

# **SMALL AND MEDIUM SCALE ENTERPRISES DEVELOPMENT THROUGH BUSINESS INCUBATORS, A CASE OF SRI LANKA**

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## **INTRODUCTION**

Generally, in Sri Lanka, a majority of new companies fail during the initial years, as is the case in many developing countries. Around 15 new companies are registered at the office of the Registrar of Companies on any working day (that adds up to nearly 4,000 companies per year). The sole proprietorship companies and partnerships registered at the Divisional Secretariat level are around 6,000 per year. Out of these 10,000 business start-ups, only about 2000 companies survive for more than five years (Department of Company Registrar, 2005). It is common that the majority of companies do not last even more than one year due to many problems. In this context, business incubators (BIs) are recommended by many SMEs experts and organizations (Culp and Shapira, 1997; Fry, 1987; Lalkaka and Bishop, 1996; OECD, 1997; 1999), to find solutions to this problem. After a brief introduction to history of BIs in Sri Lanka, this paper analyses strengths and weaknesses of existing BIs in Sri Lanka; then it develops a new BI model which is appropriate for nurturing the business start-ups in Sri Lanka, and finally, some concluding remarks and policy implications are also presented.

## **HISTORY OF BUSINESS INCUBATORS IN SRI LANKA**

The concept of BIs<sup>1</sup> originated in Sri Lanka in 1993, after consultative meetings between the Sri Lankan Industry Ministry and Japan International Corporation Agency (JICA). These meetings concluded that Sri Lanka should study business incubator (BI) models of other countries and JICA could provide Japanese experience on BIs to Sri Lanka. Subsequently, JICA prepared a Master Plan for Industrialization and Investment Promotion in 1990 and it recommended the set-up of the Small and Medium Scale Enterprises (SMEs) Development Corporation, with a view to develop SMEs in Sri Lanka. In 2000, JICA prepared another interim report which directly recommended the set-up of two BIs. The first was an Electro Incubator Centre to promote electronic and electrical SMEs in Sri Lanka. The second was a Software BI Centre, with the goal of developing IT related SMEs in Sri Lanka. The Sri Lankan government established the Nawabima BI, very close to the Moratuwa University (best technical University in Sri Lanka) in the Industrial Development Board premises. In mid 2001, United Nations Industrial and Development Organization (UNIDO) provided assistance to the Nawabima BI to prepare its strategic plan. In the same year, UNIDO assisted in the set-up of another BI in Ruhuna, which is considered as the origin of most of the Sri Lankan entrepreneurs.

### **Business Incubators in Sri Lanka**

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<sup>1</sup> The concept of Business Incubators (BI) appeared in SMEs literature in 1960s and after 1980s, it has been rapidly adopted by many developing countries. Today, there are many types of incubators, such as business, technology, marketing, sector, industry and region specific incubators existing around the world. The ultimate target of these incubators is to develop SMEs and entrepreneurship skills to full potential and in a self-sustaining manner. For more details about literature of BI, see Culp. and Shapira, (1997), Fry, (1987), Smilor, (1987), Lalkaka, . and Bishop, (1996), Lalkaka, (1997), OECD (1997, 1999). For latest information on New Zealand's BIs, see [www.nzte.govt.nz/section/11735.aspx](http://www.nzte.govt.nz/section/11735.aspx). To get some idea about the origin of Sri Lankan BIs, see Dasanayaka and Sardana (2008), Pieris (2002).

***NAWABIMA Business Incubator affiliated to the Industrial Development Board of Sri Lanka***

The Nawabima Business Incubator (NBI), established in year 2001, and affiliated to the Industrial Development Board (IDB) of Sri Lanka, has the following vision: To be a vibrant, catalytic hub for developing SMEs and business start-ups in the local business environment. Its mission is to provide an environment conducive for the sustainable development of selected incubatees during the early stages of the business cycle, to create both direct and indirect employment opportunities and to contribute to the overall economic development of the area.

*The objectives of establishing the NBI:* Facilitate development of local entrepreneurship, help entrepreneurs to develop the market, develop entrepreneurial skills within the incubatee community, develop sustainable enterprises and industries, be a stakeholder for SME policy development and assist Local Economic Revitalization. The NBI also had the characteristics of a conventional BI. It aimed to facilitate the creation of innovative companies and to reduce the cost of business start-up. It offered professional premises for hire on very flexible terms. It consisted of more than 18 office and workshop spaces of between 400-600 square feet. It also aimed to provide an efficient administrative infrastructure for its tenants. The NBI could provide a complete administrative structure with the support of local, foreign and organizational expertise. Other services offered by the NBI: tailored management consultancy (during the planning stage of the NBI, its founders formulated a panel of consultants to address the various professional areas, such as marketing, business management, accountancy, etc.), access to partner networks - incubatees of NBI are allowed to be members of the database of industries maintained by the IDB of Sri Lanka, and contact with other innovative enterprises. This facility is also provided through the network of IDB. NBI aimed to help new and existing enterprises which have ambitions to develop an innovative project; such innovations can happen on different levels:

technology, marketing, methods of management or production, products, and services levels. It aimed to provide the client enterprise with a long-term competitive advantage and growth prospects. In addition to the provision of infrastructure, equipment sharing and various business services are provided by the by NBI at the start of business. These could be considered as strengths and opportunities of the NBI: Space-Equipment: 18 units between 400-600 square feet, access of 24 hours a day and seven days a week, fully equipped meeting rooms, telephone switchboard, common fax and photo copying facilities, rest room/canteen, reception services, trilingual secretariat (Sinhala, English and Tamil), Visitors Reception Desk, personalized telephone answering facility, mail dispatch; Location: easy access via a main city, located within walking distance to the Galle Road at Katubedda, leading towards the highly enterprising segment of the country. Also, it was located in close proximity to Colombo, Sri Lanka's administrative and commercial capital. The Selection and Admission criteria formulated by the NBI: although admissions of incubatees were limited in the early stages to a few leather product manufacturers, NBI introduced a formal selection criteria of incubatees who were considered in the following manner: The quality of the proposal, prospects for development, degree of innovation and competence and sound financial position of the project promoter. General Conditions for Incubatees: Accommodation is governed by a lease contract approximately for two to three years; the enterprise thus leaves once it can support itself. Renting arrangements include three months' deposit; for enterprises not intending to set up operations in the business center straight away, the NBI offers a domiciliation scheme, by which it acts as the registered office of the enterprise with optional telephone answering service. The services of the NBI (rent charges, maintenance, common services) are charged as an all-inclusive package deal (only personal costs – telephone, photocopy machines, booking of meeting rooms) are charged

separately. Tailored Consultancy Package introduced by NBI: NBI has formulated this by considering all the aspects linked to the launch of an innovative project. Each project is given a follow-up tailored to its specific needs. Components of the management cycle are as follows: Project Evaluation (first assessment, project validation, general assessment of the enterprise and help in the realization of the market study), Business Plan (preparation of the business plan, analysis of the strategic choices and drawing up of the financial plan). Partner Finding (identification of financial, commercial and industrial partners: banks, venture capitals, sub-contracts). Start-up (setting up of management control tools. Revision of the business plan is based on the first performance, progress check, strategic review, specialized monitoring and management accounting).

Current status of operations and problems encountered with NBI are: currently, operations of the NBI have been temporarily stopped due to conflicts regarding the governing authority of the Incubator. Sometimes, the program is never revived. In fact, the program was not properly launched. Very few incubatees were absorbed and in the broader sense, most of them could not be categorized as incubatees. NBI is a critical example of public sector owned Business Development Services (BDS) ventures launched in Sri Lanka. It had a good vision; the Incubator Manager was given foreign training. All the steps, including consultancy panel, formulation of business strategies, and physical set-up of the incubator were successful. But lack of proper mechanisms to successfully operate the BI is the main factor for failure, and the problem remains unanswered. It is unclear as to what is the most appropriate public body to carry out such a function. The NBI was originally launched by the Ministry of Enterprise Development and Constitutional Affairs. Thereafter, the Government was changed, as well as the Ministry. No

specific owner could be defined for the NBI. In this context, the NBI could not be a source of study for BI practice in Sri Lanka. It is only an attempt to establish a BI due to the recommendation of foreign consultants; however, there was no proper mechanism to operate it.

***ConceptNursery.com Sri Lanka Technical Incubator (Pvt.) Ltd.***

Believing that the entrepreneurial spirit is a key component to local economic development, ConceptNursery, Sri Lanka's first technology incubator set up its operations in year 2000 to incubate technology centric innovative ideas. The company focuses on young entrepreneurs to start-up their own IT companies. This would not only stimulate the growth of the Sri Lankan IT industry, but also simultaneously encourage local entrepreneurial capitalism and attract investments from both institutional and Venture Capital sources, be it domestic or international. The primary goal is to identify, recruit and build new companies involved in cutting-edge technologies. These companies would in turn support the development of a highly skilled IT workforce, conduct advanced R&D in-web and wireless technologies and enhance the economic development of Sri Lanka through the creation of wealth and opportunities. This is an initiative backed and financed by four principle investors, synonymous with the IT and financial industry in Sri Lanka: Sri Lanka Institute of Information Technology, People's Venture Investment Company (Pvt.) Ltd, Media Solutions (Pvt.) Ltd and Prudential Holdings (Pte) Ltd. The Package offered by ConceptNursery: Infrastructure: Resident clients at ConceptNursery will receive a fully furnished office space that includes a unique address and the following facilities - individual telephone number and internet connection, access to the Incubator's fax machine, photocopy, e-mail server and web server, usage of conference room , pantry, lobby, and mail delivery.

Business guidance by ConceptNursery's incubation process mainly concentrates on providing the necessary assistance for clients, which will help to accelerate the process of learning how to build their business, and successfully grow it. These services are business advice and guidance, assistance in marketing, technology, finance and strategy formulation, development of a business plan, networking with other information technology and related businesses, introduction to delegations, business opportunities and key business contacts, opportunities for interns to work on specific projects, as well as advice on all aspects of running a business. Strategic support provided mainly drawing on various resources, delivering them to its clients and helping them to gain the needed technical, managerial and physical resource support. Besides this, guidance networking with other incubators worldwide and with global companies, access to consulting services on business strategies, advice on business launch, growth and harvest of business, creating opportunities for marketing through Board of Investment, Export Development Board, Industrial Associations and Chambers of Commerce, and opportunities for linking up with related industries. Selection criteria for incubator as a incubatee: the candidates need to submit an effective business proposal with innovative ideas and a business plan, marketability of the product and commercialization opportunities of the concept must be very clear, the skills, knowledge, expertise and commitment of the individual or team and resources needed to embark on the project. The special features of this incubator are: a) Virtual Incubator Model: in this model, clients operate from any part of the country and get access to all monitoring support provided by the incubator. Regional incubation programs and other interesting events are listed on the calendar. This model is at the experimental level at the ConceptNursery. However, there could be a demand for the services of this virtual incubator with expanding the Internet services through ADSL and CDMA technologies; b) The Entrepreneur News Portal: this portal allows

ConceptNursery to aggregate and disseminate news related to entrepreneurship and emerging technologies. One of the biggest problems for budding entrepreneurs in Sri Lanka is that they lack exposure and access to information. The entrepreneur portal cuts the clutter on the internet and allows visitors to access news and information related to the incubator's areas of interest. The entrepreneur portal is an outreach activity of ConceptNursery, primarily intended to attract potential tenants and partners; c) The Tenant Portal: this portal is dedicated for ConceptNursery tenants, both resident and virtual. The tenants can manage their own 'showroom' on the 'net' with this. The portal integrates Personal Information Management (PIM) and a web-based project monitoring tool. New applicants can apply online. The virtual residents can use the online resource request system to access and reserve various resources available from ConceptNursery; and d) Graduates of ConceptNursery: by the end of year 2004, four companies had graduated from the ConceptNursery, and six companies were operating as incubatees. Sri Logic and Zmessenger are two successful graduates of the Incubator. They are operating as leading companies in the Sri Lankan IT market.

Current Status of ConceptNursery: ConceptNursery has been developed, based purely on a foreign model. Its strategies aim to absorb many individualistic entrepreneurs in the IT sector. They are mainly English speaking urban youths. ConceptNursery is the most successful case of the three BIs initiatives in Sri Lanka. Its objectives are more clear, i.e., Promotion of Information technology entrepreneurs in Sri Lanka and the region. Venture capital companies have invested in ConceptNursery and different investors have different motives for this. There were no conflicts regarding the ownership and functionality of the Incubator. However, according to information, the expected returns for the investment in both graduated companies are not up to

the level. Even though the formation and functionality of ConceptNursery are adequate, there is no clear indication on its contribution to the national economy. Additionally, the future of ConceptNursery could not be ascertained, due to the isolated nature of ConceptNursery. Its vision and model do not represent the national requirements of Sri Lanka.

### ***Ruhuna Business Incubator***

Ruhuna Business Incubator is the third BI established in Sri Lanka. It was initiated in July 2002 and the first incubatee (businessmen) batch was hosted in February 2003. Actually, the Ruhuna Business Incubator is located in a high potential area for entrepreneurship in the country. The location was at the Matara District in Kamburupitiya. The project used the abandoned buildings of the Kamburupitiya Village Reawakening (Gam Udawa) program. Hence, there were separate isolated office/business space for each incubatee. Two BIs were operating under one roof, using common facilities, such as main office, incubator center, conference room, etc. The program was funded by the UNIDO collaboratively with Matara District Chamber of Commerce, Japan Lanka Development Corporation (JLDC), and Sarvodaya Enterprise and Economic Development Service (SEEDS). The Matara Chamber of Commerce was formed with the guidance and funding of the UNIDO. This Chamber was the management body for the Ruhuna BI. Experienced professionals were also involved in the formulation and establishment of the Ruhuna BI, monitored by a group of reputed organizations with enterprise development experience in the local and international contexts. After the setting up of the physical and documentary infrastructure, Incubatees were invited through media advertisement. A considerable number of applications were received. In order to select the most appropriate incubatee batch, several awareness programs were conducted. As per the pre-scheduled program,

the first group of incubatees were selected in following composition: one Wall Hanger manufacturer, two Poly tunnel growers, one Candy manufacturer, one Recycled paper manufacturer, one Solar cell manufacturer and one Hydroponics manufacturer. The Ruhuna BI was managed by a qualified Incubator Manager and two Incubator assistants. An advisory board monitored the progress of the Incubator and provided the necessary consultancy services.

Progress and current situation of the Ruhuna BI: the Ruhuna BI has adopted a simple model compared to the Nawabima and ConceptNursery BI models. It was more suited for the Sri Lankan socio-economic scenario. However, this program also failed due to the following reasons: lack of awareness of potential entrepreneurs on the BI, no procedure to incubate correct people, the location is far from business cities, survival is difficult, difficulty in monitoring the functions by the advisory board since most of the members of the advisory board were stationed in Colombo, peoples' attitude of expecting all services free of charge, and lack of motivation of all stakeholders of the Incubator. Even though ownership is clear, the motivation of the funding agency and incubator management were not addressed. One of the most important components of the Ruhuna BI is the Integration of its functions with other Business Development Service (BDS) sectors (e.g., Subcontracting and Partnership Exchange (SPX)). However, that was not effectively implemented. There is potential to integrate the Ruhuna BI and SPX, since both organizations are funded and looked after mainly by UNIDO, in association with the Ministry of Industrial Development and Constitutional Affairs, which established Sri Lanka's first SPX. It was launched by the Ministry of Constitutional Affairs and Industrial Development on 24 May 2001. The SPX is hosted by the Small and Medium Enterprises Developers (SMED), a project of the Federation of Chambers of Commerce and Industry of Sri Lanka and Friedrich Naumann

Stiftung, Sri Lanka. SPX is a center for Industrial Subcontracting and Partnership between main-contractors, suppliers and subcontractors. The SPX also facilitates matchmaking between main contractors and subcontractors on specific requirements. Presently, the center covers five industrial sectors namely, Engineering/Machinery, Electrical/Electronics, Plastics, Rubber and Coconut Fiber (Coir). The center is linked to 62 International Subcontracting Centers set up by UNIDO in 31 countries, facilitating local industrialists to get information on subcontracting, and other related areas. Initially, Sri Lanka was linked to the Indian Network, which comprises nine centers. The SPX which is a component of the UNIDO - Sri Lanka Integrated Industrial Development Support Program, now has a membership of 480 companies registered in the Rubber, Plastics, Engineering (Foundry, Mold-making, General Engineering) and Electronics sectors. Facilities offered by UNIDO - SPX: providing business information, match-making of business demand and supply, studying and finding solutions to problems affecting subcontracting, assisting and arranging agreements, assisting to upgrade technological managerial capacity, and quality certification such as ISO 9000, ISO 14000 and SA 8000, etc., arranging trade fairs, buyer seller meets, etc., and organizing seminars and workshops. SPX has produced three important studies, namely Study on the Handicraft Sector, Greening the Supply Chain of Coir and Rubber and Legal & Economic Constraints to Subcontracting. The findings of these studies will be presented to the Business Community and the recommendations will be forwarded to the Government. The SPX is an effective tool for the business community and industrialists to be competitive in the global market. Successful integration with SPX network and proposed BIs would be an effective program to enhance the marketing network of the SME business start-ups.

***Construction Solution Center ( Pvt.) Ltd.***

Construction Solution Center (CSC) is a recently launched construction service exchange which is equipped with several features of an Incubator. The main objective of this center is to undertake turnkey construction projects and assign emerging subcontractors, whilst supporting them, formulating and strategically developing their capacities. The main objectives of this are: to provide entire range of construction solutions under one roof, to provide infrastructure to facilitate the transfer of technology related to construction industries through seminars, workshops and various training programs. It also aims to nurture emerging construction companies (Construction Incubation). The main services of the this incubator are assistance in purchasing a land for property development, land surveying work, designing homes by Architects/Draftsman, preparing costs estimates, structural engineering solutions, ground and foundation engineering solutions, soil testing, chemical solutions, water proofing, mixtures, insecticides, etc., house construction contract facilities at various stages, supply of labor and other skilled workers, carpentry work, roofs and hand rails, house painting and renovation services, building services, bank loans and financial services, notary public and land registry and other legal systems, raw material for house construction work, hiring equipment, shuttering and scaffolding, training and workshops, human resource supply and astrology assistance in house construction. Offices maintained by the Center: Main Office, and Public Information Database. Bank loans and financial services - Agent, Public Notary and land registry legal systems - Agent and Project Management consultancy. Common Services Provided by the Center: 30 perch land for building material supplies, five permanent office spaces for various construction companies (Incubatees), 20 outdoor stalls for monthly rent, seminar room for meetings, workshops, external training etc., telephone connections comprising three lines, Internet connection (ADSL),

furnished/ non-furnished office and computers for hire, car park for 20 vehicles, security system, publicity and propaganda from main office, coordination office with photocopy and fax facilities and plotting and Computer Aided Design (CAD) services. The progress and situation analysis could not be done in relation to Construction Solution Centre (CSC) since it has not completed setting the functionalities of the center. Perhaps, the organizers have decided to delay the launching of the program due to anticipated uncertainties.

Table 1 illustrates the summarized status of four BIs or similar programs launched in Sri Lanka. Since the functionality of these organizations has not been compiled or initiated fully, it is difficult to carry out a detailed SWOT analysis.

**Table 1 - Situation analysis of existing business incubators of Sri Lanka**

Item	Ruhuna BI	NAWABIMA	ConceptNursery	CSC
<b>Year Started</b>	2000	2002	2000	2004
<b>Initial Capital</b>	15M SL Rs.	5M SL Rs.	App: 20M SL Rs.	1.5M SL Rs.
<b>Funding agency</b>	UNIDO	Government of Sri Lanka	Four venture capitals SLIIT	Private Investor
<b>Governing/Managing Bodies</b>	Ruhuna Chamber of Commerce	IDB, Ministry of Enterprise Development	Sri Lanka Technical Incubator (Pte.) Ltd.	Techno League (Pvt.) Ltd.
<b>Consultants</b>	Rustam Lalkaka Chula De Silva Dr. Kuruppu	Chula De Silva IDB	Nshantha Weerasekara Vasi Nesaiah H.D. Gunaratna Manjula Senevitratna	Bandula Karunaratna Madawa Perera
<b>Target market</b>	SME Agro-business	SME Manufacturing sector	High tech and IT	Construction Industries
<b>Business Model</b>	Weak	Weak	Strong	Under formulation
<b>Motives of Incubator</b>	Not clear	Not Clear	To acquire graduated companies, To employ students (SLIIT)	To earn a profit and undertake turnkey projects
	<b>Ruhuna BI</b>	<b>Nawabima BI</b>	<b>ConceptNursery</b>	<b>CSC</b>
<b>Motives of Incubatee</b>	Expected free facilities Minimized initial capital	Expected free facilities Minimized initial capital	Minimized initial capital Business guidance Reputation, Location	Minimized initial capital Clear business opportunity
<b>Current status and future</b>	Initial objectives not achieved. Under process of restructuring.	Closed down due to political uncertainties.	Sustainability of the Incubator is challenged.	Business model to be reevaluated. Business Postponed
<b>Problems Encountered</b>	Motivation of Incubatees, and funding agencies are not identified	Problems related to the ownership of BI	Failed to identify an appropriate model for Sri Lanka	Conflicts between the objectives of the Center and those of Investor

According to Table 1, most of the isolated attempts to establish BIs in Sri Lanka were not successful due to non-existence of proper mechanisms or coordination to integrate all the stakeholders in this area. A situational analysis shows that:

1. There is no national policy or government intervention in this area.
2. Most of the BIs face the problem of not identifying proper measures for motivating the incubator and the incubatee.
3. Industry specific Incubators may be more successful.
4. The fully government owned models are apparently not successful.  
(Nawabima BI).
5. Fully Non-Government Organization (NGO) or international bodies' backed BI models are also not successful (Ruhuna BI).
6. Government and private sector or Bank affiliated ventures would be successful  
(Examples: ConceptNursery, Sri Lanka Institute of Information Technology (SLIIT) and other venture capital firms, Hatton National Bank's *Gemi Pubuduwa*).

Table 2 is the interview results with the selected stakeholders (failed and successful entrepreneurs, business development consultants and incubatees) in business incubators. The questionnaire was filled during the informal discussions, in some occasions through telephone conversations. For this exercise, 150 individuals (See first row of table 2 for numbers from each category) were selected and interviewed. In overall most of the new business start-ups do not have any idea about this incubators or incubation process.

**Table 2- The results of the interviews with selected stakeholders of Business Incubators**

Category	Successful Entrepreneurs (50)	Failed Entrepreneurs (25)	Business development Consultants (25)	Incubatees (50)
<b>Knowledge on BI</b>	Only have some idea about BIs (20%)	Only have some idea about BIs (10%)	Know and studied on BIs 100%	Know and associated with BI
<b>Necessity of BI to promote businesses</b>	Yes 60% No 40%	Yes 100%	Yes 100%	Yes 100%
<b>Required BI model</b>	Independent BI model 20% Integrated BI model 80%	Independent BI model 40% Integrated BI model 60%	Independent BI model 20% Integrated BI model 20%	Integrated BI model 50% No Idea about BI models 10% Independent BI model 40%
<b>Ownership of the BI</b>	Public 20% Private 80%	Public 40% Private 60%	Public 60% Private 40%	Public 50% Private 50%
<b>Order of priority Services of a BI should be</b>	Business Management Guidance 60% Finance 20% Physical Facilities 10% Marketing and Human resources support 10%	Finance 50% Physical Facilities 30% Business Management Guidance 20%	Business Management Guidance 50% Finance 30% Physical Facilities 20%	Business Management Guidance 40% Finance 30% Physical Facilities 30%

According to this Table, there are different views on the ownership of the BIs. Generally the conventional BI consultants think that the ownership of BIs should be with the government hands. However, the term “Business Incubation” is new or unknown to most of the budding business community. But most accept that there is a necessity to set up an effective mechanism to BI guide and encourage business start-ups. As such, different terminologies for the term “Business Incubator” should be identified. The fact is that a considerable percentage (40%) of

successful entrepreneurs claimed that they do not feel such a mechanism is necessary for business. Perhaps, they may be so smart and confident on own values and experiences. Most of the successful entrepreneurs believe that the priority service of a BI program must be the management consultancy service. On the other hand, most failed SMEs think the main requirement for business success would be the financial support. The outcome is the fact that majority do not think basic facilities like office space and telephone facilities are the main services a business incubator should provide. All the participants stated that integration or networking of businesses is a useful mechanism for business survival and growth.

#### ***Other SME Business Development Initiatives in Sri Lanka***

According to current records, there are around 100 various Business Development Service (BDS) organizations registered in Sri Lanka to provide various services to SMEs. The contributions of BDS in nurturing and providing management support for SMEs were highlighted at the national BDS providers conference held in June 2004 in Colombo. The conference was organized by the Start and Improve Your Business Association of Sri Lanka (SIYBA). The association comprises 37 partner organizations, of which 17 are NGOs, nine Government Organizations, two Chambers of Commerce and nine private consultancy companies. All these organizations are engaged in providing supportive services to business start-ups. They provide consultancy and relevant services in the following areas: business formation, project proposal writing, training, product development, marketing support and quality control, etc. The SIYBA aims to enhance the capacity of their associate organizations to provide better services to business start-ups. Their services differ from the services of a BI, because they do not follow a typical model such as does an incubator. But there is a possibility to

network all these BDS providers and to form a virtual BI. Certain strong governing organizations should act as the controller and developer of the virtual BIs. SIYBA can also act as the governing body of this network. According to the available records of SIYBA, there is a good demand for training programs from rural SME start-ups. The newly elected President and his government introduced many initiatives such as new SME Bank and Authority and various soft financing schemes to uplift the SME sector. But evaluating the success rate of these initiatives needs more time.

### **The Development of the Appropriate Business Incubator Model for Sri Lanka**

The proposed BI model should consist of the following characteristics:

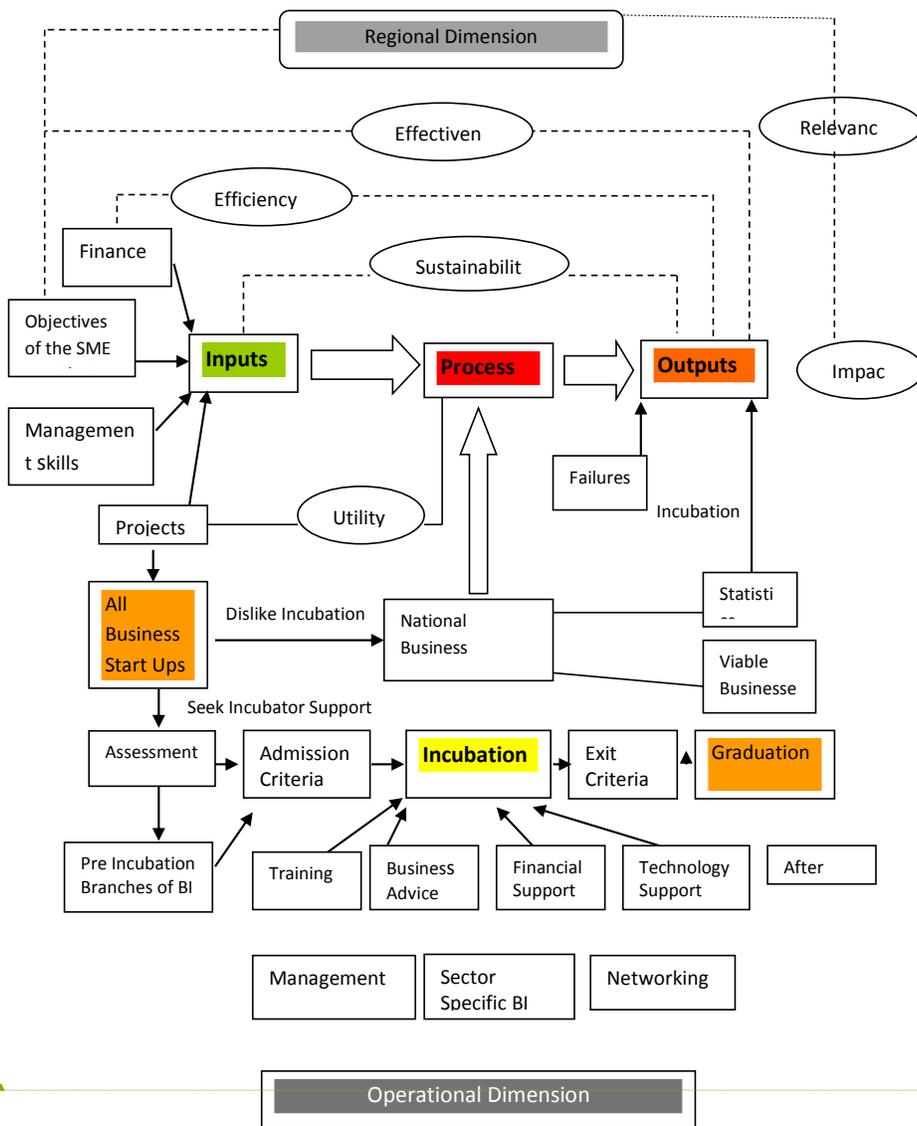
- The model should be industry-specific.
- The model need not be facility-bound.
- There should be a cluster of incubators integrating to share knowledge, opportunities and to assure the sustainability of each incubator with proper management.
- Whilst the Sector Specific National Business Incubators (SSNBIs) are managed as national organizations, all other NGOs or donor community driven BDS centers have to be re-structured as BIs. Since BI is a strange term to Sri Lankans, these should be termed as ‘Small Business Development Centers’ (SBDCs).
- Ultimately, all SSNBIs and SBDCs should be integrated and monitored by the Central Business Incubation Authority.
- A consortium of banks such as SME bank and HNB could invest and manage the proposed BIs.

- All the registered new businesses should be subjected to, monitored and assessed by the National Business Incubator, in order to absorb relevant statistics for national policy formulation and implementation.

**Model and the Flow Chart of the Proposed Business Incubator**

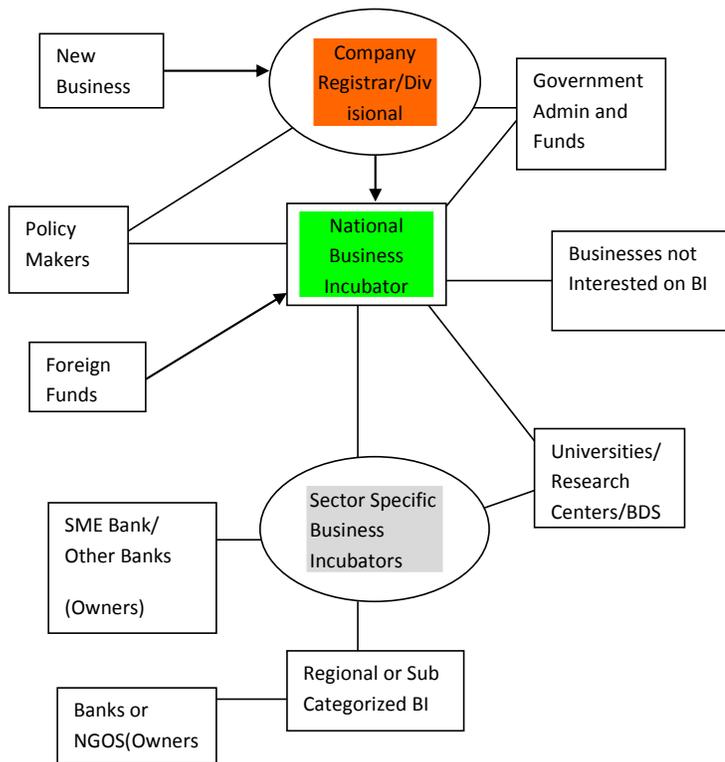
The Proposed BI Model in Figure 2 is a modification of the BI model shown in Figure 1 developed by European Commission Enterprise Directorate General (ECEDG), 2001.

**Figure 1: BI Model**



The proposed BI Model developed as an outcome of this study was not an individual BI. It outlines a National Business Incubation Program.

**Figure 2- National Business Incubator Flow Chart**



The main ingredients of this model can be explained as:

***Trigger/Motives of the Stakeholders of the National Business Incubator***

The National Business Incubator should be triggered by the national policy requirements and the interest of the Central Bank and the funding agencies. The National Business Incubator would be the data evaluation and processing center with regards to almost all the business start-ups of the

country, since the existence of a healthy SME sector would assure a steady and sustainable economic growth of the country.

#### ***Motives of the Sector Specific National Incubators***

The SSNBIs are owned by the SME Bank or consortium of banks. The motive for SSNBIs comes from the Investors/Banks.

Particularly, if we consider the SME bank, its prime objective is to provide loans to SME businesses. Hence, such investors would have the following motives:

1. There is a possibility to launch loan programs successfully the SBDC.
2. There is an effective mechanism to loan recovery.
3. Loan recovery percentage would be high.

#### ***Motives of the Incubatee***

1. Incubatee is forwarded to the relevant incubator through the Department of Business Registration. Hence, there is an official reputation for the program.
2. Incubatee is guaranteed financial support through the incumbent bank.
3. Since the SBDC is a national institution, there is an effortless accreditation to all the graduates of the center (this opportunity has to be promoted by the BI).

#### ***Services Offered by the BI***

The benefits/services that are provided by the SBDC are as follows:

1. Developing the entrepreneurial culture among business start-ups.
2. Product/project assessment.

3. Management assistance.
4. Business networking and integrating support.
5. Assistance in seed financing.

There is a clear need in business start-ups for venture assessment, management assistance and venture capital procurement. There is no high demand for facilities and services that a traditional BI offers. Also, in line with improvements in the infrastructure of the country, this trend can be increased. Actually, there is a model for SME Business Development Service Providers (SBDSPs); these SBDSPs are only equipped to do venture assessment and provide management assistance. They are in a position to assist with loan proposals, etc. But SBDSPs could not be identified as a satisfactory mode for product development and venture capital financing. The essential function of a SBDC would then be promotional.

### ***Selection Criteria***

Actually, there are no special selection criteria. At the moment, for business registration, all new business start-ups would be directed to the National Business Incubation Authority (NBIA). According to the desire of business owners, they would be directed to the relevant SSNBI or SBDC. The enrolment of a BI would not be a requirement for all the business start-ups. But the business concept and progress of all the small business start-ups would be evaluated and monitored by the NBIA. At the time of enrolment, the entrepreneurial level of the incubatee would be assessed and he/she would be supported with entrepreneurial guidance or assisted to trigger his/her entrepreneurship. Particularly, if the entrepreneur is identified as a follower,

he/she will be encouraged to merge with a business partner with high entrepreneurial potential. The business concept/project proposal would be assessed and improved as a viable business plan.

### ***Graduation***

The maximum period for the business to nurture would be five years. A company would be considered as graduated according to several standards as follows:

- a) Sustainable business, financially stable and ready to face challenges for another year. Such SMEs will be termed as graduates from the SBDC and continue with the evaluation of progress, business support and network membership.
- b) Business start-up proves the viability of his/her business concept and competency for growth - those businesses would be encouraged to find joint venture partners.

### ***Strengths of New Model***

The main strength of this model is it focus the problems of emerging entrepreneurs closely. In addition to this this model clearly shows that the government supports help to reach a wide range of business start-ups at the same time.

### ***Weaknesses of the New Model***

Without affiliating to National authorities like SME Bank, or National Business Incubator, the functionality of the SSNBIS and SBDC would be uncertain. Difficult to find qualified people to operate the incubators professionally. In some cases motivation measures for the managers and its incubatees not clearly defined.

### ***Opportunities Could be Revealed by the Program***

Successful operation of the National Business Incubator program would focus the attention of policy makers and new business start-ups to the business incubation area. The experience and R&D competence of the program gained over the time could be utilized to minimize the business failure rate. Successful operation of the program would trigger the venture capitalists.

### ***Threats for the Program***

The program is based on national policies. Government change or political uncertainty could disturb the implementation and execution of the program. Response of business start-ups is unpredictable. The impact by prevailing dynamics of the business sector could adversely affect the existence of the NBIA.

## **CONCLUDING REMARKS AND POLICY IMPLICATIONS**

Worldwide experiences prove that the BIs are a successful mechanism for nurturing of business start-ups. But operation parameters, objectives and qualitative and quantitative statistics of incubators show great variation from country to country and from type to type. Sri Lanka too has a long felt need of finding a solution for the failure of its young businesses. But the BI programs are not successful in Sri Lanka compared to most other developing countries. Perhaps, no institution has undertaken valid attempts in this regard. It is a timely requirement to find suitable methods of protecting SME business start-ups since their contribution to overall economy in many aspects are significant. A healthy SME sector would be the leading driving force of the national economy.

The situational analysis on three BIs established in Sri Lanka shows clear indication of invalidity of such models to Sri Lanka. The BDS sector is mainly dominated by non-governmental organizations and their target is to acquire more and more foreign funds for their organizations. The “Gemi Pubuduwa: SME loan scheme launched by the Hatton National Bank shows a feasibility to upgrade into a sustainable, virtual BI model despite weaknesses of the model and limitation of business development of entrepreneurs. Most of the Newly Industrialized Countries have launched macro-level enterprise promotion policies and technology incubation programs. Their main objective is to transit developing enterprise societies into knowledge-based societies. Incubator models adopted by them are beyond the capabilities of economic conditions that Sri Lanka is presently experiencing. But they have developed their strategy when they were in the poor economic condition. According to the experience record of three BIs established in Sri Lanka, there had been no good demand for their tangible services. According to the ideologies of many entrepreneurs, office space or communication are not the major problems at the stage of starting of a business. Office at a main city is important after achieving a certain level of performance. Usually, new office buildings and spaces are demanded by businessmen seeking extensions of their current business or starting new companies using the surplus of wealth generated by their early businesses. As such, the new model is introduced against the conventional BI model based on the findings of this study. However, the BI model for Sri Lanka should be a national level establishment. It has to be an integrated business development service center, networked with information databases.

There is a timely requirement to introduce an effective program to minimize the closure of many SME business start-ups during the first five years after inception. The conventional or traditional

BI model is not appropriate for Sri Lanka based on the experience of three launchings as well as the latest construction sector initiative. On the other hand, internationally too, there is an emerging criticism in relation to conventional business incubation practice and more product and process technology based incubators are coming up. The appropriate model of Business Incubation in Sri Lanka would be with the following characteristics:

- There should be a clear ownership and operation mechanism of the BI.
- BI should not be facility-bound. It should inject seed funding carefully into the business while supporting management and market networking.
- There is no high demand for the physical facilities that conventional BIs offer but the management consultancy is required by majority of entrepreneurs.
- Proper mechanism should be defined to motivate the BI and the incubatee.
- All BIs should be integrated with important enterprise development institutions, fiscal and legal authorities and various industry and trade chambers, Research and Development bodies and Universities etc.
- For the formation of favorable environment of Business Incubation, it is necessary to establish SME Banks, NBIA and a main apex body for SMEs' promotion and development.

## **POLICY IMPLICATIONS**

This study revealed weaknesses on national policies for a healthy business nurturing environment for SMEs. Any isolated attempt of business incubation would not be successful until national interest on the subject is enhanced. The following has to be considered at policy levels:

- Almost all the new business registrations should be monitored by the legal and fiscal authorities at least until five years from their registration.
- Activities and details of all BDS providers and role of NGOs and other private and public sector on business development activities must be monitored by a national apex body.
- National policies of Newly Industrialized Countries and selected Asian countries on SMEs should be carefully studied before formulating business incubation policies.
- Most of the Business Incubation programs could have failed due to the government changes. There should be 10 or 15 year national programs which should not be changed with government changes. Also, the ministries and affiliated institutions with respect to SMEs development should not be changed from time to time. There also should not be too many ministries involved in SMEs development and promotion.
- It is recommended to institutionalize an authority to assess the progress of business start-ups during the initial five years, whether they obtain the services of a BI or not. The progress record maintained by the Company Registrar's Office is not efficient and effective.
- Information on business start-ups and statistical reviews are not commonly available in Sri Lanka. Even in the Central Bank statistics, there is no trace of how many businesses are registered within a particular year and their progress review, etc. Also, it should give

attention to reveal the contribution of new business start-ups to the Gross Domestic Production (GDP) and their percentages of failure, sector-wise. That would be guidance for new business start-ups.

- Sufficient case studies in the Sri Lankan context should be made available with easy access to the business start-ups.
- When a new construction company is registered by the Institute of Construction Training and Development (ICTAD), the Institute organizes introduction meetings and training seminars for them. Also, annual evaluation and grading are done according to the contractor's progress in business. It is very useful to the new start-ups of the construction industry. Similar awareness and progress review could be done for the new company start-ups by the Company Registrar and the relevant divisional secretary.
- Almost all the BIs, Company registration bodies, BDS, Chambers of Commerce and other Enterprise Development bodies should be integrated by means of a national authority with strong operational model. Adequate reputation and attention should be focused on this new institution. The proposed National Business Incubator Scheme should be launched collaboratively with this institution.

Learning outcomes from research on local entrepreneurship and socio economic conditions would be useful to formulate business incubation policies for Sri Lanka.

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