SECTOR ASSESSMENT (SUMMARY): PUBLIC SECTOR MANAGEMENT

Sector Road Map

1. Sector Performance, Problems, and Opportunities

1. Summary. State-owned enterprises (SOEs) in Papua New Guinea (PNG) play a critical role in delivering essential goods and services to the public and supporting the economic and social development of PNG. This includes the provision of electricity in PNG (PNG Power Limited [PPL]); water, sewerage, and sanitation services across PNG (Water PNG Limited); international and domestic airline services (Air Niugini Limited [ANL]); all seaport facilities in PNG (PNG Ports Corporation Limited); telecommunications and postal services (Kumul Telikom Holdings [KTH] and Post PNG); and the National Development Bank, among others. The historically poor performance of SOEs—caused by weak governance that negatively affects management and oversight, limited technical capacities, and political interference—results in expensive, inefficient, and low-quality service provision and makes the economy less competitive. On the public sector side, inefficient SOEs are a substantial drain on scarce public funds while SOE debt represents a contingent liability and exposes the government to fiscal risk.

2. Background. The government has majority ownership of 12 SOEs, of which (i) two are resource sector companies; (ii) nine have their assets held in the General Business Trust (GBT) and are regulated under the Kumul Consolidated Holdings Authorisation (Amendment) Act 2021 (KCH Act); and (iii) one is Kumul Consolidated Holdings (KCH), the trustee of the GBT with oversight of the performance of the nine SOEs in the GBT. The GBT also includes listed investments, other state-owned assets, and several major projects such as hydroelectric power facilities, metropolitan sewerage systems, and port developments. KCH is a 100% state-owned statutory corporation mandated to hold all government-owned commercial (nonresource) assets in trust and to manage them for economic, environmental, and social value. KCH is headed by a managing director and reports to the National Executive Council (NEC) through the minister for state enterprises on matters relating to the KCH Act. The minister is also responsible for overarching policy matters related to the SOE portfolio.

3. Financial and operational performance. The performance of the SOEs in the GBT varies by business and sector. Historically, performance has been poor across the SOEs and has been in steady decline since 2015, when amendments to the KCH Act left SOEs exposed to noncommercial decision-making (para. 6). The coronavirus disease (COVID-19) exacerbated existing financial sustainability challenges for several SOEs. In 2020, SOEs in the GBT reported an unaudited consolidated net operating profit before tax of K11.9 million, a reduction by 90% from K120.8 million in 2019. ANL was particularly impacted by COVID-19, increasing its (unaudited) net operating loss after tax from K25.0 million in 2019 to K97.1 million in 2020. The poor financial performance of KTH and PPL continued in 2020, with (unaudited) net operating losses after tax of K56.7 million for KTH and K48.4 million for PPL. Other SOEs generated small net operating profits after tax, providing a total of K78.1 million in dividends to the government in

1 This document focuses on public sector management of state-owned enterprises (SOEs). For broader macroeconomic, fiscal, and public financial management information and issues, see Program Economic Assessment (accessible from the list of linked documents in Appendix 2 of the report and recommendation of the President).
2 These two resource sector companies are Kumul Petroleum Holdings and Kumul Mineral Holdings.
3 SOEs in the GBT are listed in para. 1, as well as Kumul Agriculture Limited and Motor Vehicle Insurance Limited. Government of PNG. 2021. Kumul Consolidated Holdings Authorisation (Amendment) Act 2021. Port Moresby. The act is generally referred to as the KCH Act. The 2021 amendment has been supported under subprograms 1 and 2.
2020, down from K89.2 million in 2019. The unaudited return on assets of the nine SOEs ranged from –12.8% for ANL to 8.3% for Motor Vehicle Insurance Limited in 2020; no other SOE generated a return on assets higher than 4.0%.

4. It is estimated that the government’s investment in the GBT SOEs was K6.3 billion in 2018. The SOEs have accumulated unsustainable levels of debt, more than half of which was contracted after 2015 when projects were not subjected to robust financial and economic viability assessments. The consolidated SOE debt was estimated to be K5.1 billion as of the end of December 2020, of which K1.9 billion was commercial debt. The top three SOEs in terms of debt exposure at the end of 2020 were KTH (K1.36 billion), PPL (K1.18 billion), and PNG Ports Corporation (K1.02 billion). The need for periodic capital injections in specific SOEs affects the government’s capacity to prioritize expenditure in services including education, health, and security. Several SOEs have accumulated substantial tax arrears with the Internal Revenue Service, while accumulated arrears from the government stood at K365 million in the first half of 2021.

5. Some SOEs face substantial operational challenges. KTH has a mobile market share of less than 10%, against a 92% market share for Digicel (2018 data) and is unable to meet its current financial obligations. PPL is locked into several sole-sourced independent power production contracts and has not systematically pursued commercially attractive opportunities. PNG Ports Corporation, ANL, and KCH have noncore assets that they could monetize to generate cash flows, while a few relatively well-performing SOEs (such as Motor Vehicle Insurance Limited and Post PNG Limited) could be partially privatized, but there has been limited progress in these directions in the past because of low capacity and lack of political appetite. SOEs also lack the capacity to develop beneficial public–private partnerships (PPPs).

6. Inadequate policy and regulatory framework. Weak legal and regulatory structures fail to provide the necessary incentives for SOEs to operate on sustainable and commercial bases. The KCH Act amendments in 2015 conferred the NEC with direct influence on SOEs, including powers to control the board composition of KCH and majority-owned SOEs, authorize annual plans, and approve expenditure over K10 million. This led to conflicting objectives, opaque management practices, and noncommercial decision-making. As a response, the 2021 amendment of the KCH Act supported under subprograms 1 and 2 refocused the functions of KCH to ensure that its own performance and that of SOEs in the GBT create value as measured by efficiency, profitability, and environmental and social responsibility, and operate on strict commercial principles with full transparency, accountability, and independence from political influence or instruction, except as explicitly provided for in the act.

7. Several SOEs operate under the regulatory contract model to set prices and service standards, but these agreements largely work on a "cost plus" model and do not provide incentives for SOEs to find ways to deliver services more efficiently or to a higher standard. Further, several SOEs are required to provide their services nationwide at the same cost, regardless of the actual cost. This results in cross-subsidization that is often carried out in an ad hoc and opaque manner, reducing opportunities for private sector participation. The government approved a community service obligation (CSO) policy in 2012 to provide explicit costing and

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6 These include PPL, PNG Ports Corporation, Post PNG Limited, and Water PNG Limited.
funding of CSOs to improve transparency and quality of service provision, but the policy has not been implemented.

8. **Private capital has the potential to improve the quality and reduce the cost of service provision in PNG.** Private sector involvement in service provision is inadequately enabled through PNG’s current legislative and policy settings, so agreements are concluded on an ad hoc basis with no consistent approach to assessing and negotiating commercial arrangements. In 2019, PNG was ranked equal second last of 69 economies for its capacity to implement sustainable and efficient PPPs. In 2014, the government passed the Public–Private Partnership Act 2014 (PPP Act) that provided for the systematic analysis of proposed infrastructure investments, including whether the introduction of private capital is likely to deliver better outcomes. While the PPP Act was gazetted in early 2018, implementation has stalled.

9. **Weak governance and transparency.** PNG lacks effective accountability and oversight mechanisms to achieve timely reporting and disclosure of SOE performance, resulting in reduced accountability. Most SOEs do not produce timely annual financial statements as required by the KCH Act, and audited financial statements are not publicly available (including for KCH). While some SOEs do produce annual plans, these are of varying quality, often delayed, and do not include a medium-term outlook. Without a mechanism to evaluate SOE corporate plans and closely monitor SOE performance, the government has been unable to reverse deteriorating trends. Many SOEs have weak procurement systems that do not adequately support investment on a value for money basis. The politicization of decision-making enabled by the KCH Act prior to its 2021 amendment led to the appointment of SOE boards and management that often lack requisite skills. Female representation on SOE boards is low, with only two of 48 directors in 2019 being women.

2. **Government’s Sector Strategy**

10. **Strategic support for state-owned enterprise reform.** The government’s development strategies support reform of SOEs and greater private involvement in the sector. The country’s development plans acknowledge the central role of SOEs in service provision and in achieving national goals. The strategic plans also emphasize the value of private capital, including through PPPs, and the maintenance of some presence in the market to avoid private sector monopolies. Government high-level planning documents are supplemented by specific reforms. In recognition of the severe challenges SOEs are facing (paras. 3–9), the government initiated a substantial and ongoing reform program to improve SOE performance and enable private sector participation, supported by the State-Owned Enterprises Reform Program. This sweeping SOE reform blueprint was endorsed by the NEC in November 2019 and identifies immediate, medium-, and long-term actions to (i) review existing entities to highlight reforms as well as opportunities, (ii) put in place enabling legislation and regulatory frameworks, (iii) restructure business operations, (iv) refinance to support reform and restructuring, and (v) revitalize business operations to drive service delivery.

11. The implementation of the SOE reform blueprint is led by the minister for state enterprises, through a ministerial committee comprising the deputy prime minister, minister for the Treasury, minister for communications and energy, and minister of transport and infrastructure. A technical working group comprising the Ministry of State Enterprises, departments of Transport and

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Infrastructure, and National Planning, as well as the Department of the Treasury, KCH, and relevant SOEs, has been established to drive the reform process. While the reform blueprint is ambitious, a key factor will be the limited fiscal resources of the government, aggravated through the COVID-19 pandemic response. It is anticipated that the dual need for the government to reduce capital injections into SOEs and improve the operational and financial performance of the portfolio to generate dividends for recurrent expenditure will cement reform commitment.

3. ADB Sector Experience and Assistance Program

12. Past engagement. ADB has extensive experience in promoting SOE reform in PNG through regional technical assistance (TA).\(^9\) ADB has also provided occasional assistance to SOEs to finalize annual accounts. Regional TA has supported (i) drafting and passing of a PPP policy in 2008, and the PPP Act; (ii) reviewing the consumer and competition framework and drafting the National Competition Policy; (iii) benchmarking SOE performance since 2012; (iv) designing a CSO policy; and (v) conducting prefeasibility assessments for PPPs for the National Airports Corporation, PPL, PNG Ports Corporation, and Eda Ranu. Earlier TA had mixed success because of variable political support and administrative capacity. PNG responded positively to some competition-related reforms, which highlighted successful strategies of deep working-level engagement and building local capacity and understanding of reform. Other TA-supported areas such as the implementation of the PPP Act and the CSO policy stalled because of waning political support and insufficient budgetary allocations. Advice on specific SOE transactions had mixed results, with low board capacity, management instability, and weak oversight affecting the ability to develop and successfully conclude transactions (including PPPs).

13. Lessons learnt. The key lesson from ADB’s engagement in SOE reform in PNG and the broader Pacific region is that it is crucial to capitalize on limited windows for reform. The political economy of SOE reform in PNG is dynamic and largely driven by shifts in political power, ministerial responsibilities, and performance at officials’ level. While the appetite for wholesale privatization remains limited, partnerships with the private sector are encouraged and can be a promising strategy for cementing reform gains. A primary strategy for ADB engagement in this program is to capitalize on the broad support for SOE reform that exists with the current administration, and lock this commitment in through a multiyear program that seeks to place SOEs on a firm commercial footing and partner with the private sector where feasible. Another lesson is that high-level political support for SOE reform must be complemented with targeted TA to translate the government’s goals into reality. While there is substantial experience with SOE reform in some areas of the bureaucracy—largely, in the Department of the Treasury and KCH—the breadth and complexity of reform will require additional TA. Development partner TA has been mobilized, including from the Government of Australia.

14. ADB assistance. The government has requested financial assistance of $500 million from ADB’s ordinary capital resources to support SOE reforms aligned with the government’s own SOE reform blueprint (para. 10). Following the disbursement of $100 million for subprogram 1 in 2020, subprogram 2 provides $150 million in budget financing for 2021. Subprogram 3 contains support of $250 million for 2022. In addition, ADB will continue to provide significant TA to supplement government capacity to implement reforms, in coordination with development partners.\(^10\)

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Problem Tree for Public Sector Management

Effect

Core problem

Causes

Inadequate legislative and policy framework for SOEs

Service delivery by SOEs is expensive, inefficient, and of poor quality

Poor operational performance undermines financial sustainability of the SOE portfolio

Weak SOE governance and transparency

Financial sustainability challenges facing specific SOEs

Opaque selection processes for SOE boards and management

Cash flow limited by bills unpaid by government (power, airlines)

Overlap between commercial and political decision-making in SOEs

Statements of corporate intent not prepared and/or disclosed

Challenges because of COVID-19 pandemic restrictions (airlines)

Insufficient oversight on monitoring performance of SOEs

Unclear key performance indicators to monitor performance

Inadequate capacity to divest noncore assets (ports, airlines, KCH), pursue privatization (motor vehicles, telecommunications, post), structure PPPs (power, airport), and restructure commercial debt (power, ports, airlines)

Ad hoc unstructured pursuit of PPP opportunities

Unclear key performance indicators to monitor performance

Inadequate capacity to divest noncore assets (ports, airlines, KCH), pursue privatization (motor vehicles, telecommunications, post), structure PPPs (power, airport), and restructure commercial debt (power, ports, airlines)

Absence of policy establishing key principles of SOE governance

Audited financial statements not prepared and disclosed in a timely manner

Organizational inefficiency adding to operating costs (water)

Insufficient priority to developing suitable SOE policies and legislation by prior administrations

Implementation of KCH Act limited by low in-country capacity

High debt contracted without robust financial assessment (telecommunications, power, ports)

Limited implementation of frameworks for CSOs and competition

Poor procurement and financial management processes
