



Report and Recommendation of the President to the Board of Directors

Project Number: 44304-01
October 2010

Proposed Loan and Administration of Grant Papua New Guinea: Microfinance Expansion Project

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 6 October 2010)

Currency Unit – kina (K)

K1.00 = \$0.3750

\$1.00 = K2.6667

ABBREVIATIONS

ADB	–	Asian Development Bank
BDS	–	business development skills
BPNG	–	Bank of Papua New Guinea
IBBM	–	Institute of Banking and Business Management
MFI	–	microfinance institution
MIS	–	management information system
MPB	–	mobile phone banking
MSEs	–	micro and small enterprises
NCFI	–	National Centre for Financial Inclusion
PFI	–	participating financial institution
PAM	–	project administration manual
PMU	–	project management unit
PNG	–	Papua New Guinea
QCBS	–	quality and cost-based selection
RSF	–	risk-share facility
SLS	–	savings and loan society

NOTE

In this report, "\$" refers to US dollars.

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PROJECT AT A GLANCE

1. Project Name: Microfinance Expansion Project		2. Project Number: 44304-01-3													
3. Country: Papua New Guinea		4. Department/Division: Pacific Department Pacific Liaison and Coordination Office in Sydney, Australia													
5. Sector Classification:	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th style="width: 50%;">Sectors</th> <th style="width: 10%;">Primary</th> <th style="width: 40%;">Subsectors</th> </tr> <tr> <td>Finance</td> <td style="text-align: center;">✓</td> <td>Microfinance</td> </tr> <tr> <td></td> <td></td> <td>Finance sector development</td> </tr> <tr> <td></td> <td></td> <td>Small and medium-sized enterprise finance and leasing</td> </tr> </table>	Sectors	Primary	Subsectors	Finance	✓	Microfinance			Finance sector development			Small and medium-sized enterprise finance and leasing		
Sectors	Primary	Subsectors													
Finance	✓	Microfinance													
		Finance sector development													
		Small and medium-sized enterprise finance and leasing													
6. Thematic Classification:	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th style="width: 50%;">Themes</th> <th style="width: 10%;">Primary</th> <th style="width: 40%;">Subthemes</th> </tr> <tr> <td>Private sector development</td> <td style="text-align: center;">✓</td> <td>Private sector investment</td> </tr> <tr> <td>Economic growth</td> <td></td> <td>Widening access to markets and economic opportunities</td> </tr> </table>	Themes	Primary	Subthemes	Private sector development	✓	Private sector investment	Economic growth		Widening access to markets and economic opportunities					
Themes	Primary	Subthemes													
Private sector development	✓	Private sector investment													
Economic growth		Widening access to markets and economic opportunities													
6a. Climate Change Impact:		6b. Gender Mainstreaming:													
Adaptation		Gender equity theme													
Mitigation		Effective gender mainstreaming													
		Some gender benefits													
		No gender elements													
7. Targeting Classification:		8. Location Impact:													
General Intervention	Targeted Intervention														
	Geographic dimensions of inclusive growth	Millennium Development Goals	Income poverty at household level												
	✓														
		Rural	High												
		Urban	Medium												
		National	Low												
		Regional													
9. Project Risk Categorization: Low															
10. Safeguard Categorization:															
		Environment	FI												
		Involuntary resettlement	C												
		Indigenous peoples	B												
11. ADB Financing:															
		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th style="width: 25%;">Sovereign/Nonsovereign</th> <th style="width: 15%;">Modality</th> <th style="width: 30%;">Source</th> <th style="width: 30%;">Amount (\$ million)</th> </tr> <tr> <td>Sovereign</td> <td>Project loan</td> <td>Asian Development Fund</td> <td>13.0</td> </tr> <tr> <td colspan="3">Total</td> <td>13.0</td> </tr> </table>		Sovereign/Nonsovereign	Modality	Source	Amount (\$ million)	Sovereign	Project loan	Asian Development Fund	13.0	Total			13.0
Sovereign/Nonsovereign	Modality	Source	Amount (\$ million)												
Sovereign	Project loan	Asian Development Fund	13.0												
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12. Cofinancing:															
		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th style="width: 40%;">Financier</th> <th style="width: 20%;">Category</th> <th style="width: 40%;">Amount (\$ million)</th> </tr> <tr> <td>Australian Agency for International Development</td> <td>Official, bilateral</td> <td>6.0</td> </tr> <tr> <td colspan="2">Total</td> <td>6.0</td> </tr> </table>		Financier	Category	Amount (\$ million)	Australian Agency for International Development	Official, bilateral	6.0	Total		6.0			
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Australian Agency for International Development	Official, bilateral	6.0													
Total		6.0													
13. Counterpart Financing:															
		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th style="width: 60%;">Source</th> <th style="width: 40%;">Amount (\$ million)</th> </tr> <tr> <td>Government (including contributions of beneficiaries) and sponsors</td> <td>5.1</td> </tr> </table>		Source	Amount (\$ million)	Government (including contributions of beneficiaries) and sponsors	5.1								
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Government (including contributions of beneficiaries) and sponsors	5.1														
14. Aid Effectiveness:															
		Parallel project implementation unit	No												
		Program-based approach	No												

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed loan, and (ii) proposed administration of a grant to be provided by the Government of Australia, both to Papua New Guinea (PNG) for the Microfinance Expansion Project.¹

2. The project will support the further development of the microfinance sector in PNG through six outputs. Outputs 1, 2, and 3 will strengthen the capacity of the microfinance industry to provide financial services to a broader cross-section of the community and strengthen the capacity of its clients and potential clients to utilize these services. Output 4 will provide appropriate regulation for, and supervision of, microfinance institutions (MFIs) and savings and loan societies (SLSs) through the Bank of Papua New Guinea (BPNG). Output 5 will increase lending to micro and small enterprises (MSEs) to increase rural income generation. Output 6 will provide efficient and effective project management services. As a result, institutions selected as participating financial institutions (PFIs), which will be identified through a series of institutional assessments, will be better able to provide profitable, appropriate, reliable, and safe financial services to financially literate clients and capable businesses, with a view to reducing poverty.

II. THE PROJECT

A. Rationale

3. The Asian Development Bank (ADB) estimates that only approximately 15% of the population in PNG has access to formal or informal banking facilities, and that this is lower in rural areas. Lack of access to financial services is an impediment to the monetization of rural economies, a constraint on the growth of MSEs, and a restraint on the mobilization of domestic capital. The project will extend and build on the experiences and lessons learned from ADB's Microfinance and Employment Project, which built a solid base for microfinance and developed microfinance as a suitable tool for rural development in PNG.²

4. Microfinance services in PNG are being supplied through 20 SLSs, 2 licensed microbanks, the National Development Bank, and around 70 small community-based nongovernment organizations. The microbanks, 6 SLSs, and 13 nongovernment organizations have indicated interest in project participation. Currently, these institutions have 43,000 microcredit borrowers and 250,000 deposit accounts. Asset growth in the licensed microbanks has exceeded 20% per annum, whereas recently there has been more moderate growth in other institutions. Overall, ADB estimates that the demand for microfinance services is more than twice the current supply. The project will improve supply and efficiency of use of financial services, especially in areas outside Port Moresby and major provincial capitals.

5. Despite earlier successes, the microfinance sector in PNG continues to face a number of development issues, including (i) lack of 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 MSEs; (v) lack of a microfinance-specific legal and regulatory framework; and (vi) lack of accepted industry-wide standards. The project will direct assistance to achieve greater impact on these issues through mutually reinforcing activities. Poverty in rural areas is significantly greater than in urban areas and women face particular issues in accessing income-generating opportunities. A key focus of the project will be improving access to credit and income-generating opportunities in rural areas and for women, both directly and through improvements in the enabling environment.

¹ The design and monitoring framework is in Appendix 1.

² ADB. 2000. *Report and Recommendation of the President to the Board of Directors: Microfinance and Employment Project for Papua New Guinea*. Manila. Cofinanced by the Australian Agency for International Development.

6. The design of the project has taken into consideration the key learnings from the Microfinance and Employment Project, i.e., that

- (i) there is widespread demand for accessible savings services relative to borrowing;
- (ii) different MFIs and SLSSs require greatly differing levels of support to properly manage their assets, liabilities, and operations;
- (iii) support for capacity development provided offsite, with poor follow up and mentoring can reduce its long term effectiveness;
- (iv) financial illiteracy, poor loan monitoring, and social and cultural factors have resulted in a high rate of arrears in all loan portfolios; and
- (v) MFIs have avoided lending, particularly to MSEs, due to repayment concerns.

7. The project is consistent with the Government of PNG's Development Strategic Plan 2010–2030, and Vision 2050, which recognize that significant progress is needed to extend financial services to the general population.³ It also aligns with the government's focus on rural development, as outlined in the 2010 budget. The project is also consistent with ADB's Strategy 2020⁴ and Pacific Approach 2010–2014,⁵ and is included in the PNG country operations business plan 2009–2011.⁶ The Microfinance and Employment Project has generated opportunities for ADB's Private Sector Operations Department that complement the project. Ongoing technical assistance is also available through the Pacific Private Sector Development Initiative–Phase II.⁷

8. Under the project, and more generally, ADB will cooperate, liaise, and engage with development partners focused on access to finance in PNG through coordination meetings and through local agency coordinators. These will include the Australian Agency for International Development as cofinancier of the project, the International Finance Corporation through its Pacific Microfinance Initiative and its broader activities, and the multidonor Pacific Financial Inclusion Program. Furthermore, under the project ADB will pursue synergies with development partners in rural development, including the World Bank and the New Zealand Aid Programme. More detail can be found in the development coordination linked document (Appendix 2).

B. Impact and Outcome

9. The project's impact will be increased economic growth led by the private sector. The outcome will be PFIs sustainably and safely providing financial services to a substantially increased number of clients across PNG.

C. Outputs

10. The project's outputs are summarized in paras. 11–19. They are more fully described in the detailed implementation plans and the project administration manual (PAM). In addition, further detail can be found in the sector assessment summary, the summary poverty reduction and social strategy, and the gender action plan (Appendix 2).

1. Business and Product Management Capacity of Participating Financial Institutions is Increased

11. This output will address low and variable capacity to manage operations, the lack of on-site training and follow up, and poor rural outreach. The Microfinance Competence Centre lists more than 90 organizations involved in microfinance in PNG. Twenty one of these organizations, which

³ Government of Papua New Guinea, Department of National Planning and Monitoring. 2010. *Development Strategic Plan 2010–2030*. Port Moresby; Government of Papua New Guinea. 2009. *Vision 2050*. Port Moresby.

⁴ ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

⁵ ADB. 2009. *ADB's Approach to Assisting the Pacific, 2010–2014*. Manila.

⁶ ADB. 2007. *Country Operations Business Plan: Papua New Guinea, 2009–2011*. Manila.

⁷ ADB. 2009. *Technical Assistance to the Pacific Region for Pacific Private Sector Development Initiative – Phase II*. Manila. Cofinanced by the Australian Agency for International Development.

vary widely in size and outreach, have expressed interest in working with the project for their development; data has been supplied by 13 of them.

12. Providers of microfinance services will undergo institutional assessments to identify areas of need and will commit to a series of substantial but realistic development milestones. It is expected that at least seven institutions will become PFIs.⁸ A system for independent monitoring, feedback, and evaluation of training will be developed and implemented. PFIs will be monitored and assessed before moving to the next level of assistance. A comprehensive training program will be developed for delivery to PFI staff. All training modules will incorporate gender issues, and training will be delivered in locations across PNG. PFIs will have the opportunity to receive on-site technical mentoring to strengthen their operations and systems. Business mentors will be assigned to each qualifying PFI to support implementation of improved accounting, management information systems (MISs), reporting, human resources, and operational and business management. Institutions failing to respond to, or not institutionalizing, support measures will risk losing access to project services.

13. All PFIs will receive training on data collection, reporting, analysis, and monitoring. Eligible PFIs will receive technical assistance to upgrade or replace their MISs, which will have the capacity to collect and report on sex-disaggregated data. Where appropriate, the project will provide support to PFIs to ensure their MISs can connect to electronic platforms such as mobile phone banking (MPB). This will extend rural outreach and reduce costs for PFIs by enabling clients to make payments remotely. The project will provide expertise in market research and microfinance product development. The consulting team will assist PFI product development staff to develop new products designed to service both existing and new market segments, including women and rural and agriculture-dependent communities.

2. Clients and Potential Clients Understand and Know How to Access Financial Services for Personal or Business Use

14. Poor financial literacy is a key inhibitor to making financial services accessible to the rural poor. To address this, the project will undertake a large-scale financial literacy training program targeting 120,000 clients and potential clients (at least 40% of whom will be women) of PFIs.⁹ Project staff will conduct initial needs assessments and design the training program and materials.¹⁰ It will include a training-of-trainers component enabling local “master” trainers to be trained. Delivery of the training will be contracted to suitably qualified field contractors (such as women’s groups, church groups, and other community-based organizations) or to PFIs themselves. PFIs will be able to influence the schedule and location of the training in accordance with their marketing and expansion strategies. This will ensure PFIs are able to offer financial services to graduating training participants. To assist with project start up and organization of activities, the government has requested that the training and curriculum development specialist and the microfinance institutional development specialist be engaged under advance action.

⁸ Eligibility criteria will be developed in consultation with the technical specialists. In general, the project will not support MFIs and SLSSs that have no clear prospect of financial sustainability within approximately 3 years, or that are unwilling to actively utilize resources to improve their operations.

⁹ Financial literacy pilot programs were undertaken in the later stages of ADB’s Microfinance and Employment Project. It is too early to determine their success, though consultations during project design indicate that (i) there is a link between participation in financial literacy training and the opening of savings accounts, and (ii) the training was useful to participants in better understanding and managing their household finances. In addition, a recent study on the impact of financial capability and competence on well-being in rural communities in the Fiji Islands found that there is a positive relationship between financial competence and household well-being in rural households. Households in which the principal financial decision makers are financially competent are more likely to manage household cash flows and to use a budget to plan future expenditure than those that did not. United Nations Development Programme. 2009. *Financial Capability, Financial Competence and Household Wellbeing in Rural Fijian Households*. Suva.

¹⁰ The training program and materials will be adapted from existing international best practice financial literacy programs. Wherever possible, curriculum and materials developed specifically for use in the Pacific context, and programs developed for indigenous communities, will be referenced.

15. To address poor business skills, PFIs will be able to access business development skills (BDS) training for clients they select to enable them to better manage and develop their businesses.¹¹ A network of BDS training providers throughout PNG will be identified and trained under the project. A subsidized voucher system will enable PFIs to select from the short list of training providers for the provision of BDS training to clients. Skills training will be delivered to 22,000 clients (20% of whom will be women), and at least 15% of the training courses will be delivered by women trainers to women-only groups.¹² A system for independent training monitoring, feedback, and evaluation will be developed and implemented.

3. The Association of Microfinance Institutions Monitors Jointly Agreed Microfinance Industry Standards

16. To develop, implement, and assist institutions to understand the importance of best practice microfinance industry-wide standards, industry associations will receive support and training to build their capacity for advocacy and development of services to industry members. Associations will be supported in identifying international and national financial and social benchmarks, such as those developed and reported internationally by the Microfinance Information Exchange (including indicators measuring women's and rural participation), and key operational indicators to be reported by association members and published on a quarterly basis.¹³ A website and publication on industry reports will be developed to support industry activities, promote transparency, and encourage improvement of microfinance industry standards.

4. Bank of Papua New Guinea Regulation and Supervision of Microfinance Institutions and Savings and Loan Societies is Streamlined and Improved

17. To address the lack of a microfinance-specific legal and regulatory framework, the project will propose a risk-based categorization of MFIs and SLSs. It will undertake a review of the Bank and Financial Institutions Act 2000 and the Savings and Loan Societies (Amendment) Act to develop recommendations for regulatory and supervisory requirements of each, as well as for MPB.¹⁴ The project will assist the BPNG to draft articles of regulation for MPB, SLSs, and each category of MFI. The BPNG will be assisted to develop a risk-based supervision approach to its off- and on-site supervision of MFIs, SLSs, and MPB providers.¹⁵ Operational procedures manuals will be developed for the Supervision Department as well as for off- and on-site supervision procedures and implementation skills. Lastly, staff of the BPNG MFI and SLS supervision units will undergo training in all new procedures developed.

5. A Risk-Share Facility Supports Increased Micro and Small Enterprise Lending

18. To address the low level of, and increasing demand for, MSE lending, a risk-share facility (RSF) will be established to share some of the default risk on PFI MSE loan portfolios and encourage them to expand these portfolios and improve lending quality.¹⁶ This will complement efforts under other project outputs and lead to increased demand for MSE borrowing and development of more relevant products, and wider outreach of lending for an expanded range of

¹¹ Research shows that the provision of business training in microfinance leads to improved business knowledge, practices, and revenues. MFIs also had direct benefits through higher repayment and client retention rates. Karlan and Valdivia. 2006. Teaching Entrepreneurship: Impact of Business Training on Microfinance Clients and Institutions *Yale Economic Discussion Center Discussion Paper No. 941*. New Haven.

¹² The remaining 85% of training courses delivered will be available to mixed or male-only groups.

¹³ See www.themix.org and www.mixmarket.org

¹⁴ Other commercial laws will also be reviewed as necessary to ensure that any project recommendations are not in conflict with them.

¹⁵ These articles of regulation contain specific directives that are not included in the legislation and are able to be modified, as the need arises, by the BPNG governor.

¹⁶ The demand for deposits in PNG outweighs the demand for borrowing. Thus, most institutions have enough funds to lend and therefore do not require direct financing. Instead they are constrained by the risks associated with lending and need assistance with risk mitigation. Lending quality is expected to improve as a result of the requirements set for participation in the facility. See the detailed implementation plans for more details (Appendix 2).

MSE borrowers and investments. It may also encourage development of commercially sustainable links with other donor programs and organizations. The RSF will be financed through ADB loan proceeds of \$5.4 million.

6. The Project Management Unit Provides Efficient and Effective Project Management Services

19. The project management unit (PMU) will coordinate the project, establish and manage project accounts, prepare work plans, carry out procurement, prepare and submit relevant reports, and monitor and evaluate project performance. To address the lack of capacity within the executing agency, support from key project consultants will be provided to assist the PMU.

D. Investment and Financing Plans

20. The project is estimated to cost \$24.06 million equivalent, including taxes and duties of \$0.91 million. The investment plan is summarized in Table 1. Detailed cost estimates by expenditure category and by financier are included in the PAM (Appendix 2).

Table 1: Project Investment Plan
(\$ million)

Item	Amount^a
A. Base Cost^b	
1. Microfinance capacity building (outputs 1, 2, 3)	13.56
2. Microfinance regulation and supervision (output 4)	0.73
3. Risk-share facility (output 5) ^c	6.92
4. Project management (output 6)	1.00
Subtotal (A)	22.21
B. Contingencies^d	1.22
C. Financing Charges During Implementation^e	0.63
Total (A+B+C)	24.06

^a Includes taxes and duties of \$0.91 million to be financed from government and beneficiary resources.

^b In mid-2010 prices.

^c This amount includes the risk share facility (\$5.4 million), the cost of consulting inputs to design the facility, and the cost of facility management.

^d Physical contingencies computed at 10% for field research, training, workshops, surveys, and studies. Price contingencies computed at 1% on foreign exchange costs in the first year, 0.5% in the second year, 0.3% in the third year, and 0.5% thereafter, and 9.5% on local currency costs in the first year, 7.5% in the second year, 4.5% in the third year, and 4.0% thereafter; includes provision for exchange rate fluctuation under the assumption of a purchasing power parity exchange rate.

^e Includes interest during implementation computed at 1% per annum for the Asian Development Bank loan.

Source: Asian Development Bank.

21. The government has requested a loan in various currencies equivalent to SDR 8,412,000 (\$13.00 million) from ADB's Special Funds resources to help finance the project. The loan will have a 32-year term, including a grace period of 8 years, an interest charge of 1.0% per annum during the grace period and 1.5% per annum thereafter, and such other terms and conditions set forth in the draft loan and project agreements. Interest during implementation on the loan will be capitalized into the loan amount.¹⁷

22. The Government of Australia will provide grant cofinancing equivalent to \$6.00 million¹⁸ as project specific funding to finance about 25% of the project costs, to be administered by ADB on a joint basis. The Government of PNG will provide counterpart funding of \$3.09 million equivalent, or

¹⁷ Transportation and insurance are eligible expenses for ADB financing.

¹⁸ Includes an ADB administration fee of \$250,000.

13% of the project cost, in the form of cash and in-kind contributions. The counterpart cash will be used to finance taxes and duties, and incremental recurrent costs. PFIs will fund the costs of computer hardware and software and 25% of their staff training costs, largely through capital increases, which are likely to be required by regulatory capital requirements. Beneficiary households and businesses accessing project training services will finance 16% of such costs.¹⁹ The financing plan is shown in Table 2, and further detail is available in the PAM (Appendix 2).

Table 2: Financing Plan

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank	13.00	54.0
Government of Australia ^a	6.00	25.0
PFIs and beneficiaries	1.97	8.2
Government	3.09	12.8
Total	24.06	100.0

PFI = participating financial institution.

^a This amount includes the Asian Development Bank's administration fee, audit cost, bank charges, and provision for foreign exchange fluctuations (if any), to the extent that these items are not covered by the interest and investment income earned on this grant, or any additional grant contribution by the Government of Australia.

Source: Asian Development Bank.

E. Implementation Arrangements

23. The National Centre for Financial Inclusion (NCFI) will be formed from the current Microfinance Competence Centre under the Institute for Banking and Business Management (IBBM). Until NCFI is established, IBBM will be the implementing agency for outputs 1, 2, and 3 and will be assisted by about seven administrative staff that will be recruited to work in the NCFI. Once established as an independent entity, within approximately 9 months of the beginning of project implementation, the NCFI will replace the IBBM as the implementing agency for outputs 1, 2, and 3. The NCFI will also be supported by international and national consultants. It will generate revenue from PFIs and client contributions to training costs, as well as from other services it may provide. At the time of the project's midterm review, an assessment of the post-project role of the NCFI will be undertaken, and a plan developed to ensure that it is able to generate sufficient revenue or attract further donor funding to continue its activities.

24. Implementation arrangements are summarized in Table 3 and described in detail in the PAM.

Table 3: Implementation Arrangements

Aspects	Arrangements
Implementation period	1 January 2011–31 December 2017
Estimated project completion date	31 December 2017
Loan and grant closing date	30 June 2018
Project management	
(i) Project steering committee	BPNG (chair), DFCD, DNPM, AMFI, FESALOS, IBBM, DOT, SBDC, PMU (secretary), ADB, AusAID (observers)
(ii) Executing agency	BPNG
(iii) Project management unit	Headed by a project manager for output 6
(iv) Implementing agencies	IBBM for outputs 1, 2, and 3; BPNG for output 4; DOT for output 5 ^a
a. Project implementation unit	BPNG, MFI, and SLS 1 international consultant, 2 national

¹⁹ Strong anecdotal evidence collected during broad stakeholder consultations undertaken during project design indicated that the payment of a small fee for training is accepted and expected, particularly where the participants value the training. In fact, stakeholders indicated that participants are likely to value the training more if they are required to pay a nominal fee to participate.

Aspects	Arrangements		
	supervision units	consultants, and 14 counterpart staff	
b. Project implementation unit	IBBM	5 international and 8 national consultants, 7 PIU staff	
c. Project implementation unit	DOT (with RSF manager)	1 international consultant and third-party manager, plus responsible party within DOT	
Procurement			
(i) IT software	International competitive bidding	<5 contracts	\$0.90 million
(ii) Studies and surveys	National competitive bidding	Multiple contracts	\$0.50 million
(iii) Workshops	Shopping	>7 contracts	\$0.67 million
(iv) Vehicles, furniture, computers, and website	Local shopping	4 contracts	\$0.17 million
Consulting services			
(i) Training and curriculum development specialist	Individual (advance action)	24 person-months	\$0.73 million
(ii) Microfinance institutional development specialist	Individual (advance action)	84 person-months	\$0.37 million
(iii) Consultants: International and national	QCBS, 80:20	311 person-months (1 contract)	\$3.67 million
(iv) Business mentors	QCBS, 70:30	75 person-months (1 contract)	\$0.83 million
(v) Financial literacy training	Individual / SSS / QCBS	Multiple contracts	\$4.02 million
(vi) BDS training	Individual / SSS / QCBS	Multiple contracts	\$1.14 million
(vii) PFI staff training	Individual / SSS / QCBS	Multiple contracts	\$1.46 million
(viii) RSF management	QCBS	1 contract	\$1.41 million
Advance action	The training and curriculum development specialist and microfinance institutional development specialist will be engaged under advance contracting.		
Disbursement	The loan and grant proceeds will be disbursed in accordance with ADB's <i>Loan Disbursement Handbook</i> (2007, as amended from time to time) and detailed arrangements agreed upon between the government and ADB. An RSF of \$5.4 million will be established through the direct payment method.		

ADB = Asian Development Bank, AMFI = Association of Microfinance Institutions, AusAID = Australian Agency for International Development, BDS = business development skills, BPNG = Bank of Papua New Guinea, DFCD = Department for Community Development, DNPM = Department of National Planning and Monitoring, DOT = Department of Treasury, FESALOS = Federation of Savings and Loan Societies, IBBM = Institute of Banking and Business Management, IT = information technology, MFI = microfinance institution, PFI = participating financial institution, PIU = project implementation unit, PMU = project management unit, QCBS = quality- and cost-based selection, RSF = risk-share facility, SBDC = Small Business Development Corporation, SLS = savings and loan society, SSS = single source selection.

^a The Structural Policy and Investment Division will be the responsible division within the DOT for output 5.

Source: Asian Development Bank.

25. Significant training services will be delivered through the project across PNG. Field level service delivery contractors will be engaged to deliver this training, and a panel of stakeholders and consultants will be established within the NCFI to manage the process. Contractors will be selected following ADB procurement procedures.

26. The majority of international and national consultants will be recruited through a firm using quality-and cost-based selection (QCBS) with a quality:cost ratio of 80:20. The government has requested that one international and one national consultant be engaged as individuals under advance action to enable project start-up. Business mentors will be hired through a firm using

QCBS with a quality:cost ratio of 70:30. A services firm will be engaged through QCBS to provide management services for the RSF using an 80:20 quality:cost ratio, modified for evaluation criteria.

III. DUE DILIGENCE

27. The project is expected to increase access to safe and reliable financial services for people living throughout PNG, particularly in rural areas. Extensive consultations and focus groups were undertaken with potential financial services users, policy makers, civil society, the private sector, educational institutions, and development partners during project design. Key stakeholders also participated in a workshop to review and comment on the final proposed project design. There is broad-based support for the project from all sectors.

A. Economic and Financial

28. Over the project period, approximately 18,000 jobs will be created.²⁰ It is estimated that PFI loans outstanding will increase by more than \$54.00 million, to an additional 52,000 borrowers. Approximately 60% of this increase, or around \$33.60 million, will be in MSE borrowing. Savings deposits are expected to increase by more than \$100.00 million and the number of deposit households will increase by more than 160,000.²¹ An economic and financial internal rate of return analysis was undertaken for the proposed project. The results of this analysis are heavily influenced by the mix of activities selected to represent a reasonable activity mix; a different mix would yield a different result. As such, overall rates of return are not shown. Details are in the economic and financial analysis (Appendix 2).

B. Governance

29. The BPNG was the executing agency for the ADB Microfinance and Employment Project and has the structure, skills, capacity, and authority to implement the project by establishing a PMU inside the BPNG and a project implementation unit inside the Supervision Department. Financial management and procurement assessments found satisfactory capacity in the BPNG. The IBBM has also demonstrated satisfactory financial management skills, in particular as the implementing agency for a major component of the Microfinance and Employment Project. The implementing agency for the RSF will be the Department of Treasury, although the facility will be managed by a professional manager. International and national consultants have been included in project design to support financial management and procurement activities. While the financial management, procurement, and corruption situation in PNG remains weak, the assessments show few concerns regarding such capabilities within the relevant agencies.

30. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and the BPNG. The specific policy requirements and supplementary measures are described in the PAM (Appendix 2).

C. Poverty and Social

31. Throughout PNG, lack of access to financial services, particularly in rural areas, is a major constraint on income growth for households and MSEs.²² The project's activities will increase

²⁰ This is based on one full time job being created for each \$1,843 in MSE loan disbursements.

²¹ Under the project, it is assumed that each household has approximately 1.4 deposit accounts. The total increase in the number of deposit accounts as a result of the project is therefore about 250,000. Household disposable income is a major determinant of savings volumes and households are the key focus for development of new savings products. For more detail, see the economic and financial analysis (Appendix 2).

²² It is estimated that less than 16% of the population use financial services. ADB. 2009. *Country Strategy and Program Midterm Review: Papua New Guinea, 2006–2010*. Manila.

outreach and access by building the capacity of PFIs to deliver services and products in rural areas. This will increase rural incomes and reduce poverty by stimulating informal business activity (via loan services), balancing income and expenditure, and increasing asset accumulation (via savings services). The delivery of training to clients will improve their ability to access and use financial services. Women will benefit from (i) financial literacy training; (ii) BDS training; (iii) development of new, women-focused products; (iv) gender awareness training for PFI staff; (v) improved monitoring of services and participation; and (vi) links to women-focused programs.

D. Safeguards

32. The project is classified as environmental category FI (financial intermediary), although it will be treated as category C as it is unlikely to have adverse environmental impacts. Urban microfinance borrowing is mainly for retail activities and transport. Rural microfinance borrowing is mainly for agriculture and consumer finance, such as school fees and life-cycle events such as births and funerals. The project will not finance any of the activities included in ADB's prohibited investment activities list.

33. The project will have no involuntary resettlement impacts and has been classified category C. The project does not specifically target indigenous peoples as the population is largely indigenous. Its goal to increase access to financial services will have only positive impacts for a broad cross-section of the population, particularly women and those living in rural areas. Accordingly, although the project has been classified B, an indigenous peoples plan is not required. Wide-ranging consultations across PNG to ensure that project design is sympathetic to the needs of PNG's people confirmed overwhelming support for the project. The project has been categorized as effective gender mainstreaming.

E. Risks and Mitigating Measures

34. Major risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan (Appendix 2).

Table 4: Summary of Risks and Mitigating Measures

Risks	Mitigating Measures
Project Management and Coordination	
Poor project management and project components not effectively implemented	BPNG has previous experience in managing ADB projects. PMU staff will be trained in monitoring and disbursements. PIUs have skilled staff, supported by project consultants.
Procurement	
Lack of available, appropriately qualified national consultants and counterpart staff	BPNG and implementing agencies have strong staff and experience with procuring qualified consulting services.
Delays in procurement hinder implementation of key project activities	A national procurement specialist will be engaged to establish and facilitate procurement processes. An international MIS specialist will support the PIU in identifying and procuring appropriate MISs for PFIs.
Socioeconomic	
Community and/or social constraints restrict entrepreneurial effort, demand for loans, and repayment capacity (refer to PAM Section VIII for detail)	Inclusive financial literacy training within communities Involvement of women Business skills training Deposit accounts encouraged

Risks	Mitigating Measures
Microfinance Sector	
PFI's unable to achieve financial viability	Improved supervision and regulation of MFIs and SLSs Improved accounting and loan portfolio management within PFI's, including through business mentor training Installation of improved management and control systems Design and introduction of more suitable products
PFI's averse to expansion of financial service outreach, especially in rural areas	Establishment of risk-share facility Market research/development of new products for PFI's PFI's lead in financial literacy and business skills training National and provincial workshops held to encourage commercial links with variety of organizations

ADB = Asian Development Bank, BPNG = Bank of Papua New Guinea, MFI = microfinance institution, MIS = management information system, PAM = project administration manual, PFI = participating financial institution, PIU = project implementation unit, PMU = project management unit, SLS = savings and loan society.

Source: Asian Development Bank.

IV. ASSURANCES AND CONDITIONS

35. The government and the BPNG have assured ADB that implementation of the project shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the PAM and loan documents. The government and the BPNG have agreed with ADB on certain covenants for the project, which are set forth in the loan agreement and project agreements.

36. Prior to the disbursement of the loan, the following conditions will have been satisfied:

- (i) The government will have established the project steering committee, in accordance with the PAM.
- (ii) The government will have established the PMU and will have appointed the project manager in accordance with the PAM.

V. RECOMMENDATION

37. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

- (i) the loan in various currencies equivalent to SDR 8,412,000 to Papua New Guinea for the Microfinance Expansion Project from ADB's Special Funds resources with an interest charge at the rate of 1.0% per annum during the grace period and 1.5% per annum thereafter; for a term of 32 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan and project agreements presented to the Board; and
- (ii) the administration by ADB of the grant not exceeding the equivalent of \$6,000,000 to Papua New Guinea for the Microfinance Expansion Project, to be provided by the Government of Australia.

Haruhiko Kuroda
President

6 October 2010

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
Impact Economic growth led by the private sector is enhanced	The number of people engaged in income-generating activities increases by at least 18,000 by project end	Household income and expenditure surveys ^a BPNG and MFI reports	Assumptions Access to financial services stimulates greater participation in the cash economy and entrepreneurship Data is available Risks Community and/or social constraints restrict entrepreneurial effort, demand for loans, and repayment capacity
Outcome PFIs sustainably and safely provide financial services to a substantially increased number of clients across PNG	By project end: 160,000 increase in households with active deposit accounts (baseline 187,500, 2010) 52,000 increase in households with current loan accounts (baseline 43,000, 2010) The PAR30 for PFIs is <10% (excluding loans that are 100% cash collateralized) and financial self-sufficiency is >100% by project end ^b At least 90% of participating MFIs and SLs are compliant with BPNG regulations by project end	BPNG annual reports Quarterly microfinance industry benchmarking reports Reports from PFIs, including audited financial statements	Assumptions Political stability and consistency of government policy Macroeconomic and inflationary stability The security situation does not deteriorate further MFIs respond to training, product development, and risk mitigation opportunities. Rural households respond to training opportunities Risks PFIs are unable to reach financial viability Community/social constraints restrict entrepreneurial effort, demand for loans, and loan repayment capacity
Outputs 1. Business and product management capacity of PFIs is increased 2. Clients and potential clients understand and know how to access financial services for personal or business use	At least 85% of PFIs produce accurate annual financial accounts, and quarterly portfolio performance indicators by end of year 3 At least 70% of PFIs offer new financial products (and at least 20% of these new products are women-focused) by project end At least 70% of trainees (personal and MSEs) sign up for new financial products within 6–12 months after completing the training program (and at least 35% of these are women)	BPNG annual reports Reports from PFIs, including audited financial statements AMFI and FESALOS reports Quarterly microfinance industry benchmarking reports RSF quarterly reports	Assumptions BPNG approves classification and revised regulation, and implements appropriate supervisory measures Willingness of AMFI to promote and manage industry standards PFIs are committed to utilizing and implementing project supports Participating institutions are able to qualify for the RSF Risks Lack of available, appropriately qualified national consultants and counterpart staff Delays in procurement hinder implementation of key project activities Poor project management and project

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
3. The AMFI monitors jointly agreed microfinance industry standards	50% of PFIs report agreed standard indicators by end of year 2 (with 80% reporting sex-disaggregated data) At least 90% of PFIs report agreed standard indicators by end of year 5		components not effectively implemented
4. BPNG regulation and supervision of MFIs and SLSS is streamlined and improved	80% of MFIs and SLSSs are classified according to risk and are fully supervised on- and off-site by end of year 2 At least four MFIs or SLSSs draw on the RSF by end of year 3		
5. A risk-share facility supports increased MSE lending	Total MSE loan portfolios have grown by at least \$33.00 million by project end		
6. The PMU provides efficient and effective project management services	The firm-based consulting contract is completed within 5 months of project effectiveness PMU quarterly reports are received by the PSC within 30 days of quarter end		

Activities with Milestones	Inputs																										
1. Business and product management capacity of PFIs is increased 1.1. Training staff of PFIs in microfinance services (2011–2015) 1.1.1. Establish NCFI as the PIU (2011) 1.1.2. Develop training modules/materials, train training specialists (2011) 1.1.3. Market and deliver training to staff (2011–2017) 1.1.4. 4,500 person days of training is provided to PFIs (2011–2017) 1.2. On-site technical support and mentoring (2011–2015) 1.2.1. Institutional assessments/project participation plans (2011–2012) 1.2.2. Identify, select, and field business mentors (2011–2013) 1.2.3. Implement in-house mentoring and on-site support (2011–2015) 1.3. MIS selection, procurement, and training (2011–2015) 1.3.1. Identify and review MFI MISs (2011) 1.3.2. Procure, select, and install MIS upgrades (2011–2015) 1.3.3. Produce accounts/performance indicators/reporting (by end 2012) 1.4. Market research and product development conducted (2011–2015) 1.4.1. Undertake market research (2011–2015) 1.4.2. Develop, test, and launch new products and linkages (2011–2015)	ADB: \$13.00 million <table> <tr> <th>Item</th><th>Amount (\$ million)</th></tr> <tr> <td>Outputs 1, 2, 3</td><td>4.915</td></tr> <tr> <td>Output 4</td><td>0.201</td></tr> <tr> <td>Output 5</td><td>6.865</td></tr> <tr> <td>Output 6</td><td>0.097</td></tr> <tr> <td>Contingencies</td><td>0.297</td></tr> <tr> <td>Interest during implementation</td><td>0.625</td></tr> </table> Government of Australia: \$6.00 million <table> <tr> <th>Item</th><th>Amount (\$ million)</th></tr> <tr> <td>Outputs 1, 2, 3</td><td>5.077</td></tr> <tr> <td>Output 4</td><td>0.121</td></tr> <tr> <td>Output 5</td><td>0.050</td></tr> <tr> <td>Output 6</td><td>0.308</td></tr> <tr> <td>Contingencies</td><td>0.444</td></tr> </table>	Item	Amount (\$ million)	Outputs 1, 2, 3	4.915	Output 4	0.201	Output 5	6.865	Output 6	0.097	Contingencies	0.297	Interest during implementation	0.625	Item	Amount (\$ million)	Outputs 1, 2, 3	5.077	Output 4	0.121	Output 5	0.050	Output 6	0.308	Contingencies	0.444
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Output 6	0.308																										
Contingencies	0.444																										
2. Clients understand and know how to access financial services for personal and business use 2.1. Financial literacy training for clients (2011–2015) 2.1.1. Develop new training modules and materials (2011)																											

Activities with Milestones	Inputs												
2.1.2. Identify, select, and train financial literacy training providers (2011) 2.1.3. Market and deliver training to clients (2011–2017) 2.1.4. 120,000 clients (> 40% women) trained (2011–2017) 2.2. Business development skills training for clients (2011–2015) 2.2.1. Identify, select, and train BDS training providers (2011) 2.2.2. Market and deliver training to clients (2011–2017) 2.2.3. 22,000 clients (> 20% women) trained (2011–2017) 2.2.4. >15% of BDS training delivered by women to women-only groups	Government of PNG: \$3.09 million <table> <tr> <th>Item</th><th>Amount (\$ million)</th></tr> <tr> <td>Outputs 1, 2, 3</td><td>1.773</td></tr> <tr> <td>Output 4</td><td>0.408</td></tr> <tr> <td>Output 5</td><td>0.000</td></tr> <tr> <td>Output 6</td><td>0.600</td></tr> <tr> <td>Contingencies</td><td>0.307</td></tr> </table>	Item	Amount (\$ million)	Outputs 1, 2, 3	1.773	Output 4	0.408	Output 5	0.000	Output 6	0.600	Contingencies	0.307
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Output 4	0.408												
Output 5	0.000												
Output 6	0.600												
Contingencies	0.307												
3. The AMFI monitors jointly agreed microfinance industry standards 3.1. Select benchmarks/indicators, including sex-disaggregated (2011–2012) 3.2. Establish quarterly data collection processes (2011–2012) 3.3. Publish quarterly industry reports (2012–2017) 3.4. Develop and launch website for PNG microfinance industry (2011–2012)	PFI and beneficiaries: \$1.97 million <table> <tr> <th>Item</th><th>Amount (\$ million)</th></tr> <tr> <td>Outputs 1, 2, 3</td><td>1.793</td></tr> <tr> <td>Output 4</td><td>0.000</td></tr> <tr> <td>Output 5</td><td>0.000</td></tr> <tr> <td>Output 6</td><td>0.000</td></tr> <tr> <td>Contingencies</td><td>0.175</td></tr> </table>	Item	Amount (\$ million)	Outputs 1, 2, 3	1.793	Output 4	0.000	Output 5	0.000	Output 6	0.000	Contingencies	0.175
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Output 4	0.000												
Output 5	0.000												
Output 6	0.000												
Contingencies	0.175												
4. BPNG regulation of MFIs and SLSs is streamlined and improved 4.1. Legal and regulatory reform 4.1.1. Establish requirements/classification of MFIs/SLSs (2011) 4.1.2. Draft new specific regulations for MFIs/SLSs/MPB (2011) 4.2. Strengthening of BPNG MFI/SLS/MPB supervision units 4.2.1. Develop and implement risk-based approach for supervision (2011) 4.2.2. Develop operational procedures manuals (2011) 4.2.3. Develop supervision manuals for MFIs/SLSs/MPB (2012) 4.3. Strengthening of data management 4.3.1. Establish MFI/SLS/MPB reporting requirements and formats (2011) 4.4. Capacity building BPNG MFI/SLS/MPB supervision units 4.4.1. Deliver risk-based supervision training (2011–2012) 4.4.2. Deliver training on operational procedures (2012) 4.4.3. Deliver off- and on-site supervision training (2011–2012)													
5. A RSF supports increased MSE lending 5.1. Identify the RSF manager and establish the PIU (2011) 5.2. Develop the criteria and qualifications for accessing the RSF (2011) 5.3. Market and implement the RSF (2012–2017)													
6. PMU provides efficient and effective project management services 6.1. Coordinate the project 6.2. Establish and manage project accounts 6.3. Prepare annual work plans 6.4. Select, engage, and manage consultants 6.5. Carry out procurement activities 6.6. Provide data to auditor and submit audited financials to ADB on time 6.7. Prepare and submit all reports to the PSC and ADB 6.8. Monitor and evaluate project performance													

ADB = Asian Development Bank, AMFI = Association of Microfinance Institutions, BDS = business development skills, BPNG = Bank of Papua New Guinea, FESALOS = Federation of Savings and Loan Societies, MFI = microfinance institution, MIS = management information system, MPB = mobile phone banking, MSEs = micro and small enterprises, NCFI = National Centre for Financial Inclusion, PAR = portfolio at risk, PFI = participating financial institution, PIU = project implementation unit, PMU = project management unit, PNG = Papua New Guinea, PSC = project steering committee, RSF = risk-share facility, SLS = savings and loan society.

^a A household income and expenditure survey (HIES) is being undertaken in PNG during 2010. HIESs have not been consistently undertaken in PNG in the past. Based on an agreement between the governments of Australia and PNG in 2009, an HIES will be undertaken every 5 years.

^b Portfolio at Risk 30 (PAR30) measures the outstanding principal balance of all loans past due more than 30 days as a percentage of the outstanding principal balance of all loans. Financial self-sufficiency measures business revenue (excluding grants and extraordinary items) as a percentage of total expenses adjusted for cost of funds subsidies, in-kind subsidies, and inflation.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=44304-01-3>

1. Loan Agreement
2. Grant Agreement
3. Project Agreement
4. Sector Assessment (Summary): Finance
5. Project Administration Manual
6. Contribution to the ADB Results Framework
7. Development Coordination
8. Economic and Financial Analysis
9. Country Economic Indicators
10. Summary Poverty Reduction and Social Strategy
11. Gender Action Plan
12. Risk Assessment and Risk Management Plan

Supplementary Documents

13. Financial Management Assessment
14. Procurement Assessment
15. Detailed Implementation Plans