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Re-positioning non-bank service strategy in Papua New Guinea

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Abbreviations

ADB	Asian Development Bank
AusAID	Australian Agency for International Development
BMFS	Bougainville Microfinance Scheme
BPNG	Bank of Papua New Guinea
BRI	Bank Rakyat Indonesia
BSP	Bank South Pacific
CGS	Credit Guarantee Scheme
CIC	Coffee Industry Corporation
CID	Commercial Investment Division
DAL	Department of Agriculture and Livestock
ENBSLS	East New Britain Savings and Loans Society
EPU	Economic Policy Unit
FORD	Foundation for Rural Development

HLGS	Housing Loan Guarantee Scheme
HLISS	Housing Loan Interest Subsidy Scheme
IBBM	Institute of Banking and Management
IMC	Implementation Monitoring Committee
KAM	key account management
MFI	microfinance institutions
MOA	memorandum of agreement
NEC	National Executive Council
NIS	National Investors Scheme
PFI	participating financial institution
PNG	Papua New Guinea
PNGBC	Papua New Guinea Banking Corporation
RDB	Rural Development Bank
SACS	Smallholder Agriculture Credit Scheme
SAG	Stand Alone Guarantee
SBDC	Small Business Development Corporation
SBGF	Small Business Guarantee Facility
SLS	Savings and Loan Society
TPNG	Territory of Papua New Guinea
UNDP	United Nations Development Programme
WHWCCS	Western Highlands Womens' Council Credit Scheme

The provision of financial services for rural development, or more specifically poverty alleviation, has evolved under various banners from 'subsidised credit' in the 1970s, 'microcredit' in the 1980s, and to 'microfinance' in the late 1990s. This evolution reflects the transition of world economies towards more market-based principles of economic management. It also exemplifies the realisation that the poor do not just need credits but also broader financial services, including savings and insurance products. The microfinance paradigm captures the changing perception that the poor are indeed bankable and can afford to pay market interest rates, a conception contrary to earlier positions. Microfinance institutions (MFIs) are now generally accepted as a major tool in the fight against poverty in developing countries as well as in poor urban segments of developed countries such as in Europe and the United States (Hussain, Maskooki and Gunasekaran 2001).

Examples such as those of the Grameen Bank of Bangladesh, BancoSol in Bolivia and the *unit desa* (village post) system of the Bank Rakyat Indonesia (BRI) are seen as providing lessons for poverty alleviation generally.

Attempts have been made to replicate these experiences in the Pacific. Grameen prototypes have been attempted in Fiji, Papua New Guinea (PNG) and Western Samoa. Best practice lessons from these innovative schemes have also been grafted onto development banks, credit unions and revolving funds in the region. While some positive lessons have been learnt in the Pacific from such experimentation, the overall result is such that there are wide

'expectation gaps'. Amongst the problems identified by expert commentators are the findings of McGuire (1997) that Pacific MFIs' outreach depth remained shallow and that none of the programs were operating on a sustainable basis both operationally and financially.

Increasingly, the question being asked is the one posed by Cornford (2000): given the peculiarities of the Pacific environment, is it appropriate to use one of the 'off-the-shelf' models in the Pacific or is there a need for a reassessment of client needs and subsequent innovation of products and services through market segmentation and environmental analysis? Cornford's answer to the above question is certainly in favour of the need to differentiate products and service through careful environmental and market analysis as well as through innovation. She argues that, because the poor are certainly not a homogenous group, the challenge is to develop innovative financial service mechanisms which are sustainable. The innovation aspect must meet the particular needs of the client group while the sustainability aspect refers to the achievement of repayment at rates and over periods which make the MFI financially viable. It seems most likely that this can be achieved through the emergence of a wide range of microfinance organisations and strategies with a diverse set of sound practices based on a process of learning and innovation rather than through the application of a unitary and linear set of best practices (Dunford 2000).

This need for a differentiated approach also applies to the aims of MFIs. Commentators have concluded that "it is

extremely difficult for MFIs to achieve financial self-sufficiency" even in ideal circumstances (McGuire and Conroy 2000). In other words, the goal of financial self-sufficiency for MFIs that has hitherto been idealised in the international MFI model may be overly simplistic. Even well managed programs such as Grameen are still dependent on donor support. This finding is consistent with the underlying rationale for financial market intervention that first prompted directed credit in the 1970s, one that stems from the intertwining relationship between market failure and state failure (Kavanamur 2000). Market failure results from excessive transaction costs in dealing with poor people and small business generally, while state failure in the provision of physical infrastructure and local amenities in developing countries exacerbates these transaction costs. Moreover, imperfect or asymmetric information leads to market failure in finance. So the target market of MFIs, the poor, makes financial self-sufficiency a nonsensical aim. If this market had the resources to achieve financial sustainability, the people in it would not be poor and would not require this service of MFIs.

This article considers the experience of the application of microfinance in PNG. It looks at a selection of institutions involved in microfinancing activities at various levels and in various ways. Non-microfinance schemes such as the Smallholder Agriculture Credit Scheme and the PNG Government Credit Guarantee Scheme are also included in this process for comparative purposes *vis-à-vis* managerial experiences. It then draws lessons about the difficulties they have faced. The institutions chosen include MFIs

quite similar to the Grameen-style organisation as well as state-owned organisations and a private sector savings society which have used microfinance techniques to improve their lending practices.

An overview of the landscape

A brief overview of the performance of some of the key non-bank institutions in PNG for which data are available will help paint a broader picture of the landscape. Some of these financial programs do not necessarily fall into the category of MFIs, but their experiences are instructive because they show up the successes and failures while operating under PNG business conditions. Papua New Guinea has one development bank, 1000 credit unions, 334 Grameen prototypes and 500 revolving funds serving an average rural population of five million people (McGuire 1997). Those looked at here are Liklik Dinau Abitore Trust, Western Highlands Women's Council Credit Scheme (WHWCCS), FORD Inc Microfinance, the Rural Development Bank's (RDB) Smallholder Agriculture Credit Scheme (SACS), the East New Britain Savings and Loans Scheme (ENBSLS), the Small Business Development Corporation's (SBDC) Small Business Guarantee Facility (SBGF), and the PNG Government's Credit Guarantee Schemes (CGS). The following organisations represent both state and private sector efforts aimed at stimulating the productive sectors of the PNG economy through the use of loans. The lessons drawn from this experience show just how difficult a task they face in achieving a financially sustainable basis for their operations.

Liklik Dinau

Liklik Dinau is the best known replica of the Grameen Bank experience in Papua New Guinea. Liklik Dinau emerged from the partnership of seven parties including government departments, the Papua New Guinea Banking Corporation (PNGBC), the United Nations Development Programme (UNDP), the National Council of Women, and the Foundation for Law, Order and Justice. Liklik Dinau offers a standard one-year loan and both voluntary and compulsory savings accounts which attracted a five per cent interest rate in 1999. Its target population is a minimum 50,000 disadvantaged women in rural Eastern Highlands. The scheme lends to both groups and individuals through three branches and 71 centres with a loan recovery rate of 96 per cent. Loans are disbursed on a succession basis from K300, K750 and K800. The scheme's outreach totalled 1,120 borrowers by September 1998—four years after its initiation—with a successful savings portfolio of around K113,000. Group members receive training as a prerequisite

for taking out loans and social collateral is relied upon for loan recovery, namely group liability and peer pressure. The performance of Liklik Dinau has been extensively documented elsewhere (see Fleisher 1996; Hickson et al. 1998 cited in Conroy 2000; Lacson and Zacarias 1996; AusAID 1999).

Although Liklik Dinau offers a promising model for Papua New Guinea, its performance had lagged behind expectations by the end of 2001. At the time of the author's visit to Goroka in May 2002, Liklik's operational funds had dried up and in its operations were being mothballed as further donor funds were being sought. Symptomatic of imprudent management, running costs had been covered by clients' savings, which apparently had not been adequately quarantined (Newsom, personal interview, 15 October 2002). Donors became impatient with the scheme's outreach progress as well as the slow progress towards the achievement of both operational and financial sustainability. By December 1999, the total number of members was only 2,704 but the number of outstanding loans

Table 1 Key performance indicators of Liklik Dinau/Abitore Trust, 31 December 1999

Outreach	
No. of total members	2,704
No. of outstanding loans	1,495
No. of depositors	2,704
Av. Loan size (K)	487
Av. deposit size (K)	176
Sustainability	
Portfolio at risk	>50%
Operational sufficiency	<30%
Staff productivity	135 borrowers per field officer

Source: Ennenbach, J.C., 2000. *PNG Microfinance and Employment Project: summary. The institutional landscape of microfinance in Papua New Guinea, international best practice and institutional capacity*, Bankakademie Micro Banking Competence Center, Frankfurt:39.

was 1,495 (Table 1). This translated to an overall portfolio at risk of more than 50 per cent.

A number of evaluative studies had earlier correctly pointed out potential operational difficulties. First, a UNDP review in 1998 (Hickson et al. 1998, cited in Conroy 2000) pointed out that, although the savings performance of Liklik Dinau was an outstanding aspect of the scheme at 55 per cent (K75,000) of the outstanding loan portfolio, there was no separate account for savings held at a commercial bank and therefore an absence of any reserve savings to meet contingencies. Second, an AusAID review in February 1999 cautioned that Liklik Dinau's continued operation was at stake because of a looming liquidity crisis. The scheme had earlier on been bailed out by AusAID and the Government of Papua New Guinea. After the 1999 review the two parties had injected a further A\$1.2 million over a 3-year period up to 2002 (Conroy 2000). This support was premised on the scheme meeting a set of stated performance targets, with a twice-yearly reporting schedule. The AusAID review of 1999 reasoned that, for Liklik Dinau to achieve a degree of sustainability and self-sufficiency, donor support would have to be continued beyond three years.

Clearly, although the repayment rate had improved within a year from inception, about half of all current borrowers in 1998 were in arrears, portfolio at risk was calculated at around 60 per cent, the program dropout rate was more than 40 per cent, and repeat loans were insignificant (Hickson et al. 1998, cited in Conroy 2000). A restricted range of economic activities for

which loans were being made was cited as a source of weakness. Third, Bablis' (2000) performance evaluation of Liklik Dinau, based on a questionnaire survey (12 per cent of 734 women in the Goroka area), found that although 66.3 per cent of the respondents favoured the 20 per cent interest rate on the repayment of loans, the remaining 33.7 per cent thought otherwise. This was seen by Bablis as indicating that almost one-third of the clients could choose to become wilful defaulters for one reason or another. Bablis (2000) also found that there was an equal division between clients who favoured weekly repayments and those favouring a more flexible repayment pace. This latter group supported a 'non-Grameen Bank pace' that, according to the international model, would make sustainability impossible.

A possible explanation for the observation made by Hickson et al. (1998) that half of the borrowers were in arrears in 1998 is offered by Bablis (2000:56) who found that 84.9 per cent of his respondents did not have a clue of the meaning of 'profit'. This meant that most of the Liklik Dinau borrowers operated income-generating activities with little appreciation of the profit motivation assumed in an economic way of thinking. Perhaps they were generally happy to be seen to be doing something in the name of *bisnis* with inherent underlying social/political implications related to local realities rather than to any assumption about the business cycle. This echoes the findings of Epstein (2000), who describes a young woman seller at the Gordon open market in Port Moresby who would normally pay K280 to air freight her father-in-law's

broccoli and cabbages from Mt. Hagen to Port Moresby and sell them for only K240. Although the transaction was a loss-making venture she obviously enjoyed the time she spent at the market.

In sum, although Liklik Dinau has empowered the majority of less fortunate women in the program and has underscored the high savings propensity of rural women in Goroka and generally in Papua New Guinea (see Fernando 1990, 1991), its expected goals of mass outreach, sustainability and self-sufficiency have been overly sanguine. McGuire and Conroy (2000) conclude that a long period is required for MFIs to achieve financial self-sufficiency and some degree of ongoing subsidisation from donors and governments will continue to be required. From the repayment experiences of Liklik Dinau it appears likely that factors other than time may be required where attitudes to finance are based on non-economic ways of thinking.

Western Highlands Womens' Council Credit Scheme

The Western Highlands Women's Council Credit Scheme (WHWCCS) initially emerged from a partnership between the Government of Papua New Guinea, the South Pacific Forum's Women's Bureau through the Asia Pacific Development Centre in 1982 and the National Council of Women. Of the many provinces that benefited from this scheme in the early years of credit schemes or microfinance in Papua New Guinea, Western Highlands stood out with its exceptional performance by 1995 (UNDP 1998). By the late 1990s, additional partners had come on board and others had left. New partners included the New

Zealand Government, the Department of Religion, Home and Youth Affairs, the Rural Development Bank and eventually the World Bank, which contributed K2 million to the K945,300 already in circulation.

In the Western Highlands Province, as was the case in other provinces, the RDB was used as a conduit to disburse a further grant of K490,000 from the Wingti/Chan government in 1994 as part of an overall country lending portfolio of K1.2 million. The maximum amount lent to women borrowers under the RDB's Women and Youth Scheme was K2,000 at 8 per cent, payable over two years. Kopel (2002) undertook an evaluation of this scheme and established from the Provincial Council of Women's records that 80 per cent of the RDB loans had been repaid with interest. Lending under this scheme was mainly through the extensive network of women's associations throughout the province. In response to the perceived success of this scheme, the Western Highlands Provincial Government undertook to provide further funding with an initial K1 million in 1999 and an additional K500,000 in 2000 (Kopel 2002).

Loans are disbursed from the Provincial Women's Council to associations. By 2000, there were 139 of these associations, of which 109 had received funding (Kopel 2002). The associations then passed on the funds to 7,140 groups in the six districts of the province—Hagen Central, Anglimp/South Waghi, Minj, Banj, Dei and Baiyer. The number of individuals in these groups ranged from 79 to 3,249 women. The total number of beneficiaries of the scheme was 7,140 women in 2000.

In terms of performance, it is clear that the scheme has achieved some social and

political success. It has, for instance, socially empowered the women to be independent and become self-motivated (Kopel 2002). Financial sustainability is less clear. Repayment can take up to two years because of the flexible repayment pace, unlike in the Grameen model followed by Liklik Dinau which requires weekly repayments. From the K1 million seed funding, K685,773.89 (68.6 per cent) was repaid within two years of disbursement (2000–01). By June 2001, 31.4 per cent of funds remained outstanding and by March 2002 the balance of loanable funds stood at K98,788.09 (10 per cent of seed money). As in revolving funds, repaid money was reinstated and disbursed to new associations as well as for repeat loans. The low levels of loanable funds attracted a further K500,000 from the province's 2002 annual budget. The interest rate (8 per cent) has been far below market rates which have been well above 20 per cent since 1999.

Moreover, repayment has been hampered by the existence of a splinter women's group within the province that has established a rival Women's Council. The group is affiliated to opponents of the governor of the province, who committed the seed capital. Within this opposition group there are 36 associations which owe loans amounting to K231,926. This problem is typical of schemes that are perceived to have underlying political motivations. Furthermore, while record keeping may have been up-to-date at the RDB and Women's Council offices, this was found to be wanting at the association and group levels due to the high rate of illiteracy. It is obvious that customised management training is required for loan recipients and at association and group management levels.

Foundation for Rural Development Inc.

The Foundation for Rural Development (FORD) Inc is a registered local non-government organisation founded in 1997 and based in Mt Hagen, Western Highlands Province. Although FORD is a registered training provider and partner of the SBDC, it has also entered the area of microfinance. FORD's vision is to empower people through its three development programs focusing on community development, microenterprise development and rehabilitation programs for youth (The Foundation for Rural Development, information leaflet). Its development activities are supported by its Information and Media Unit. FORD's major donors have been Protestant churches in Germany, AusAID's Community Development Scheme and the Global Environment Facility Small Grant Scheme. FORD is both a newer player in the MFI scene and has also adopted a different strategy. It targets workers who receive regular income and guarantees repayment of loans by deducting amounts directly from loan recipients' pay.

FORD commenced its microenterprise program in 1999 with donated funds totalling K300,000. Lending was primarily through community groups. In the period 1999–2001, FORD lent to 45 groups at subsidised interests ranging from 10–15 per cent. Each group had to sponsor a representative to attend a short business training course offered by FORD at a cost of K300 per person. The idea was to foster cooperative projects that would benefit the community at large. After a review of the first phase of operation (1999–2001), however, FORD found that the idea of cooperative groups did not work.

During the first phase, FORD realised that loan repayments were not forthcoming as expected and that, even with the training, management skills remained rudimentary. FORD then went through an internal brainstorming session involving all its 12 staff plus staff seconded from the government of the Western Highlands Province. This resulted in a revised strategy aimed at ensuring the sustainability of the scheme by directing its lending to a new target group of low-income earners. It is hoped that targeting low-income earners will enable these groups to act as development catalysts at the community level (Pu, personal interview, 11 May 2002). FORD needs about K2 million from donors to effect this second phase of the microfinance scheme. Successful repayment by low-income earners secured through direct payroll deductions would help build up loanable funds, which would then be on-lent to viable borrowers in the informal sector.

Prospective borrowers would be thoroughly screened on the basis of their employment record, project proposal both for individual and group, bank accounts, and character assessment via community leaders and employers. This screening process may take 3–4 weeks, after which time the lender and borrower will have to agree on how much should be deducted. Only after the first payroll deduction is actually made out to FORD will the loan be released. Lending is strictly for entrepreneurial activities rather than for consumption.

At the time of the interview, FORD had already secured the necessary 'deduction code' with the Department of Treasury,

enabling access to direct loan deduction by government departments/agencies. Within three weeks of this, a total of K60,000 had been on-lent to 20 borrowers at 30 per cent, a rate which was 10 per cent above market rate. Because the service fee charged by payroll offices for the deduction service is five per cent, the actual percentage that accrues to FORD is 25 per cent. FORD also intends to charge a 3–5 per cent fee for the business training and advisory services it provides to borrowers. Previously these services were free.

In sum, FORD's independence as an NGO has helped ensure the viability of its microenterprise promotion program and therefore its own institutional survival. From its review of the first phase of lending, FORD realised that market rates had to be charged and that an effective repayment system had to be developed given the lack of a strong loan repayment culture based on commercial trust and integrity. FORD realised that the K300,000 it had disbursed earlier was being perceived as simply a hand-out and that the culture of borrowing and repaying had to be developed from scratch. It realised also that, in an environment where villagers were used to receiving direct government handouts for political purposes, experimenting with large amounts of money for mainly start-up operations was a big mistake.

This approach is quite a contrast to the WHWCCS and Liklik Dinau operations which are dependent on government and donor funds. FORD realised that its operational costs could not be effectively catered for if it lent directly to rural clients.

The trick then was to lend first to those with the capacity to repay and then target rural borrowers at a cautious pace once the operational costs of the scheme was assured.

Smallholder Agriculture Credit Scheme

The RDB and its Smallholder Agricultural Credit Scheme is not an MFI but borrows concepts and instruments from the microfinance area to improve its service to small-scale farmers who make up a large percentage of Papua New Guinea's low-income poor. For this large state-owned institution, the relevance of the microfinance experience is not only in sustainability but also in the reduction of transaction costs. The link between the two is the role of networks, the mobilisation of social capital, and strategic alliance management skills.

The RDB began operations in Papua New Guinea in 1967 to service mainly small to medium-scale agricultural projects and enterprises. Since its inception up until 1998 the RDB was used as the main lending conduit for rural development by both donors and the government, none of whom gave much thought to how it could eventually move into financial self-sufficiency. Its failure in the last three decades to extend coverage and achieve financial sustainability has been the subject of debate. Various evaluative reports have been critical of its operational structure, investment strategy, portfolio mix, debt management, and mounting losses (Kannapiran 1995; United Nations Development Programme 1998; Bank of Papua New Guinea 1998).

A major criticism relates to excessive overhead costs that seem to have no relationship to the extent of outreach. For

instance, the RDB provided only 45,000 loans in the 20-year period from 1967–87 (United Nations Development Programme 1998). Given that 90 per cent of Papua New Guinea's 3 million people were within the RDB's target clientele during this period, this was seen as a poor performance. Throughout the 1980s and well into the 1990s its administrative costs competed with loan disbursements in most years. For instance, in 1992 the RDB disbursed loans worth K13 million at overhead costs of K11 million (Kannapiran 1995), or at over 75 per cent overhead costs of total loan disbursement. In that year, a total of 1,900 borrowers were served by 360 staff.

Excessive costs and a perception of inefficient management have effectively side-lined the RDB from participating in a number of new innovative financial schemes. Examples include the establishment of a proposed agri-business credit scheme to be housed within the Department of Agriculture and Livestock (DAL) and a Microfinance Competence Centre housed at the Institute of Banking and Business Management (IBBM) with sponsorship from the Government of Papua New Guinea, the BPNG and the ADB amounting to a total capitalisation of US\$20 million and aimed at promoting sustainable MFIs.

During the 1990s, the RDB instituted a number of innovative schemes aimed at overcoming the transaction costs that have plagued it. While many of these have failed, the lessons are crucial for the development of sustainable financial products. Although the RDB reconfigured the operational strategy using network partners, it felt

constrained by interest rate caps imposed by its mandate of delivering loans at 'affordable' rates. One such scheme that offers key lessons for a successful reform of the RDB is its Smallholder Agriculture Credit Scheme (SACS) which has been operational since 1997. The importance of the scheme lies in its attempt to root the program in the private sector with annual recapitalisation expected from commodity bodies (Department of Agriculture and Livestock 1996). Alliance partners in the scheme include the Department of Agriculture and Livestock (DAL) and eight commodity industry bodies including those of the coffee, cocoa, oil palm, copra, livestock, food crops, spices and rubber industries.

With initial funding of K10 million provided by the Government of Papua New Guinea through DAL, the scheme commenced operation on a revolving finance basis in which the principal of the loan is reinstated for further on-lending upon repayment and the RDB retains the interest portion to cover its administrative costs. The seed money given is only half of a K20 million grant that was initially agreed to by the Government of Papua New Guinea in National Executive Council (NEC) Decision No. 184/95 of 07 November 1995. The maximum loan for any one project is K10,000, and interest is charged at a subsidised rate of 5 per cent with a 3-year grace period (Rural Development Bank 1998). The maximum loan term is 10 years. The loan to each commodity sector is secured by the general guarantee provided by the seed capital itself, as no collateral is required from the borrower. The success or

failure of the scheme therefore rests entirely on the rate of default. A high rate of default will see the seed capital eroded, leaving behind few loanable funds.

Responsibilities were clearly allotted to the partners: the RDB was responsible for managing the funds, loan documentation, disbursement and collection of payments; the DAL had overall control of coordinating and sourcing funding; and industry bodies were tasked with appraising projects and providing localised extension services to loan recipients. Each partner had a coordinator and was represented on the scheme's Implementation Monitoring Committee (IMC) responsible for impact evaluation and planning future schemes. The operations of the scheme are governed by tripartite memoranda of agreement (MOA) between DAL, RDB and respective industry bodies. The MOAs outline the responsibilities and obligations of the partners involved, and several agreements have been finalised (Department of Agriculture and Livestock 1996). Individual MOAs between DAL, RDB and concerned industry bodies specifically called for the latter group to inject an annual allocation to its revolving fund. At the time of the review it was clear, however, that this had not been adhered to, with a tendency for the industries to rely solely on the seed capital. In this way, the industries behaved similarly to the participants in the MFIs discussed above.

After five years of lending (1997–2001) the scheme was suspended in early 1999 for the coffee, cocoa and livestock sectors. The reinstatement of these schemes can only happen once their respective cash positions

are restored to 50 per cent of the seed money. Since 1997, more than K12 million has been committed as loan approvals, of which K11 million has been disbursed.

A total of 3,856 farmers in the country have benefited from the scheme (Rural Development Bank 2002). The RDB had increased lending during the first two years and over 66 per cent of the total seed capital of K10 million was committed. Due to an unhealthy cash flow position, however, lending declined during the three years up to December 2001. To date, the rate of repayment does not match the speed at which loans have been written out for projects; total repayments in the five year period amount to only K3.097 million. Thus the overall position at end 2001 shows that the loan portfolio has K8.8 million, of which K6.39 million is in active portfolio and K2.4 million is categorised as bad doubtful loans (Rural Development Bank 2002). The RDB notes that arrears continue to mount at an alarming rate, thereby threatening the value of the K6.39 million loan portfolio. The cash position of the SACS is K6.140 million, of which K3.791 million is currently invested in government treasury bills.

The RDB has requested the write-off of 817 doubtful accounts valued at K2.4 million, much of which is in cocoa, copra, livestock and food crops. Only coffee, oil palm and spices have had few doubtful accounts. The relative success of coffee is partly due to the efficient management of the Coffee Industry Corporation (CIC), while the success of the oil palm industry is due to the well organised Oil Palm Industry Corporation and the structure of the industry, in which smallholder blocks

revolve around the mill operator which acts as the lead organisation. All three commodities have benefited from relatively stable prices and have well developed extension services. As in all other industries, however, road dilapidation is a real threat. For example, parts of the Highlands Highway are literally now impassable. The more poorly performing industries suffer from many familiar structural factors, but a salient debilitating factor is the heavy politicisation of their industry boards. Although this problem is not insurmountable, the failure of governments to address it effectively renders the problem intractable in the short term.

In terms of the microfinance aims of innovative service and sustainability, the SACS has only achieved levels of repayment to ensure its long-term viability where the industry partner's performance has been good. This illustrates that there is a need for SACS partners to review the scheme's repayment methodology.

Small Business Guarantee Facility

Another PNG government attempt to come to terms with the need for small-scale finance is the Small Business Guarantee Facility (SBGF), which sought to cater for the financing needs of small business, a category of business that was widely seen as being neglected by commercial banks.

The Small Business Development Corporation came into existence with the enactment of the *SBDC Act (1990)*. The *SBDC Act* empowers SBDC to develop credit and business advisory service schemes aimed at promoting small business. The Act not only established SBDC as a statutory government

entity, but also provided the possibility of it becoming a financial institution. Since its inception, SBDC has presided over the conception and development of a number of financial incentive schemes such as the working capital (raw material) assistance program, the small equipment leasing assistance program, venture capital investment, small-scale credit funds, and microcredit facilities. The performance of those programs, however, did not meet the goals that the Government of Papua New Guinea had hoped to achieve through the SBDC.

There have been few evaluation studies to gauge the performance of the various financial schemes promulgated by the SBDC. The success of the SBDC lies mainly in the business training courses it offers through its network of partners rather than with its credit management. An initial attempt to assess the impact of the SBDC's loan guarantee facility found that few small firms had actually accessed funds from three types of bank guarantees available under the SBGF, namely the Clean Loan Guarantee, Collateral Short Guarantee, and the Credit Risk Guarantee (Kavanamur 1999). Accessibility of such funds was constrained by the delivery network limitations of both the SBDC and participating financial institutions (PFIs), imperfect information which acted against firms that were not streetwise, and the unwillingness of all major commercial banks operating at that time to participate—only the Bank South Pacific (BSP) and the ANZ Banking Group were initially enthusiastic. Despite the increasing financial support given to the SBDC over the years, its performance was well below par (Kaul 1998).

One attempt to address this was the Small Business Guarantee Facility. This started with high expectations in 1996 with an initial capitalisation of K1.6 million by the Government of Papua New Guinea. Loan guarantees ranged from 50–100 per cent of principal loan and eligible loan amounts ranged from K1,000–100,000. The SBDC initially placed K500,000 each in term deposits with two PFIs at below market rates to act as guarantees for lending by the commercial banks to targeted clients.¹ It was agreed by the partners that, to help reduce default risk to the banks and ensure a reduction in interest cost to borrowers down to 10 per cent,² only 4 per cent would be paid on the SBDC guarantee deposits (Kaul 1998:32). The first loan under the scheme was made in December 1996, and up to March 1998 K840,000 loans had been disbursed resulting in K662,095 being guaranteed under the scheme. BSP was the most active PFI with K546,900 worth of loans approved for 65 per cent of the guarantee portfolio.

Despite high expectations, the actual number of loans disbursed under the scheme was no more than 30 (Weseliyaki, personal interview, 02 May 2002). Indeed, by mid 1998, a total of only 18 clients had taken out loans worth some K87,000. The scheme has been plagued by a high default rate as commercial banks have taken the easy way out in cases of default by simply calling upon the guarantee to redeem non-performing loans (Weseliyaki, personal interview, 02 May 2002).

According to the SBDC, the banks often decided not to exhaust loan recovery processes, opting instead to rely on the

SBDC's 80 per cent guarantee of the outstanding loan amount. Banks were also demanding excessive security from clients, reflecting their risk-averse nature even though their risks were negligible—risks were fully covered by the 80 per cent SBDC guarantee, 20 per cent borrower equity, and the banks' first call on mortgage of the assets of the borrower (Kaul 1998). The risk-averse nature of commercial banks vis-à-vis guarantee schemes has also been observed by Wosae (2000) in his review of the Government of Papua New Guinea's credit guarantee scheme administered through the Department of Treasury.

One of the many reasons for the low level of lending under the SBF over the past 12 years is that banks were determined to reduce their lending transaction costs by giving preference to loans above K10,000. As a result, many firms requiring lesser amounts were turned away. SBDC also defaulted in fulfilling its extension service delivery to the clients as it was difficult and costly to provide a one-to-one consultancy service (Weseliyaki, personal interview, 02 May 2002). SBDC's limited service delivery network was a major constraint in this regard. Borrowers often misused loan allocations for purposes other than for which the loan was originally obtained. Typically, this was to meet family obligations. This point demonstrates the potential 'fungibility' of loans.

The temporary closure of the SBDC due to a drastic cut in the 1999 budget did not help the cause of the organisation. In a panic move to retrench staff, the guarantee deposits placed with PFIs, which by now included the PNGBC, were withdrawn and

used for retrenchment purposes. Both the BSP and ANZ had to withhold portions of the deposits as cover for outstanding loans. The announcement that SBDC would be abolished was seized upon by many borrowers as a signal to cease repayment altogether (Longai, personal interview, 01 May 2002), which made the work of the banks difficult and heralded a break down in 'trust' between the strategic alliance partners.

The situation at the SBDC had not improved so that by 2002, donors were advising SBDC to shift its core business away from credit management, and instead concentrate on business training—an area in which it was generally perceived to be succeeding through its network partners. In his evaluation report, Kaul (1998) found a number of weaknesses within SBDC. Salient amongst these is the point that there was a lack of 'responsibility' over the years by staff in the conception, implementation and monitoring processes of the organisation's various financial programs, particularly with the raw material assistance and leasing schemes.

Kaul (1998) also found that the high default rates experienced under the SBF were due to the unworkable relationship between the banks and SBDC because banks were unwilling to commit resources towards the monitoring of loans and were less prepared to share risk factors. Kaul's view was that the SBF should have been brought in-house to give more control over loan monitoring and advisory support to clients. Major weaknesses were evident in SBDC's institutional capacity in terms of project design, implementation and monitoring capacity.

Moreover, although SBDC spoke of building network partnerships, it lacked the requisite strategic alliance management skills and qualities. In-depth interviews by the author with SBDC personnel reveal little relationship-building effort by the alliance partners, particularly on the part of SBDC because the SBGF was critical to the achievement of its strategic intent. It was counterproductive on the part of the SBDC not to devote resources to relationship building, which should have been part and parcel of an overall strategy of process management. Although SBDC had deposited guarantee funds with PFIs as financial 'hostages', the token of trust seems not to have been reciprocated by the PFIs. Because organisational outcomes are inseparable from the processes, the outcome of SBDC's efforts should not be detached from what was going on within.

PNG Government's Credit Guarantee Scheme

The Government of Papua New Guinea instituted a number of financing facilities in the 1970s and 1980s to help develop a cadre of entrepreneurs. Five schemes formed the basis of this strategy: the Credit Guarantee Scheme (CGS, up to 80 per cent), the Stand Alone Guarantee (SAG, up to 100 per cent), the Housing Loan Guarantee Scheme (HLGS), the Housing Loan Interest Subsidy Scheme (HLISS) and the National Investors Scheme (NIS).

At the outset, it must be noted that except for the housing loans most of these schemes epitomise the Government of Papua New Guinea's incapacity to manage non-bank financial services. Because of high default rates, the schemes were no longer operational by end 2001 and there are no

plans to revive them, except to salvage the scrap value of outstanding loans and to meet the huge default obligations. The obligations stood at K17.3 million on an original loan stock of K13,469,499, excluding external default called-up guarantees of K18.5 million as at 30 April 2000 (Wosae 2000).

A large portion (88 per cent) of the default obligation come under the stand-alone guarantee scheme dealt with directly by NEC and is of less importance to this article. The outstanding loans under the CGS and NIS stood at about K4 million and K15 million respectively at end 1999 (Department of Treasury, personal interviews, April–May 2002). PFIs of the schemes have also been frustrated by the slow progress in settling default guarantees. It is not the intention of this article to undertake a thorough review of these schemes except to paint a broad picture of the management styles and organisational culture of public sector organisations and the attitudes of banks and borrowers vis-à-vis government-supported credit schemes. From this, useful lessons could be gleaned for the development of MFIs in Papua New Guinea.

The performance of the various financial incentive schemes under the auspices of the Departments of Treasury and Finance has been affected by a number of factors. It has proved difficult, owing to budget constraints, to redeem the mounting default claims made by commercial banks on loans made, under the schemes' inducements, to often unviable borrowers. A review of the schemes by Wosae (2000) found that the cost of maintaining the default guarantees is very high because interest accrues daily on

account of the fact that the banks have not frozen interests on the loans. Default claims also carry penalty fees charged to the guarantor.

Within the Ministries of Treasury and Finance, shortcomings in terms of skilled human resources, management capacity and information systems have been seen as impacting on the schemes. Treasury lacks a database capable of reliably storing and retrieving information necessary for timely decisionmaking and loan tracking; often loan files go missing (Wosae 2000; Department of Finance 1996a, 1996b). Prudential management through careful record-keeping, loan application evaluation, monitoring and liaison with stakeholders, and assiduous pursuit of clients for repayment have been acutely absent due mainly to staff shortages; at the time of interviews management of the CGS effectively rested with one junior staff member within the Commercial Investment Division (CID). Attempts to collect outstanding loans by the Loans and Revenue Division were merely symbolic as the aim was to satisfy the Auditor-General's reporting requirements.

Staff constraints led Treasury to adopt a minimalist approach by choosing to depend entirely on the goodwill of banks to monitor loans and provide business advice to borrowers. Moreover, the financial facilities were housed in three different divisions at different times, first at the Economic Policy Unit (EPU), then at the CID, and later, upon failure of a scheme, at the Loans and Revenue Division. A typical case is the NIS, which ceased operations in 1989 but to date remains to be foreclosed by the Loans and Revenue Division.

In terms of management culture, the Ministries of Treasury and Finance appear to have failed to nurture a management and prudential culture conducive to managing lending portfolios over time (Department of Finance 1996a, 1996b). Interviews by the author revealed a lack of staff exchanges between the PFIs and Treasury to learn each other's culture as a way of generating a cultural fit, meaningful communication and networking. The management of such soft issues has been proven to be a vital ingredient in strategic alliance management, as it oils the relationship and develops mutual trust which can facilitate the prompt resolution of conflicts (Yoshino and Rangan 1995; Buttery and Buttery 1994).

In terms of process management, little effort has been put into relationship building processes and this has resulted in a breakdown in trust between the guarantor, banks and borrowers. Banks on their part have been accused by Treasury of failing to fulfil their obligations under the MOUs to monitor and supervise loans and for failing to report regularly on their status. They have also been accused of taking the easy way out in cases of default by simply calling upon the guaranteed values of bad loans instead of first exhausting loan recovery measures. Borrowers on the other hand appear to have taken advantage of the loans by choosing to 'wilfully default' without guilt because government-supported loans are viewed as 'handouts'. The World Bank observed recently that misappropriation and non-payment of obligations have become 'common and socially acceptable' (World Bank 1999:183).

Moreover, whenever Treasury called for loan recovery measures to be exhausted

prior to any guarantee payment, banks would often delay the process resulting in additional interest accruals with penalty fees added on (Ermot, personal interview, 07/05/02). In this type of atmosphere, relationship building remains merely academic. The main losers in this game have been the tax payers.

East New Britain Savings & Loans Society

Savings and Loans Societies (SLSs) in Papua New Guinea have gone through a long period of learning. SLSs were initiated in 1961 during the Australian colonial administration of what was then known as the Territory of Papua and New Guinea (TPNG). This was part of the Reserve Bank of Australia's major effort to educate the indigenous people on money, savings, banking and credit (May 1998). This resulted in the enactment of a *Savings and Loan Societies Ordinance* passed in the Territory legislature. The early SLSs formed part of a 'pre-banking system' aimed at nurturing a savings and credit culture hitherto non-existent in a traditional society based on 'subsistence-affluence' (Fisk 1982) as well as accelerating the monetisation of a pre-capitalist economy (Epstein 1968). As is evident from the foregoing discussion, over 35 years later this task seems incomplete. The SLS movement reached its peak in the 1960s and went into decline by 1975. By the 1990s, however, reforms were instituted through the BPNG aimed at revitalising this important financial instrument.

With support from the Australian Association of Credit Unions and the BPNG, a number of resurrected SLSs have been set up primarily as savings institutions, but

with loans now secured against the borrower's savings on a 1:1 basis. The main focus goes beyond the urban salariat as a number of rural-based SLSs have been established or revived. One of these is the relatively successful ENBSLS, which now boasts of nearly 20,000 members and a savings portfolio of K10.4 million as at 4 January 2002 (East New Britain Savings & Loan Society, personal interview, 05 April 2002). Contrary to the perception that SLSs are mainly suitable for the urban salariat, the East New Britain Savings and Loans Society (ENBSLS) has proven that rural income earners could also be drawn into the system. In September 1998, 65 per cent of its membership was self-employed and rural-based (Kavanamur and Turare 1999). The experience of *Putim na Kisim* operating in Morobe and parts of the Highlands and the Bougainville Microfinance Scheme (BMFS), both of which have been assisted by the Credit Union Foundation Australia, also prove the point that rural people are bankable (Kopunye, Purumo and Newsom 1999; Newsom 2002).

A closer look at the ENBSLS reveals a number of pertinent lessons as well as concerns. First, the success of the society can be attributed to the fact that there is a constant flow of deposits from the 35 per cent of the membership who are salaried workers. The society has ensured that employees of the provincial government, other government agencies and the private sector are able to place direct deposits through payroll deductions into their savings accounts with the society. Further analysis of the break-up of savings may reveal that a good portion of savings is

actually attributable to this regular group of savers, thus ensuring that the society enjoys a degree of certainty in its investment decisions.

Second, without a closer strategic alliance with BSP, the society would not have had convenient access to an efficient banking service. The society operates three banking accounts with the BSP/PNGBC banking group—an operating account, a clearing account and a cash management account. BSP accepts deposits from the society's members anywhere in the country and performs as the clearing-house within a 14-day period. Third, the society benefits from modern accounting software recently imported from Australia at a cost of K400,000 (Tololo, personal interview, May 2002). Fourth, the society's overhead costs are always kept in check and its number of staff is less than 10, including two professional accountants.

The successes of the ENBSLS notwithstanding, the society has had to grapple with a number of management and environmental threats. First, there were management concerns in the society because delinquent loans amounting to K4–5 million had attracted a BPNG audit on the loan portfolio at the end of 2001. Concerns about increasing delinquent loans prompted the BPNG to appoint an administrator to the society for two weeks to make recommendations on a restructure of operational procedures. There were concerns that the supervisory committee and the manager had lagged behind in following up on delinquent loans, and views were expressed concerning the need for a professional manager with a background in

accounting and banking. There were concerns also that bank reconciliation had lagged behind, but it was thought that this would be easily rectified with the new accounting software.

The problem with delinquent loans stems from the fact that over half the contributors are not regular income earners, hence constant repayments could not always be guaranteed. With the price of copra and cocoa depressed, coupled with high inflation, disposable income became overstretched for many rural dwellers. A final concern relates to rising theft cases that led to the closure of two outstation posts, at Pomio and Duke of York Island.

While the longer-term prospects of SLSs in Papua New Guinea seem secured because of their minimalist approach to banking and close supervision by BPNG, concerns have been raised over the interest rate caps on lending placed by the BPNG (now at 6 per cent per annum or 1 per cent per month on the unpaid balance). Conroy (2000) suggests that there is a strong case for liberalisation of SLS interest rates.

Re-positioning lessons for financial intermediation

A number of key lessons can be gleaned from the foregoing discussion on the status of non-bank financial provision in Papua New Guinea. The lessons are both positive and negative. At the outset, a positive lesson is that the 35-year period of experimentation with financial intermediation in Papua New Guinea is now increasingly being documented both in academic works and consultancy reports. These are important

sources from which lessons could be derived for charting the course of MFIs both in Papua New Guinea and the Pacific. A number of lessons therefore abound.

First, from the foregoing review it is obvious that any over-institutionalisation of an intermediary would ultimately incur unsustainable overhead costs that would be to the detriment of the scheme's outreach and sustainability goals. This is clear from the experience of Liklik Dinau where operational funds would often soak up loanable funds as well as deposit funds if they were not adequately quarantined. High transaction costs in financial intermediation in Papua New Guinea, even where a lean structure exists, invariably justifies a continued role for donors. Transaction costs would continue to hinder the operation of financial intermediaries in Papua New Guinea for well known reasons that include low population densities, lack of local amenities, collapsing physical infrastructures, difficult geographical factors, and so on.

Second, MFIs in Papua New Guinea ought to work from the risk-averse principle that assumes at the outset that at least 50 per cent of borrowers are likely to default in any situation given the embryonic credit culture. Following from this, only 50 per cent of seed capital should be on-lent and the remaining portion should be invested in high-yielding, but risk-free investment instruments such as treasury bills, banks and finance institutions. If the capitalisation is large enough, interest income should be used to meet overhead costs; if not, government funding and donor funds would continue to be required. Interest income also has the potential to

cushion the seed capital from the corrosive effect of inflation.

Third, the use of external network design of schemes has pointed up interesting findings. In Papua New Guinea, the use of networks does not assume the same set of social capital factors evident elsewhere. In particular a PNG network strategy must be centred on the need to minimise the default risk environment. Central to this strategy of risk reduction is the establishment of a Credit Risk Assessment Centre. The idea is to keep track of the credit histories of borrowers and potential borrowers. This prompts borrowers to self-regulate to some extent, thus helping eliminate the growing culture of default. Currently, this is the practice adopted by banks, but not practised within society at large and therefore needs to be further explored. The provision of extension services and the assiduous tracking of borrowers are also pertinent.

Fourth, the use of strategic partnerships needs to be more professional. Industry bodies would do well to adopt important principles of portfolio management and key account management (KAM), which are central to demand chain management and widely used in relationship marketing and strategic alliance management (Ojasalo 2001; Bensaou 1999; Proenca and Castro 1998). A key point ventured here is the need to build relationships with clients and to treat each of them as important. By focusing on and building up a manageable set of clients one at a time, a pull effect on would-be borrowers will be set in train based on the principle of trustworthiness. The type of relationship-building espoused here goes beyond the rigid emphasis on number

crunching issues as it incorporates into the financial intermediation calculus the management of 'soft issues'. This is clearly lacking in the management of government-backed credit schemes in Papua New Guinea.

In addition to the positive lessons reviewed here, there are also negative lessons that need to be pointed out. First, government-backed guarantee schemes managed in partnership with commercial banks have largely failed. The poor state of affairs in the various guarantee schemes offered by the PNG government and also the SBGF underscore this proposition. A lack of relationship-building has led to an absence of trust and created animosity and apathy between the guarantor and PFIs. Differences in strategic and cultural fit due to a lack of bonding ensured that there was never a sustainable working relationship. In other words, the relationship was purely transactional, with the banks often being accused of opportunistic behaviour and portraying the problem of 'moral hazard'. Future attempts to revamp such schemes should begin by erasing this negative experience from the partners' institutional memories.

One can also safely infer from the negative experience with government-backed schemes that, although the intentions were noble, the failure to redesign the schemes may have inadvertently contributed to the development of the current culture of default. The current practice whereby politicians are allowed to hand-out slush funds freely in their electorates outside the normal governmental apparatus does little to eliminate this subculture. The use of

'credit schemes' in pronouncements during the 2002 election campaign is worrying because it has the potential to taint the activities of the more genuine ones. The collapse of the RDB's Oro Small Business Credit Scheme sponsored by politicians should act as a lesson for decision makers contemplating similar arrangements.

A second negative lesson is derived from the continued failure of the RDB to successfully re-invent itself in order to reduce its high overhead costs. To avoid this, the PNG government will need to change the structure of ownership at the bank to minimise the level of political involvement that has marred the bank's operations over the years.

Conclusion

The experience with financial intermediation in PNG has produced useful lessons for the re-positioning of existing schemes as well as for the design and management of new ones. As Cornford (2000) points out, MFIs and non-bank institutions generally need to be modified to suit local conditions rather than merely adopting 'off-the-shelf' models. A significant factor in this might be the acknowledgment of limitations of experience with many economically active players operating in a non-market oriented way. One explanation for the fact that the credit culture of Papua New Guinea has not matured is that much of the lending is 'security guarantee-based' rather than 'collateral-based'; these wasted resources could be put to good use elsewhere such as into a new deposit-taking Rural Development Bank (Kavanamur 2002). Attempting to apply a lending system based

on security guarantee may be asking PNG entrepreneurs to learn to 'walk' before they can 'crawl'. Efforts should be geared towards helping would-be borrowers to graduate through a spectrum of micro-small-medium-large loans. The ultimate aim, however, is not to make MFIs become ends in themselves, but to graduate clients through these schemes into more formal banking services once market and state failures are addressed. It is imperative that government-backed loans and hand-outs through the slush fund cease operation under current terms in order to stem the worrying development of a 'default culture' in the country's financial system.

This article points out that because transaction costs and asymmetric information will always be concerns, there is room for re-positioning savings and loans societies and revolving funds in order to extend outreach and achieve some degree of operational and financial sustainability. It also raises hope for the successful re-positioning of the RDB and highlights the need for financial intermediaries to adopt important management principles such as portfolio management, key account management and demand-chain management. These are useful tools which now predominate in the fields of relationship marketing and strategic alliance management. Finally, the article argues that the lack of a strong credit culture in Papua New Guinea is not insurmountable because it can be addressed over time through the development of a credit-record tracking agency and the reduction of cash hand-outs in society for political purposes.

Notes

- 1 The guarantee fund deposited in PFIs was later increased commensurate with the number of disbursed loans and default claims.
- 2 Kaul (1998) doubts whether the subsidised 10 per cent was actually charged by PFIs on the basis that the Bank of PNG thinks otherwise.

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