Validation Report

Reference Number: PVR–211
Project Number: 32472
Loan Number: 1768
December 2012

Papua New Guinea: Microfinance and Employment Project

Independent Evaluation Department
Asian Development Bank
ABBREVIATIONS

AusAID – Australian Agency for International Development
BPNG – Bank of Papua New Guinea
IBBM – Papua New Guinea Institute of Banking and Business Management
MCC – Microfinance Competence Centre
MSEs – micro and small enterprises
NCFI – National Centre for Financial Inclusion
NMB – Nationwide Microbank
PIU – project implementation unit
PNG – Papua New Guinea
RFF – revolving finance facility
SDR – special drawing rights

NOTE

In this report, “$” refers to US dollars.

Key Words

Microfinance Competence Centre, Microfinance Institution, National Centre for Financial Inclusion, Nationwide Microbank, revolving finance facility, microfinance, papua new guinea, employment, small enterprises, financial institutions, institutions

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I. PROJECT DESCRIPTION

A. Rationale

1. During project appraisal, approximately 31% of the population lived below the poverty line of $1 per day. In the Papua New Guinea (PNG) context, poverty was characterized by limited opportunities to earn sufficient cash income to pay for school fees, health care, and other nonfood items, and low levels of personal saving. This was largely attributed to difficulties encountered in transforming the economy to a market economy. Only a small number of jobs could be provided by the formal sector. There was a need to explore income-generating opportunities from smallholder agriculture, agro-processing, and trading.

2. PNG’s financial system displayed a significant institutional gap, which could not sufficiently provide financial services to micro and small enterprises (MSEs), semi-subsistence farmers, and poor households. Microfinance institutions (MFIs) were scattered across the country, and operated in isolation without clear business plans. Knowledge of microfinance best practices was limited, including the capability to design appropriate savings and loan products to suit clients' needs. Institutional capacity of these MFIs to sustain their operations in the near to medium-term was also limited. Given these, there was a need to introduce support measures to provide savings facilities to the poor segment of the population.
B. Expected Impact

3. The project’s envisaged impacts, as indicated in the project framework of the report and recommendation of the President (RRP) of the Asian Development Bank (ADB) were: (i) reduced poverty by integrating the poor to the mainstream, monetized development process; (ii) enhanced private sector-led economic growth and employment creation; and (iii) deepening of the overall financial system. The project completion report (PCR) utilized the final design and monitoring framework (DMF) valid at project completion. It was changed during the special project administration mission in 2009.

4. The RRP did not indicate any impact indicator. On the other hand, the PCR listed as target indicator the increase of domestic credit to the private sector by 10% per annum over the project period.

C. Objectives or Expected Outcomes

5. The intended outcome of the project, as indicated in both the RRP and the PCR pertained to formal and semiformal microfinance institutions providing sustainable microfinance services to viable formal and informal enterprises of all sectors and savings services to the population at large. Outcome indicators were divided into “outreach” and “sustainability”. The outreach indicators, updated in the PCR, were: (i) an increase in MFIs’ outreach by at least 30,000 borrowers and 40,000 depositors by end of 2008; and (ii) from 2008 to the end of the project, an increase in MFIs’ outreach to 370,000 depositors and 170,000 borrowers. The sustainability indicators, as modified in the PCR, were: (i) at least 3 of the 5 largest participating MFIs, with regard to portfolio outstanding, would reach operational self-sufficiency within 2 years after participating in the project, and 2 will reach financial self-sufficiency within 4 years; (ii) at least 7 MFIs of the promising group would show annual improvement of the operational self-sufficiency indicator and would reach 100% after five years of participation to MCC activities; and (iii) by the end of the project, the portfolio at risk would be less than 10% for MFIs that are not regulated by the savings and loan society.

6. Provision of microfinance services was envisaged in order to establish MSEs and expand existing ones, particularly in rural areas where the majority of MFIs operated. This was to create much-needed employment opportunities. More than 45,000 people were to directly benefit from the project. These beneficiaries comprised poor households, MSEs, and semi-subsistence farmers. The project was designed to enable MFIs to increase their outreach and provide services to unserved segments of the population. At least 40 potentially sustainable, existing and new MFIs were to benefit from the project.

D. Components and Outputs

7. The project had three components: (i) component A which pertained to capacity building of MFIs through a microfinance competence center (MCC); (ii) component B which concerned development, testing, and implementation of new savings and loan products and delivery methods; and (iii) component C which focus on the establishment of a revolving finance facility (RFF) for MFIs.

8. Given these components, the project was expected to build the institutional capacity of various providers of microfinance services. In turn, these MFIs were to provide small business loans for working capital and investment purposes to MSEs. Savings services were to be made available to households in rural areas where majority of the poor lived.
E. Provision of Inputs

7. The actual project cost was $13.9 million, which was lower than the $20.5 million estimated at appraisal. Of the $9.6 million approved loan amount, $8.5 million was disbursed while $1.1 million was cancelled. The partial cancellation was due to the lower-than-expected expenditure financed by the ADB; and the appreciation in the special drawing right (SDR) to the dollar exchange rate, which increased the size of the approved loan in US dollar.

F. Implementation Arrangements

8. The Bank of Papua New Guinea (BPNG) was the executing agency (EA) and was responsible for the overall coordination and implementation of the project. Components A and B were implemented by the Papua New Guinea Institute of Banking and Business Management (IBBM). Component C was to be implemented by BPNG, but was cancelled following the mid-term review. In 2009, a minor change in the implementation arrangement moved the responsibility of project activities from IBBM to its subsidiary—the MCC.

9. Most of the loan covenants were complied with. Partial compliance was recorded for delays in appropriation and release of counterpart funds which resulted in shortfall in government counterpart funding. The covenants concerning the implementation of the RFF was not applicable due to the cancellation of component C in June 2005.

10. The actual cost of consulting inputs was $3.8 million, compared with the $2.1 million estimated. This reflected an increase in person-months of consulting services which was agreed upon by the EA and stakeholders during the midterm review and subsequent review missions. There were no major problems encountered in procurement. In general, the performance of consultants and contractors engaged through the project was satisfactory.

II. EVALUATION OF PERFORMANCE AND RATINGS

A. Relevance of Design and Formulation

11. The PCR rated the project relevant, claiming that it was consistent with the government and ADB priorities to improve access to financial services for the poor particularly in rural areas. However, there were changes made to the original design of the project. The project design relied on assumptions about the state of and potential for development in the microfinance industry in PNG, but the assumptions did not hold as envisaged. At appraisal, it could not be foreseen that the key microfinance providers close down within 2 months of the project starting with no other MFI remaining that could use the RFF. However, this design was significantly adapted over the lifetime of the project to address the volatile and rapidly changing environment in which it was operating. Initially a nascent microfinance sector, the support activities contributed to the establishment of two microbanks—both of which are operating on a sustainable basis today. Savings became cheaper source of funds for MFIs than the funds from the RFF. Hence, the RFF component was cancelled and the funds originally earmarked were reallocated to other project components.

12. The project was substantially redesigned following the June 2005 midterm review to reflect the actual conditions and requirements for support in the sector. Performance indicators were simplified and more realistic targets were set for the components. It was also agreed that the microbanking pilot scheme was to be incorporated and divested. The change in the project framework proved to be responsive and relevant to the sectoral issues during that time. Project
design was flexible enough to accommodate these changes. Stakeholders recognized the project as having played a key role in the emergence of a microfinance industry in PNG.

13. The special feature of microfinance in PNG is the dominance of savings deposit. This project did not address this issue well, but rather continued with the usual focus on credit supervision and capacity-building of providers. This validation, on balance, rates the project relevant.

B. Effectiveness in Achieving Project Outcomes

14. The PCR rated the project effective, claiming that most of the expected outcomes and outputs that were realized pertained to savings. According to the PCR, the targets set for outreach after the midterm review was exceeded. As of December 2008, the estimated outreach of MFIs was 145,000 borrowers and 312,000 depositors, exceeding the targets of 125,000 borrowers and 267,000 depositors. In 2009, targets for outreach were increased further to 170,000 borrowers and 370,000 depositors. By June 2010, the number of borrowers reached 184,000 or 108% of target, and depositors reached 509,000, or 138% of target.

15. The project helped MFIs in developing new savings and loan products. During 2002–2008, 37 new products were tested and offered by MFIs, exceeding the target of at least one new product each for savings and loans. Of the 37 products developed, 20 were savings products.

16. In 2004, the project piloted a microbanking pilot scheme in Wau, which was later incorporated as Wau Microbank. In 2008, its name was changed to Nationwide Microbank (NMB) and was granted full banking license by the BPNG. Since then, NMB has operated on a commercial basis and has become the biggest licensed microbank in PNG with over 100,000 active customers with savings accounts through its 14 branches. The microbanking pilot scheme that led to the establishment of the NMB was one the project’s most visible and successful outputs.

17. The target for the portfolio quality of regulated MFIs or microbanks was not achieved at completion. The portfolio at risk (PAR) of more than 10% for PNG Microfinance and 18% for Microfinance Nationwide bank (NMB) indicated poor portfolio quality that was not within the target of less than 10% set in the design framework. This indicated that the capacities of these institutions need to be developed further, particularly in responding to delinquencies. Balancing the strong achievement of the outcome and output targets and the establishment of the NMB and the weaknesses relating to the performance in MFIs’ new products and portfolio quality, this validation concurs with the PCR’s effective rating.

C. Efficiency of Resource Use in Achieving Outputs and Outcomes

18. This evaluation concurs with the less than efficient rating of the PCR. Implementation took 46 months longer than planned at appraisal, resulting in higher costs for the project implementation unit. The project was extended twice and part of the ADB loan was cancelled. More could have been accomplished in a shorter time if the issues on the design were addressed earlier. Poor data record keeping and data collection also reduced the project’s

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1 Data on PAR as reported by the PCR as of early 2011 (Appendix 1). PAR is defined as outstanding balance of all loans past due more than 30 days divided by outstanding balance of all loans. PARD claimed that the average portfolio at risk over the project life time would remain below the targets.
efficiency. For example, there were no core performance indicators reported regularly on the financial performance of MFIs such as financial self-sufficiency and efficiency of microfinance operations.

19. In terms of enhancing the institutional capacity of MFIs, the project, through the MCC, delivered training to practitioners from 21 formal and informal microfinance institutions and achieved the target of 1,500 person-days of training per year. Financial literacy training was also provided to over 7,000 people in the pilot test locations exceeding the target of 6,000 people.

D. Preliminary Assessment of Sustainability

20. The PCR rated the sustainability of the project likely. At the same time, the PCR reports that financial sustainability of eight MFIs was partly achieved in that breakeven was achieved in 2008 but the effects of the global financial crisis and the rising domestic costs since then led to losses in the industry (para. 34, PCR). Faced with higher demand for savings than for loans, MFIs invested the surplus funds from savings in government securities and treasury bills, but the returns on these investments dropped to 3%–4% (para. 35, PCR). Thus, the returns to these investments were much lower than what could have been realized had the surplus funds been fully utilized for loans. In addition to this constraint, MFIs are faced high cost of delivering services to clients due to poor infrastructure, low population density, and rising costs of hiring qualified staff. These factors affect the MFIs’ ability to achieve financial sustainability.

21. As regards the NMB, it operated profitably since its transformation into a licensed microbank except in 2010 due to rising operating costs and lack of demand for loans. Based on its track record and wide network or branches, it is likely that it will recover and continue to operate profitably.

22. The MCC, established within IBMM, did not achieve sustainable level of operation. The 2008 business plan showed that it was unlikely to be sustainable in the short to medium term. It would need to expand its services and require continued further external funding. To broaden the scope of its activities and facilitate sustainability, the National Centre for Financial Inclusion (NCFI) will replace the MCC in the follow-on Microfinance Expansion Project financed by ADB, which was approved in October 2010.

23. The NMB demonstrated sustainable microfinance operations. This cannot be said of the other MFIs due to lack of data on sustainability. The high cost of delivering financial services due to poor infrastructure and low population density would remain a problem to MFIs. The replacement of the MCC by NCFI is expected to sustain the capacity building efforts for MFIs. Follow-up activities under the Microfinance Expansion Project would enhance the sustainability of project outcomes. The sustainability of the project outcomes and the MFIs shows a mixed picture. However, considering the planned follow-on activities to enhance sustainability through another ADB-financed project, the project can be rated likely sustainable.

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2 However, there was no data presented in the PCR that showed the operational self-sufficiency of participating MFIs.

E. Impact

24. The project provided impetus for the emergence of a microfinance industry that was previously nascent. Two licensed microbanks emerged with a growing branch network and microfinance providers including savings and loan societies were strengthened. More than 500,000 clients were reached with microfinance services by the end of June 2010. The project supported private sector development as indicated by the increase of the ratio of private sector credit to gross domestic product from less than 15% in 2005 to 27% in 2010. The project laid the foundation for future growth of the industry and facilitated the integration into the financial sector of households who never had access to institutional financial services. The impact in terms of poverty reduction and employment creation cannot be determined because pertinent data were not collected and integrated in the monitoring framework. Overall, the impact is rated significant.

III. OTHER PERFORMANCE ASSESSMENTS

A. Performance of the Borrower and Executing Agency

25. This validation supports the PCR in that BPNG and IBBM performed satisfactorily. The microfinance steering committee chaired by the BPNG provided overall guidance and coordination of the project. The project implementation unit was established. However, its location within IBBM weakened BPNG’s oversight role resulting in delays in reporting and submission of withdrawal applications. IBBM was effective as implementing agency and contributed greatly to the accomplishments of the project.

B. Performance of the Asian Development Bank

26. This validation concurs with the PCR’s satisfactory rating of ADB’s performance. The intervention of ADB to change the project design during the midterm review successfully adapted the project to the realities and circumstances of the microfinance industry. However, the flaws in the original design reflect the inadequacy of assessments made by ADB during appraisal. The transfer of project administration in 2006 from ADB headquarters to the PNG resident mission, and in 2009 from the PNG resident mission to the Pacific Liaison and Coordination in Sydney, did not have significant adverse effects on project implementation and outcomes.

C. Others

27. There were no adverse effects on the environment. No issues on safeguards, governance, resettlement, and fiduciary aspects were identified.

IV. OVERALL ASSESSMENT, LESSONS, AND RECOMMENDATIONS

A. Overall Assessment and Ratings

28. The PCR rated the project successful. This validation endorses the successful rating (see the table). The project provided impetus for the emergence of a microfinance industry in a difficult environment of low population density and high cost of delivering services.

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4 The project was investigated and sanctioned by ADB’s Office of Anticorruption and Integrity.
### Overall Ratings

<table>
<thead>
<tr>
<th>Ratings</th>
<th>PCR</th>
<th>IED Review</th>
<th>Reason for Disagreement/Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relevance:</td>
<td>Relevant</td>
<td>Relevant</td>
<td></td>
</tr>
<tr>
<td>Effectiveness in Achieving Outcome:</td>
<td>Effective</td>
<td>Effective</td>
<td></td>
</tr>
<tr>
<td>Efficiency in Achieving Outcome and Outputs:</td>
<td>Less efficient</td>
<td>Less than efficient</td>
<td>The project had a significant impact in that it led to the emergence of a microfinance industry that was previously nascent. It should be noted, however, that the impact on employment could not be determined due to lack of data (para. 24).</td>
</tr>
<tr>
<td>Preliminary Assessment of Sustainability:</td>
<td>Likely sustainable</td>
<td>Likely sustainable</td>
<td>There was lack of data presented on the sustainability of MFIs. Impact on households and employment was not assessed (para. 33).</td>
</tr>
<tr>
<td>Overall Assessment:</td>
<td>Successful</td>
<td>Successful</td>
<td></td>
</tr>
<tr>
<td>Borrower and EA:</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
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<tr>
<td>Performance of ADB:</td>
<td>Satisfactory</td>
<td>Satisfactory</td>
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<tr>
<td>Impact:</td>
<td>Not rated</td>
<td>Significant</td>
<td></td>
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<tr>
<td>Quality of PCR:</td>
<td>Less than satisfactory</td>
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**ADB = Asian Development Bank, DHC = district heating company, IED = Independent Evaluation Department, PCR = project completion report.**

**Note:** From May 2012, IED views the PCR's rating terminology of "partly" or "less" as equivalent to "less than" and uses this terminology for its own rating categories to improve clarity.

**Source:** ADB Independent Evaluation Department.

### B. Lessons

29. This validation agrees with the lessons identified by the PCR. Project design needed to be realistic especially when the industry was still emerging and operates in a difficult environment. The capacity of institutions and constraints to the development of the sector needed to be adequately assessed at appraisal to maintain the relevance of the project and to avoid major changes in the design during implementation. In addition, core indicators on financial and social performance of participating MFIs needed to be integrated and collected in the monitoring system of the project.

### C. Recommendations for Follow-Ups

30. This evaluation concurs with the recommendation of the PCR to incorporate the monitoring of the microfinance sector in PNG as part of ADB’s Microfinance Expansion Project. In this regard, indicators should be aligned with international standards for measuring financial, operational and social performance of MFIs such as those used by the Consultative Group to Assist the Poor and the Mix Market.⁵

31. The issues that will be addressed by the subsequent Microfinance Expansion Project are relevant and are a logical follow-up to the project. These issues are the continued insufficient access to financial services in the rural areas, poor financial literacy, low capacity of institutions, unmet credit demand of micro and small enterprises, absence of industry-wide standards, and lack of legal and regulatory framework specifically for microfinance. The

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technical assistance for the introduction of mobile phone banking by NMB will advance financial inclusion especially in the context of PNG where population is dispersed and rural infrastructure is poor.6

V. OTHER CONSIDERATIONS AND FOLLOW-UP

A. Monitoring and Evaluation Design, Implementation, and Utilization

35. Indicators on the financial, operational and social performance of MFIs were not integrated in the monitoring system. There was no available systematic way of monitoring the performance of MFIs in terms of sustainability, efficiency, depth of outreach and portfolio quality. Further, no baseline data was established on the poverty and income levels of participating households. Hence, the socio-economic impact of the project at the household level cannot be fully assessed. Data collected for monitoring project performance at the MFI and household levels was very limited. There is also a need to follow-up on the monitoring of the microfinance sector in the activities of the said project.

B. Comments on Project Completion Report Quality

33. The PCR is generally consistent with the PCR Guidelines (PAI 6.07). The lessons and recommendations are sound and valuable to ADB particularly for microfinance operations in the Pacific. The report is clear on its presentation and analysis of the issues, outputs and outcomes. However, there was a lack of data to substantiate the sustainability of participating MFIs. Only NMB case was clearly presented. Further, the impact on participating households and employment was not assessed due to lack of data. Overall, the quality of the PCR is less than satisfactory.7

C. Data Sources for Validation

34. Back-to-office mission reports, ADB PCR, RRP, midterm review report, project progress reports, project processing documents.

D. Recommendation for Independent Evaluation Department Follow-Up

36. A project performance evaluation report may not be needed.


7 PARD did not agree that the PCR quality is less than satisfactory due to lack of data presented and/or not assessed by the PCR by arguing that the data were not available for those items.