promote private sector growth, new systems and regulations that impose the least possible burden on economic performance⁴ should be introduced.

14. **Corporate Governance.** To improve corporate governance in the public sector, Parliament passed a Code of Best Practices in Corporate Governance for Public Enterprises (Code). The Code must be implemented in all SOEs. Additionally, corporate governance must be improved to meet international best practice standards in the private sector for listed companies and securities on the Colombo Stock Exchange. There is also a significant need to improve corporate ethics for financial service professionals.

III. THE TECHNICAL ASSISTANCE

A. Purpose and Output

15. Following up on the earlier TA and taking into account ongoing reforms in the private sector, in part supported by PSDP subprogram I, the proposed TA will further support private sector development as outlined in paras. 7-14 as well as assist in implementing reforms and removing barriers to private sector development as outlined in *Regaining Sri Lanka*. The TA will assist in preparing PSDP subprogram II.

16. The TA will prepare the overall design and principal implementation components of subprogram II. The major components will focus on (i) continuing support to foster a competitive capital market and nonbank financial sector; (ii) reducing Government intervention in commercial activities by accelerating the privatization of SOEs and commercializing government owned assets; (iii) further strengthening corporate governance to enhance market discipline, and to implement international best practices for corporate governance in the public and private sectors; and (iv) supporting deregulation activities and streamlining regulations that undermine economic growth. The TA framework is in Appendix 1.

17. As a collaborative effort, the TA will be implemented in close consultation with stakeholders. The World Bank, through its Poverty Reduction Support Credit, supports labor and land reforms, public enterprise restructuring, private participation in infrastructure, and financial sector reforms. The Japan Bank for International Cooperation (JBIC), Swedish International Development Cooperation Agency (Sida), and United States Agency for International Development (USAID) support an enabling environment for business development.

B. Methodology and Key Activities

18. The TA will engage international and domestic consultants who will work closely with the executing and implementing agencies, market participants, and ADB in the following areas:

1. Capital Market and Nonbank Financial Sector

19. The TA will explore ways of improving and deepening the products and services offered in the nonbank financial market, including the need to increase the issuance of medium- and long-term bonds and to introduce debt and equity-related instruments that provide risk

⁴ Part of the policy reform being implemented under policy Loan 1894. ADB. 2001. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for Small and Medium Enterprise Sector Development Program*. Manila.

management products for issuers and investors. The TA will support improving the quality of asset management services presently available and recommend changes to promote new products and services.

20. The TA will explore the possibility of introducing in the capital market publicly traded securitized obligations (e.g., asset-backed and/or pass-through bonds) for home mortgages. The experience with secured transactions reform and development of securitized instruments for the South Asian region will be analyzed. The use of securitized instruments in other sectors (e.g., infrastructure, financing companies, etc.) will be reviewed.

21. The focus will be on further strengthening the insurance market. The TA will review the implementation of regulations for the nonbank financial sector and make suitable recommendations for enhancing effectiveness, as appropriate.

2. Private Sector Participation in Restructuring State-Owned Enterprises and Developing Government-Owned Assets

22. Although accelerating the sale of SOEs to the private sector is a high priority of the Government, making some SOEs commercially viable can have significant restructuring costs (e.g., need for working capital, capital investment, capacity building for retraining employees, and retrenching employees). Additionally, business units within some of the larger SOEs could be spun off into smaller enterprises to commercially benefit from private sector intervention. The TA will explore the possibility of creating a loan facility (Fund) to facilitate the financing of acquired SOEs for private sector buyers. The possibility of obtaining co-investors (local and/or international, debt and/or equity) for the Fund will be explored. The TA will also assess the possibilities of commercializing Government-owned assets through public-private limited partnerships and/or joint ventures with the private sector.

3. Corporate Governance

23. Taking into account work already done by the Government, ADB, and other aid agencies, the TA will (i) improve and expand the implementation of the Code; (ii) review and recommend changes in financial governance and business ethics for publicly listed companies (listed or not) issuing publicly traded securities; and (iii) recommend rules and regulations for improving business ethics for financial service professionals.

4. Deregulation and Streamlining the Regulatory Process

24. The TA will analyze the systems, time and costs of obtaining regulatory approval for (i) ports and customs clearance of goods, and (ii) starting and operating a business enterprise. Recommendations will be made for the design of new systems for both areas, as well as for management information systems.

C. Cost and Financing

25. The total cost of the TA is estimated at \$1,000,000 equivalent comprising \$680,000 in foreign exchange and \$320,000 equivalent in local currency. ADB will provide \$800,000 equivalent to cover the entire foreign exchange cost and \$120,000 equivalent of the local currency cost. The Government will contribute \$200,000 equivalent to fund counterpart staff, office facilities and administrative services. The TA will be financed on a grant basis by ADB's TA funding program. The cost estimates and financing plan are in Appendix 2.

D. Implementation Arrangements

26. The Ministry of Finance will be the Executing Agency. The TA will be implemented over 6 months starting in February 2004 and ending in August 2004. A team of 9 international consultants and 6 domestic consultants will provide 28 person-months of consulting services (14 international, and 14 domestic). The international consultant for the secured transaction analysis will be recruited on a direct selection basis, and all others will be recruited in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for engaging domestic consultants. The quality-based selection method will be applied in selecting the consultants because of the relative complexity of the program, which covers a number of subsectors, debt and equity markets, institutional investors, nonbank financial intermediaries, and market infrastructure. The issues are highly sensitive and will require high-level policy interaction with government officials and extensive consultations with other stakeholders, particularly aid agencies in the field. The consultants must have high level of credibility and competence. Outline terms of reference are in Appendix 3.

27. In support of the TA activities, the executing and implementing agencies (e.g., Ministry of Finance, Customs Department, etc) will provide (i) furnished office space for the consultants and access to a conference room, (ii) secretarial support, and (iii) local communication facilities for the consultants in Colombo. The Government will release two full-time counterpart staff to work as part of the deregulation team. Additional staff will be made available on a part-time basis, as necessary.

28. The consultants will submit an inception report to the Government and ADB within 2 weeks of the start of work; an interim report halfway through the engagement, which would incorporate a draft policy matrix; and a draft final report 2 weeks before the end of the engagement. The draft final report will be discussed at a tripartite meeting involving the Government, the consultants, and ADB. The final report will incorporate results from the meeting and be made available 2 weeks from the date of the meeting.

IV. THE PRESIDENT'S DECISION

29. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$800,000 on a grant basis to the Government of Sri Lanka for preparing the Private Sector Development Program (Subprogram II), and hereby reports this action to the Board.

TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Goal Assist the Government in formulating a program of policy reforms to support private sector development and growth by</p> <p>(i) Eliminating impediments to private sector development</p> <p>(ii) Adopting market-oriented policies and increasing reliance on and use of market mechanisms to support private sector growth</p>	<p>Reduce the cost and time to obtain necessary regulatory approvals for (i) goods passing through ports and customs; and (ii) establishing and operating businesses</p> <p>Eliminate areas that create distortions in the capital market and deter private sector growth</p> <p>Further financial reforms and fostering a competitive capital market</p> <p>Remove Government from all commercial activities that can be more efficiently undertaken by the private sector</p>	<p>Technical assistance (TA) interim and final reports</p> <p>Tripartite meeting of Government, consultants, and the Asian Development Bank (ADB)</p>	<p>Political will to implement policy reforms</p> <p>Systemic implementation of policy reform program to promote a more conducive environment for the private sector</p> <p>Policy changes inadequate to meet required reforms of the capital market</p> <p>Restructuring costs of state-owned enterprises (SOEs) too high to attract private sector investors</p>
<p>Purpose</p> <p>1. Support new products, transparency and growth of the capital market by</p> <p>introducing new products and services to the debt and equity markets</p>	<p>Increase the issuance of corporate bonds, improve liquidity in trading equity and debt instruments</p> <p>Introduce publicly traded securitized obligations into the market</p>	<p>TA interim and final report</p> <p>Tripartite meeting of Government, consultants, and ADB</p> <p>Volume of stock and bond trading</p> <p>Number and volume of publicly traded securitized obligations</p>	<p>Government's receptiveness to implement changes to stimulate growth of capital market</p> <p>Capacity of consultants</p> <p>Available expertise to meet output requirements</p>

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>2. Accelerate the restructuring and privatization of SOEs and commercialization of Government assets through private investments</p> <p>3. Strengthen corporate governance and enhance market discipline in both publicly and privately owned enterprises</p> <p>4. Support deregulation activities and streamline regulations that impede private sector growth</p>	<p>Introduce new financial instruments to deepen the capital market</p> <p>Strengthen insurance industry and improve quality of products and services</p> <p>Improve the quality and availability of asset management services</p> <p>Increase number of SOEs sold, increase proceeds received by the Government and effectively utilize Government-owned assets to improve available services</p> <p>Implement good governance in publicly and privately owned enterprises</p> <p>Policy actions in (i) ports and customs; and (ii) registering and operating business entities that meet program goals</p>	<p>Number of new financial products</p> <p>Financial ratios of insurance companies</p> <p>Volume of insurance products sold</p> <p>Return on investment on the funds managed by asset managers</p> <p>Number of asset management companies</p> <p>Amount of funds managed by asset managers</p> <p>Various Government reports</p> <p>Tripartite meeting of Government, consultants, and ADB</p> <p>Reduction in time and cost to obtain necessary regulatory approvals</p>	<p>Willingness of private sector buyers to assume risks</p> <p>Quality of SOEs to be commercialized</p> <p>Interest from domestic and/or foreign investors (debt and/or equity) to invest in commercializing SOEs</p> <p>Capacity of affected institutions to carry out reforms</p> <p>Lack of cooperation by concerned parties and agencies</p> <p>Weak capacity of implementing agency/ies</p>
<p>Outputs</p> <p>1. Policy matrix</p> <p>2. Report covering</p> <p> a. Enhancing the capital market</p> <p> b. Strengthening the bond market</p>	<p>Policy actions that meet program goals properly paced and sequenced</p>	<p>TA final report</p> <p>Tripartite meeting of Government, consultants, and ADB</p>	<p>Completeness of coverage of consultants inputs</p> <p>Available expertise to meet output requirements</p>

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<ul style="list-style-type: none"> c. Developing securitized bonds d. Strengthening asset management e. Strengthening the nonbank financial market f. Restructuring, privatizing, and commercializing SOEs and government-owned assets g. Deregulating and streamlining regulations for (i) ports and customs, and (ii) registering new and ongoing businesses h. Recommendations for improved corporate governance in the public and private sectors 			
<p>Inputs</p> <p>14 person-months international consultants</p> <p>14 person-months domestic consultants</p> <p>\$20,000 seminars/workshops/conferences</p>			

COST ESTIMATES AND FINANCING PLAN
(\$)

Item	Foreign Exchange	Local Currency	Total Cost
A. Asian Development Bank Financing^a			
1. Consultants			
a. Remuneration and Per Diem			
i. International Secured Transaction Consultant	31,000	0	31,000
ii. International Consultants – Other	449,000	0	449,000
iii. Domestic Consultant	0	45,000	45,000
b. International Travel			
i. Secured Transaction Consultant, Speakers and International Participants at Seminar	30,000	5,000	35,000
ii. International – Other international consultants	74,000	10,000	84,000
c. Local Transport	0	4,000	4,000
2. Seminars/Workshops			
a. Secured Transaction Conference	0	10,000	10,000
b. Seminars/Workshops - Others	0	10,000	10,000
3. Communications, Translations, and Reports	5,000	2,000	7,000
4. Representatives for Contract Negotiations	5,000	0	5,000
5. Contingencies	86,000	34,000	120,000
Subtotal (A)	680,000	120,000	800,000
B. Government Financing			
1. Counterpart Staff	0	70,000	70,000
2. Office Facilities and Equipment	0	70,000	70,000
3. Supplies, Utilities, and Other Logistical Support	0	60,000	60,000
Subtotal (B)	0	200,000	200,000
Total	680,000	320,000	1,000,000

^a Financed by Asian Development Bank's technical assistance funding program.
Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. Financial/Capital Market Experts (3 international, 4 person-months; 2 domestic, 3 person-months)

1. One of the international consultants will serve as team leader for the components: (i) enhancing the capital market, (ii) strengthening the bond market, (iii) developing securitized bonds, (iv) enhancing the equity market, (v) strengthening asset management, and (vi) strengthening the nonbank financial market. The team leader will guide and oversee the overall execution of the technical assistance (TA) and ensure the delivery of required outputs. The team leader will be responsible for preparing (i) the detailed framework and policy matrix for the ensuing program, and (ii) the checklist of the Asian Development Bank (ADB) to assess if private sector development is optimized within the project. The international and domestic consultants must have extensive experience and exposure to the capital market (debt and equity), asset management, and the insurance industry.

1. Capital Market Expert

2. **General.** The expert will undertake the following tasks:

- (i) Review work already done by the Government, multilateral, and bilateral aid agencies, and other consultants on ways of improving the capital market in Sri Lanka.
- (ii) Define ways of broadening the capital market (i.e., equity, bond, and other securities/hybrids) that would decrease market imperfections and inefficiencies.
- (iii) Analyze the reasons for the high intermediation cost and recommend how financing costs can be reduced for the private sector.
- (iv) Recommend methods of increasing issuers' and investors' interest (i.e., institutional and household investors as well as domestic and foreign investors) into the Sri Lankan capital market (i.e., bond and equity markets).

3. **Bond Market.** The expert will undertake these tasks.

- (i) Review the performance of and developments in the bond market (i.e., Government and corporate securities). Analyze the corporate bond market and (a) the reasons for the limited number and volume of issues; (b) liquidity constraints and demand for long-term bonds; and (c) suggest methods for enhancing development, including incentives for improvement.
- (ii) Analyze and recommend incentives to increase the issuance of, demand for, and investment in commercial paper instruments, medium-term notes, and long-term bonds by Governmental authorities and corporate issuers.

4. **Equity Market.** The expert's tasks are as follows:

- (i) Identify new products and services that the Colombo Stock Exchange can offer.

- (ii) In consultation with the corporate governance expert, identify and recommend changes, following international best practice standards, to strengthen corporate governance and business ethics for publicly listed securities and publicly listed companies.
- (iii) Identify the need for capacity building in good governance and business ethics for financial services professionals (e.g., accountants, lawyers, and stockbrokers), issuers, and investors.

5. **Asset and Investment Management Companies.** The expert's tasks are as follows:

- (i) Review the availability and quality of present services of asset and investment management companies.
- (ii) Identify areas that require improvement and recommend specific measures to overcome market deficiencies.

2. Securitized Bonds Expert (asset-backed and pass through bonds)

6. The expert will perform the following tasks:

- (i) Analyze the need for and market size of publicly traded securitized obligations (asset-backed and/or pass-through bonds) for the housing market, and the present constraints to issue and trade of such instruments.
- (ii) Analyze the potential investors (i.e., domestic and foreign) and investment demand (i.e., institutions and individuals) for securitized obligations.
- (iii) Evaluate the need for capacity building for potential investors and issuers.
- (iv) Evaluate and recommend changes in the accounting rules to follow international best practice in issuing securitized bonds.
- (v) Assess the availability and quality of other services that are necessary (e.g., rating agency and trustee services) to issue publicly traded securitized bonds.
- (vi) Identify potential issuers of securitized securities (government and corporate issuers) and investors, and estimate the size and phasing of such a market.

3. Nonbank Financial Market Expert

7. The expert's tasks are as follows:

- (i) Review the status of work already done by the Government, aid agencies, and other consultants on implementing regulations and supervising the nonbank financial market, and suggest enhancements that can be implemented.
- (ii) Working closely with the International Monetary Fund consultant, review and recommend changes within the insurance industry to make it more vibrant and stronger; include an outline of the activities to be undertaken and a suggested time frame.

- (iii) Identify new products and services for the insurance industry, and the legislative and regulatory issues to be resolved prior to their introduction.

B. Capital Market Legal Experts (1 international and 1 domestic lawyer, 1 person-month each)

8. The lawyers will have an extensive background in the legal aspects of the capital market. Previous experience with capital markets in Sri Lanka and other developing countries in Asia will be an advantage for the international lawyer. The lawyers will perform the following:

- (i) Evaluate and recommend changes in laws, if any, to facilitate the issuance of publicly traded securitized bonds in general and securitized house mortgage bonds in particular.
- (ii) Review the current legal and regulatory framework impacting on the development of capital markets and nonbanking financial markets, and recommend necessary amendments to the present laws and identify areas that should be changed to support further development, particularly for asset management.

C. Secured Transaction Lawyer (international, 1 person-month)

9. The international lawyer will have an extensive background in secured transaction law and securitization. The lawyer will evaluate subregional developments which are relevant to Sri Lanka, through a subregional conference on the impact of secured transactions reform on securitization.

D. Experts in Restructuring, Privatizing, and Commercializing State-Owned Enterprises and Government-Owned Assets (1 international, 5 person-months; 1 domestic, 6 person-months)

10. The international consultant will have an extensive background in undertaking restructuring, privatizing, and commercializing business enterprises; and a broad knowledge of innovative solutions to the structuring of asset sales. Previous experience with financial restructuring of businesses in Sri Lanka and other developing countries in Asia will be an advantage. The domestic consultant's experience should be similar, but with geographical focus on Sri Lanka.

11. **Commercializing State-Owned Enterprises.** The consultants will carry out the following tasks to restructure, privatize, or commercialize SOEs:

- (i) Review with the Public Enterprises Reform Commission (PERC) the list of state-owned enterprises (SOEs) approved by the Cabinet for sale. Analyze and evaluate (including assumptions)
 - (a) the amount of funds necessary for restructuring the SOEs,
 - (b) the possible type of restructuring cost (e.g., working capital, investment capital, retrenchment of employees, etc.),
 - (c) preliminary estimated purchase price of the SOE, and
 - (d) potential interest of private sector buyers to acquire SOEs.
- (ii) Identify and analyze larger SOEs with business units that can potentially be spun off and sold to private sector investors, prioritize the list of the potential spin-off

candidates and reasons for the spin-off, recommend methods of sale, and estimate the purchase price of the enterprise and the need/cost for restructuring.

- (iii) Analyze management capabilities/availability within and outside the SOEs to support management buy-out and/or management buy-in activities.
- (iv) Define ways for the Government to work more closely with the private sector to improve services offered as well as to manage and use existing Government assets. Suggest methods on how the Government can implement a program for private investment in government owned assets.

12. **Establishing a Fund.** To explore the proposal to establish a fund for SOE buyers, the consultants will carry out these tasks:

- (i) Develop a possible structure for a fund that would provide debt financing to potential buyers of SOEs to be restructured.
- (ii) Identify the interest of Sri Lankan banks and other institutions (domestic and international) to co-invest in or finance the fund with debt and/or equity.

13. **Capacity Building.** The consultants will review and evaluate the capacity of the Sri Lankan financial institutions to make sound credit and investment decisions for restructuring SOEs and develop a capacity building plan (e.g., cash flow analysis).

E. Deregulation and Streamlining Regulations Expert (2 international, 2 person-months; 2 domestic, 4 person-months)

14. The consultants should have strong expertise in deregulation and management information systems (MIS). Knowledge of ports and customs regulations in Sri Lanka and experience in establishing and operating a business are advantages. Under the component of deregulation and streamlining regulations, the consultants' scope of work is as follows:

- (i) To understand the present regulatory system for importing and exporting goods as well as the time and costs associated with obtaining the necessary approvals, review the work already done by the Government's Deregulation Committee and other agencies on the potential reorganization of Sri Lanka's customs and ports. Analyze the step-by-step procedures needed to obtain regulator approvals (e.g., prepare guides and flow charts identifying all steps required to obtain necessary approvals, and reasons for the approvals, costs and responsible authorities, etc.). Determine time and costs for the importer or exporter (e.g., warehousing, moving goods to be imported and exported, etc.) as well as the cost to the Government of operating the present regulatory system.
- (ii) As in step (i), provide similar analysis of the present regulatory system for
 - (a) establishing a new business or enterprise, and
 - (b) running an existing enterprise.
- (iii) Design new MIS that will streamline the present regulatory process for each of the following areas:
 - (a) importing and exporting goods through ports and customs,
 - (b) establishing a new business or enterprise, and

- (c) running an existing enterprise.
- (iv) Analyze the cost and requirements of developing and modernizing the MIS for (iii) above.

F. Corporate Governance Expert (international, 1 person-month)

15. The consultant must have strong expertise in corporate governance. Previous experience in Sri Lanka and other developing countries in Asia on corporate governance will be an advantage. The consultant will perform the following tasks:

- (i) Review the status of work already done by the Government, aid agencies, and other consultants on implementing corporate governance in the public and private sector, and make recommendations that can be implemented to improve corporate governance.
- (ii) Review and recommend changes to implement international best practice standards for corporate governance in publicly listed companies and for publicly traded securities on the Colombo Stock Exchange.
- (iii) Together with the capital market expert, recommend appropriate disclosure requirements for all companies issuing public securities, whether the securities are listed or not.
- (iv) Follow international best practice standards for improving the business ethics of financial service professionals (e.g., lawyers, accountants, and security brokers).