

RESTRICTED

TAR:KIR 25246

ASIAN DEVELOPMENT BANK

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TECHNICAL ASSISTANCE

TO THE

REPUBLIC OF KIRIBATI

FOR THE

COMMERCIALIZATION AND PRIVATIZATION

OF

PUBLIC ENTERPRISES

April 1992

CURRENCY EQUIVALENTS
(as of 30 January 1992)

<u>Currency Unit</u>	-	<u>Australian Dollar (A\$)</u>
A\$1.00	=	US\$0.75
US\$1.00	=	A\$1.33

Australian currency is used in Kiribati.

NOTES

- (i) The fiscal year of the Government ends on 31 December.
- (ii) In this Report, "US\$" refers to US dollars and "A\$" refers to Australian dollars.

I. INTRODUCTION

1. In July 1991 the Government of the Republic of Kiribati requested Bank technical assistance for the commercialization and privatization of selected public enterprises. In response, a Fact-Finding Mission from the Bank's South Pacific Regional Office visited Kiribati from 27 November to 6 December 1991 to review the Government's proposal. The Mission reached an understanding with Government officials on the scope and terms of reference of the proposed TA. The TA first appeared in ADB Business Opportunities in March 1992.

II. BACKGROUND

A. Government Policies for Commercialization and Privatization of Public Enterprises

2. At the time Kiribati gained independence in 1979 a shortage of skills, capital and management experience in the private sector necessitated substantial public sector involvement in a broad range of economic activities. As a result, the Government currently owns and operates most of the larger enterprises providing goods and services within the economy. These public sector enterprises operate in such areas as wholesale and retail trading, printing, food manufacture, shipping, airways, fuel supply, ownership of residential housing, public utilities, banking, insurance, hotel accommodation, telecommunications, fishing and seaweed harvesting. A total of 37 Government corporations, companies and authorities have been established for these purposes.

3. Recognizing the constraints in terms of personnel policies, financial discipline, financial management and economic development that have resulted from public sector ownership and management of many of these activities, the Government in 1989 adopted a policy framework that provides an emphasis on privatization of selected Government-owned enterprises as a means of promoting economic growth and development. Key features of this policy framework include:

- (i) the objective of divesting full or majority ownership of all Government-owned enterprises to the private sector; the policy framework, however, provides for exceptions to this approach on the grounds of "natural monopolies or strategic considerations";
- (ii) recognition of the need for privatization of the management function where privatization of ownership is held to be inappropriate;
- (iii) availability of fiscal and other incentives where considered necessary for investors to participate in privatization transactions; and
- (iv) constraints on further Government investment in activities that might compete with private sector investment.

4. To oversee the implementation of this policy framework, a Special Committee on Privatization was established. Reflecting the high priority attached to the work of that Committee, its membership was set at a senior level

including two cabinet ministers and five department heads. Since the establishment of the Special Committee, two Government corporations (Air Tungaru Co. and Kiribati Supply Co.) have been converted into limited liability companies as a preliminary step to their eventual privatization. In addition, two Government-owned companies (Telecom Kiribati Ltd. and Kiribati Oil Company Ltd.) have entered into private management arrangements, and around 25 percent of shares in Abamakoro Trading Company have been sold to private sector investors.

B. Need for the Technical Assistance

5. Despite these developments, the Government has made little real progress toward achieving its commercialization and privatization objectives. As a result, the economy retains a strong public sector character, and the underlying objective of creating a more dynamic, private sector led investment environment remains as distant as it was in 1989. The reasons for this lack of success are not completely clear. However the following factors may have been important contributors:

- (i) Kiribati does not have any form of capital market. Private sector investors have very limited means for assembling investment capital.
- (ii) Commercialization of public sector entities has not been systematic and has not been based on detailed and carefully developed strategies. The Government's approach to privatization activities has been based largely on the analysis and recommendations of two United States Agency for International Development-funded experts who visited Kiribati in 1987 for two weeks. It is unlikely that, within such a limited time, these experts would have been able to produce more than a broad outline approach to a privatization program.
- (iii) Reflecting (ii), detailed business plans for efficient and profitable operation were not produced for the public enterprises that were the subject of the initial commercialization/privatization proposals.
- (iv) For the public sector enterprises that have been changed into limited liability companies, appropriate financial restructuring in terms of their loan and equity mixes has not been undertaken. The financial status of the companies remains uncertain, which has been underscored by apparent delays in the production of up-to-date audited accounts.
- (v) No significant attempt has been made to reorganize public sector procurement practices. This has been particularly important because of the relatively high proportion of both capital and recurrent expenditures (including procurement for the private sector) that has been made through Kiribati Supply Co. Ltd.
- (vi) There is a shortage of experience and appropriate expertise within key Government departments for the development and implementation of commercialization/privatization procedures.

6. Commercialization and privatization of public enterprises may be undertaken in two stages. Stage one will be undertaken by a team of consultants provided by a consulting firm with a strong track record in commercialization/privatization activities. The firm will field a team of experts to develop fully a detailed strategy for commercialization/privatization of selected public enterprises. This strategy will have the aim of substantially meeting the Government's objectives in this regard for the period until 31 December 1994. Included in the strategy will be specific proposals for the reorganization, development and divestment of the selected public sector activities and enterprises. The public sector enterprises included for commercialization/privatization under the TA have been selected based on discussions between the Government and the Bank. The enterprises selected are listed in Appendix 1. These enterprises have total assets among them of A\$25 million.

7. Stage two would entail the implementation of the strategy and proposals developed from stage one. The particular expertise inputs required for this implementation process would be identified as part of the stage one exercise. The Government has been advised that, wherever practicable, the costs of that expertise should be carried as an operating expense by the various commercial entities that would be the subject of the commercialization/privatization process.

8. This TA is for the implementation of stage one only.

III. THE TECHNICAL ASSISTANCE

A. Objectives

9. The main objectives of the TA are to:

- (i) review the operations of the companies/enterprises listed in Appendix 1 and identify a division of the activities currently undertaken by these companies/enterprises that would best promote the development of an efficient, progressive private business sector within the country; included in this review will be a full review of public sector procurement practices and a full review of the Government's involvement in the development and ownership of residential real estate;
- (ii) develop detailed strategies for the companies/enterprises listed in Appendix 1 that will facilitate their reorganization and operation as profitable, viable, self-sustaining entities capable of meeting stated objectives in terms of the Government's social and economic objectives; these strategies should take full account of the findings from i) above;
- (iii) develop detailed business plans for each of the companies/enterprises for the period until 31 December 1994 including financial plans, business and market development plans and staffing plans;

- (iv) develop strategies, where practicable, for the eventual privatization of the companies/enterprises listed in Appendix 1 that will enable their disposition in an orderly and profitable manner by sale of shares or sale of assets; and
- (v) develop a detailed plan of action for implementing the strategies and plans developed in (ii) to (iv) above.

B. Scope

10. The TA will investigate the activities of the companies/enterprises listed in Appendix 1. The consultants' tasks will commence with a review of the work undertaken to date by the Government towards the commercialization/privatization of public enterprises and identification of the major problems encountered in that process. The consultants will then review all aspects of the operation of the companies listed in Appendix 1 including public sector procurement practices and the current policies for the Government's involvement in and management of residential real estate. From the review, specific strategies for the commercialization/privatization of all activities will be developed. The consultants' will submit (i) detailed business plans for the commercialization/privatization of all the companies/enterprises listed in Appendix 1, and (ii) detailed action plans for implementing these business plans. Included in each action plan will be recommendations for recruitment of all necessary expertise for implementation of the action plan including terms of reference for personnel considered necessary for monitoring implementation. Whether and to what extent these personnel could be paid for under a TA (from the Bank or elsewhere) will be discussed and agreed upon between the Bank and the Government at a tripartite meeting following completion of the assignment. The detailed terms of reference for the consultancy services are given in Appendix 2.

C. Manpower Requirements

11. The consulting assignment will be undertaken by a firm with strong and appropriate experience in the commercialization or corporatization of public sector enterprises and in the privatization of such enterprises. The assignment is expected to require a total of 24 man-months of consulting services and will be undertaken over a nine-month period. The team fielded by the firm will include individuals with a wide range of expertise including (but not necessarily restricted to) privatization, corporate finance, corporate law, marketing, drafting of related legislation, hotel operation, airline management, public sector procurement practices, transactions in and management of residential real estate, wholesale and retail trading, personnel recruitment and management and investment banking. A team leader appointed by the firm will be present in the field throughout the duration of the assignment. The firm will be recruited and engaged in accordance with the Bank's Guidelines on the Use of Consultants.

D. Reporting Requirements

12. The team leader will be accountable, through the Secretary of Finance and Economic Planning, to the Special Committee on Privatization. Within one month of commencing fieldwork, the team leader will present an inception report to the Secretary of Finance and Economic Planning describing a proposed work plan

for the assignment. Documentary submissions made by the consultants during the term of the assignment will be restricted to those working papers necessary for decision-making by the members of the Special Committee and the controlling authorities of the various companies/enterprises, the various enterprise-specific strategies and business plans, and the action plan for implementation of the recommendations and findings of the assignment. At the completion of the assignment, the team leader will participate in a tripartite meeting with the Government and the Bank to review the manner in which the assignment was undertaken, the likely result and the future TA requirements for implementing the consultants' recommendations.

E. Cost Estimates and Proposed Financing Arrangement

13. The total cost of the TA is estimated at US\$613,000, of which US\$569,000 will be in foreign exchange and US\$44,000 equivalent in local currency (see Appendix 3). It is proposed that the Bank finance the entire foreign exchange cost and US\$20,000 equivalent of the local currency costs, totalling US\$589,000. The TA will be charged to the Bank-funded TA program. The Government will provide the equivalent of US\$24,000 in local currency to cover the costs of counterpart staff, secretarial services, office accommodation and office supplies.

F. Implementation Arrangements

14. The Executing Agency will be the Ministry of Finance and Economic Planning.

IV. THE PRESIDENT'S DECISION

15. The President, acting under the authority delegated to him by the Board, has approved the provision of technical assistance to the Government of the Republic of Kiribati in an amount not exceeding the equivalent of US\$589,000 for the purpose of commercializing and privatizing public enterprises and hereby reports his action to the Board. This technical assistance will be made available as a grant.

ENTERPRISES TO BE COMMERCIALIZED/PRIVATIZED

Abamakoro Trading Co.

Air Tungaru Co.

Atoll Motor and Marine Services Co.

Kiribati Shipping Corporation

Kiribati Supply Co. Ltd

Marine Export Division

Otintaai Hotel Co. Ltd

Capt. Cook Hotel

Betio Shipyard

Housing Corporation

Kiribati Insurance Corporation

(References in text: page 3, para. 6; page 4, paras. 9-10)

DETAILED TERMS OF REFERENCE

The consultants' tasks will include:

- (i) a review of the progress achieved by the Government in the commercialization/privatization of public enterprises since 1988 and identification of the main problems and constraints encountered in implementation of the program;
- (ii) a review of public sector procurement practices and identification of needed changes to the procedures that could be implemented and that would have best prospects for promoting the development of healthy and sustainable growth within the private sector business community;
- (iii) a review of the Government's involvement in the ownership and management of residential housing assets and identification of needed changes to the related policies, procedures and institutional arrangements that would offer best prospects, having regard for the Government's overall economic and social goals, for promoting the development of healthy and sustainable growth within the private sector business community;
- (iv) taking full account of the findings from tasks i) to iii), identification of the needed division and reorganization of the business activities currently undertaken by the companies/enterprises listed in Appendix 1 (and any other companies/enterprises with closely related activities) that would offer best prospects for their profitable, autonomous and efficient undertaking;
- (v) preparation of policy papers and draft legislation, where necessary, for consideration by the Government to allow the establishment and operation of the various business units that would be necessary for implementing the division and reorganization of various public sector enterprises as identified from task iv) above;
- (vi) undertaking all necessary steps (including negotiation of the reorganization of the assets and liabilities) and legal functions for the incorporation of all business units as limited liability companies or similar autonomous entities;
- (vii) preparation of a three-year business plan for the operation of each business unit, including detailed business development and marketing plans, financing plans, and management and staffing plans including a staff remuneration policy's;

(Reference in text: page 4, para. 10)

- (viii) assistance with the identification of appropriate Boards of Directors and management teams for each business unit; this task will involve participation in international and local recruitment activities or in drafting of recommendations for procedures to be followed to enable successful international recruitment;
- (ix) preparation of a plan of action for the implementation of the output from tasks v) to viii) above and for the privatization or other divestment of those business units that the consultants consider can be practicably privatized or divested; included in this task should be an analysis of the range of potential purchasers of the companies to be privatized and of the types of assistance that could be provided by the Government to facilitate their purchase by Kiribati citizens; and
- (x) recommendations to the Government for further assistance required by it for implementation of the commercialization/privatization of the various business units.

COST ESTIMATES

<u>ITEM</u>	<u>FOREIGN EXCHANGE COST (US\$ '000)</u>	<u>LOCAL CURRENCY COST (US\$ '000 EQUIVALENT)</u>	<u>TOTAL COST</u>
A. <u>Financed by the Bank</u>			
Remuneration; 24 man-months @ US\$15,000	360	...	360
Per Diem @ US\$3500 per man month	84	...	84
International Travel (8 trips @ US\$4,000)	32	...	32
Domestic Travel	...	10	10
Computer, Software, and Photocopy Machine	12	...	12
Contract Negotiations	5	...	5
Vehicle Hire	...	8	8
Contingencies	76	2	78
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Subtotal	569	20	589
B. <u>Financed by the Government (in kind)</u>			
Counterpart Staff	...	15	15
Secretarial Services	...	5	5
Office Accommodation	...	2	2
Supplies	...	2	2
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Subtotal	...	24	24
TOTAL	569	44	613
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