

## SECTOR ASSESSMENT (SUMMARY): FINANCE<sup>1</sup>

### Sector Road Map

#### 1. Sector Performance, Problems, and Opportunities

1. Financial markets in Papua New Guinea (PNG) do not support efficient investment and entrepreneurship. The ratio of private sector credit to gross domestic product is below 30%, even though financial institutions have substantial liquidity. While the commodities boom has spurred rapid lending growth since 2004, financial markets remain underdeveloped. Although no official data exists, the Asian Development Bank (ADB) estimates that only 15% of the population has access to formal or informal banking facilities. Particularly in rural areas, access to finance remains extremely low and discourages economic activity. Small and medium-sized firms have difficulty getting financing, and credit is costly—the spreads between borrowing and lending rates and on foreign exchange transactions are high by international standards. PNG does not have a secondary debt market. A rudimentary collateral framework and lack of credit information on prospective borrowers further inhibit lending, although a credit bureau was established in 2008. On a more basic level, the recent growth of savings accounts among the few rural finance institutions in PNG demonstrates significant unmet demand for deposit facilities.

2. By international comparison, PNG's formal financial sector is small relative to the size of its economy, as measured by the ratio of domestic credit extension to the private sector as a percentage of gross domestic product. PNG has four commercial banks, a state-owned National Development Bank, two major superannuation funds, a number of finance companies, two regulated microfinance institutions (first-tier MFIs), about 20 savings and loan societies (SLSs), and a number of unregulated semiformal and informal microfinance service providers, including nongovernment organizations, community organizations, and some multipurpose cooperatives (second-tier MFIs). The commercial banks, including the locally based Bank of South Pacific (BSP), the Australia and New Zealand Banking Corporation, and Westpac, comprise the largest lending group and generally target formal businesses and larger and more creditworthy customers.

3. The two principal microfinance providers, PNG Microfinance Limited and Nationwide Microbank, have expanded their rural outreach and now have a total of 21 branches. SLSs and the second-tier MFIs have also grown. However, the cost of reaching rural banking customers through traditional branch networks remains high, and institutions are increasingly looking to innovative models for rural outreach. In some cases, this has involved creating linkages between the larger, regulated microbanks and the smaller, local institutions. In addition, branchless and mobile phone payments and banking models are becoming more attractive. These models, which are made possible by the increasing coverage of the mobile telephone network throughout PNG, are being explored by existing commercial banks as well as smaller microfinance institutions as a cost-effective mechanism for expanding outreach.

4. An antiquated collateral framework, which discourages financial institutions from accepting movable property as collateral for borrowing, also inhibits access to finance. Reforming this collateral framework and creating a functioning filing archive will allow anyone to borrow against future cash flows, inventory, vehicles, or other movable property, thereby

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<sup>1</sup> This summary is based on ADB. 2008. *Foundation for the Future: A Private Sector Assessment for Papua New Guinea*. Manila; and the documentation prepared for the proposed Microfinance Expansion Project.

significantly expanding their collateral base and encouraging greater lending.

## **2. Government's Sector Strategy**

5. The PNG Development Strategic Plan 2010–2030 acknowledges that financial services have failed to reach the majority of the population, and that the depth of services remains thin and underdeveloped, especially in rural areas.<sup>2</sup> Whereas microfinance has been growing rapidly to bridge this gap, significant progress is needed in extending the availability of low-cost financial services to the general population, especially women. The plan stresses the role of informal financial institutions that operate savings, credit, and other financial services, and acknowledges that a suitable regulatory framework will need to be designed and implemented by the Bank of Papua New Guinea (BPNG). A lack of access to credit is identified as a major impediment to the development of small and medium-sized enterprises (SMEs).

6. The 2010 budget notes that improved access to credit is an important tool in promoting rural development and poverty reduction, and commits the government to supporting the development and expansion of a sustainable microfinance industry.<sup>3</sup> In the 2010 budget, the government allocated K20 million to the state-owned National Development Bank for the extension of credit in rural areas.

## **3. ADB Sector Experience and Assistance Program**

7. Since 2001, ADB has supported the development of the microfinance subsector in PNG through the Microfinance and Employment Project.<sup>4</sup> The project, which is closed at the end of June 2010, has built a solid base for microfinance in PNG and has developed microfinance as a suitable tool for rural development in the country. It has successfully laid the foundation of a nascent microfinance subsector and has been successful, both in delivering services directly and in generating broader competencies in the subsector. The microfinance institutions and SLSs have extended their outreach to about 400,000 clients in 2010. The project created the Microfinance Competence Centre to provide training services to the subsector and more recently has supported the development of the PNG Association of Microfinance Institutions, which is a practitioner-led advocacy group that seeks to develop the subsector further. Most recently, the project has undertaken rural linkages pilot programs in four locations in PNG to extend the reach of microfinance further. ADB also assessed the potential for mobile banking applications to reduce transaction costs dramatically and increase access to finance in rural areas.

8. In 2004, the project launched one of the first licensed microbanks in PNG, Wau Microbank. Since then, the bank has established 12 branches throughout the country, has provided savings services to about 120,000 clients, and has made more than 25,000 loans. The bank was renamed Nationwide Microbank in 2008 and was issued a full banking license by the Bank of Papua New Guinea in the same year. The government continues to be the main shareholder in Nationwide Microbank. ADB has assisted Nationwide Microbank in assessing the potential for implementing a mobile banking system. ADB is also assisting Nationwide Microbank in strengthening its human resources and risk management capacity.

<sup>2</sup> Government of Papua New Guinea, Department of National Planning and Monitoring. 2010. *Papua New Guinea Development Strategic Plan, 2010–2030*. Port Moresby.

<sup>3</sup> Government of Papua New Guinea. 2009. *Budget 2010*. Port Moresby.

<sup>4</sup> ADB. 2000. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Papua New Guinea for the Microfinance and Employment Project*. Manila (Loan 1768-PNG).

9. While the microfinance subsector in PNG is an emerging success story, a number of development issues remain: (i) continued poor access to financial services, particularly in rural areas; (ii) poor financial literacy and business management skills; (iii) low capacity among microfinance and socioeconomic institutions; (iv) increasing demand for borrowing by micro and small enterprises; and (v) lack of a microfinance specific legal and regulatory framework.

10. ADB will continue to support the growth of the microfinance subsector through the proposed Microfinance Expansion Project, which will seek to extend and build on the achievements of the Microfinance and Employment Project. It will have four main components: (i) improving rural outreach and capacity development both for the institutional capacity of MFIs and microfinance clients, (ii) developing the lending market for micro and small enterprises, and (iii) developing an effective and relevant legal and regulatory environment for microfinance. Gender issues are of particular concern in PNG. The project will seek to improve the availability of financial services and training for women and other disadvantaged groups. Gender will be mainstreamed through several of the key outputs of the project, including ensuring the development of sex-disaggregated data. Project preparation and approval work will be undertaken in 2010, and project implementation will begin in 2011.

11. In addition, ADB will pursue collateral or secured transaction reforms through the Private Sector Development Initiative Phase II,<sup>5</sup> and will continue to assist in the development of branchless banking.

12. ADB's support for improved access to finance in PNG reflects one of the five core areas of specialization under Strategy 2020: finance sector development.<sup>6</sup> Furthermore, ADB's activities support one of the key drivers of change in ADB's Pacific strategy 2010–2014: an improved private sector environment.<sup>7</sup> The outcome to be supported by ADB will be financial institutions that can sustainably and safely provide financial services to a substantially increased number of clients across PNG. The outcome will be measured through the growth of the microfinance customer base, the ratio of domestic private sector credit to gross domestic product, and the adoption and implementation of collateral reforms.

13. ADB's work in access to finance in PNG, through activities in microfinance, branchless banking, and collateral or secured transactions frameworks, contributes directly to improving income-earning opportunities for men and women. Making financial services more broadly available across the country, increasing the capacity of the rural and urban population (especially women) to take advantage of these services, and lowering their cost will make supply chains more efficient, improve the accessibility of the formal economy, and facilitate the development of micro and small enterprises.

14. ADB will also pursue private investment opportunities in the finance sector in PNG through the Private Sector Operations Department during the country partnership strategy period. Such opportunities, which will be examined on their individual merits, will complement ADB's existing activities in the sector. Where possible, ADB will use technical assistance

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<sup>5</sup> ADB. 2009. *Technical Assistance for the Pacific Private Sector Development Initiative Phase II*. Manila (TA 7430-REG).

<sup>6</sup> Strategy 2020 focuses ADB operations in five core areas and three complementary areas. The five core specializations are (i) infrastructure, (ii) environment, (iii) regional cooperation and integration, (iv) finance sector development, and (v) education. ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

<sup>7</sup> ADB. 2009. *ADB's Approach to Assisting the Pacific (2010–2014)*. Manila.

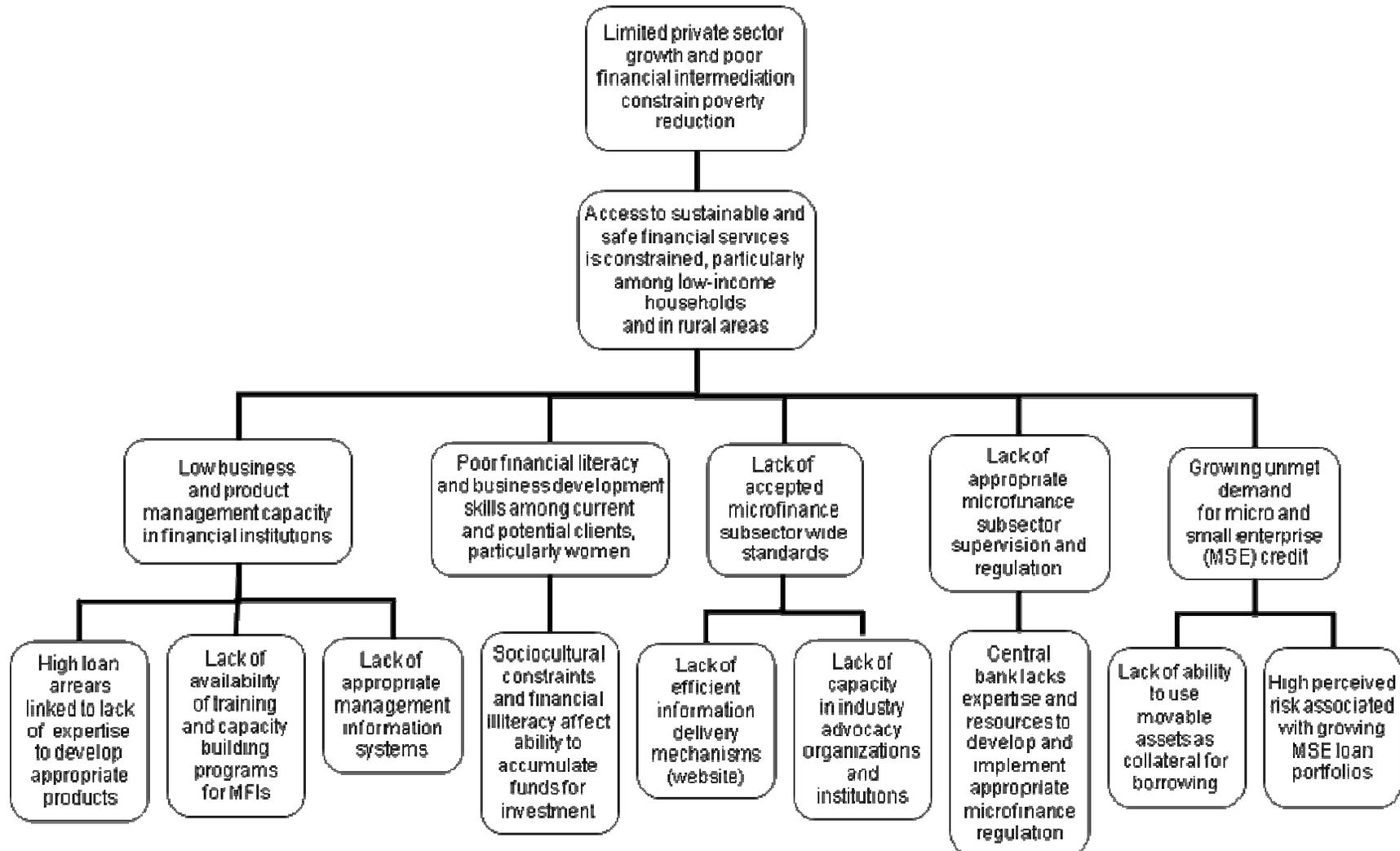
resources to fund private sector project formulation.

15. Cooperation with development partners is an important feature of ADB's activities in support of improved access to finance in PNG. The Australian Agency for International Development (AusAID) has provided significant grant cofinancing for ADB's access to finance interventions, including the Microfinance and Employment Project, as well as ADB's Private Sector Development Initiative.<sup>8</sup> AusAID is expected to provide grant cofinancing for the proposed Microfinance Expansion Project. In addition, ADB, AusAID, the International Finance Corporation, and other bilateral and multilateral development partners involved in private sector development work across the Pacific meet quarterly to discuss and coordinate their activities. These meetings involve discussions of general private sector development issues as well as financial inclusion (including microfinance). Development partner activities in PNG account for a significant part of these meetings.

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<sup>8</sup> ADB. 2006. *Technical Assistance for the Private Sector Development Initiative*. Manila (TA 6353-REG); ADB. 2009. *Technical Assistance for the Pacific Private Sector Development Initiative Phase II*. Manila (TA 7430-REG).

**Problem Tree for the Finance Sector**  
Core Problem Focus on Access to Finance



MFI = microfinance institution; MSE = micro and small enterprise  
Source: Asian Development Bank.

### Sector Results Framework (Finance, 2011–2015)

Country Sector Outcomes		Country Sector Outputs		ADB Sector Operations	
Outcomes with ADB Contribution	Indicators with Targets	Outputs with ADB Contribution	Indicators with Incremental Targets (Baselines Zero)	Planned and Ongoing ADB Interventions	Main Outputs Expected from ADB Interventions
Financial institutions sustainably and safely provide financial services to a substantially increased number of clients across PNG	<p>By 2015:</p> <p>100,000 increase in households with active deposit accounts</p> <p>30,000 increase in households with current loan accounts</p> <p>The PAR30 is less than 10% (excluding loans that are 100% cash collateralized) and financial self sufficiency is less than 100% for 70% of sustainable microfinance institutions</p> <p>80% of MEP-supported MFIs and SLS comply with BPNG regulations</p>	<p>Business and product management capacity of financial institutions is increased</p> <p>Microfinance clients and potential clients understand and know how to access financial services for personal or business use</p> <p>The PNG Association of MFIs monitors jointly agreed microfinance subsector standards</p> <p>BPNG regulation and supervision of microfinance and savings and loan services is streamlined and improved</p> <p>A risk share facility supports increased MSE lending</p> <p>A collateral registry is established and operational</p>	<p>At least 85% of MEP-supported financial institutions produce accurate annual financial accounts by the end of 2013</p> <p>At least 70% of MEP trainees sign up for new financial products within 12 months after completing a training program (at least 35% of these are women)</p> <p>100% of MEP-supported financial institutions report agreed standard indicators by the end of 2015</p> <p>MFIs and SLS are classified according to risk by the end of 2013 (baseline 0)</p> <p>Risk sharing on greater than \$15 million in MSE loan portfolios established by 2015 (baseline 0)</p> <p>The first 100 security interests registered within 1 year of passing of new collateral law (baseline 0)</p>	<p><b>Planned key activity areas</b></p> <p>Microfinance (90% of funds)</p> <p>Collateral reforms (10% of funds)</p> <p><b>Pipeline projects with estimated amounts</b></p> <p>Microfinance Expansion Project (\$24.06 million)</p> <p><b>Ongoing projects with approved amounts</b></p> <p>TA 7430-REG: Private Sector Development Initiative Phase II (\$12 million)</p> <p>Regional TA with focus on access to finance, SOE reforms and PPPs, and improvements to the legal enabling environment for business</p>	<p><b>Planned key activity areas</b></p> <p>PFI sustainably and safely provide financial services to a substantially increased number of clients across PNG</p> <p><b>Pipeline projects</b></p> <p>Business and product management capacity of PFIs is increased</p> <p>Microfinance clients and potential clients understand and know how to access, financial services for personal or business use</p> <p>The PNG Association of Microfinance Institutions monitors jointly agreed subsector standards</p> <p>BPNG regulation and supervision of MFIs and SLS are streamlined and improved</p> <p>A risk-share facility supports increased lending to MSEs</p> <p><b>Ongoing projects</b></p> <p>MEP design completed</p> <p>Collateral reforms completed</p>

ADB = Asian Development Bank; BPNG = Bank of Papua New Guinea; MEP = Microfinance Expansion Project; MFI = microfinance institution; MSEs = micro and small enterprises; PAR = portfolio at risk; PFI = participating financial institution; PNG = Papua New Guinea; PPP = public-private partnership; SLS = savings and loan society; SOE = state-owned enterprise; TA = technical assistance.

Source: Asian Development Bank.