



Technical Assistance Report

Project Number: 50396
Knowledge and Support Technical Assistance (KSTA)
July 2017

Supporting Finance Sector and Private Sector Development in the Pacific

This document is being disclosed to the public in accordance with ADB's Public Communications Policy 2011.

Asian Development Bank

ABBREVIATIONS

| | | |
|------|---|---|
| ADB | – | Asian Development Bank |
| BIF | – | Business Investment Facility |
| DMC | – | developing member country |
| MEP | – | Papua New Guinea Microfinance Expansion Project |
| PSDI | – | Private Sector Development Initiative |
| SABS | – | Samoa Agribusiness Support Project |
| SMEs | – | small and medium-sized enterprises |
| TA | – | technical assistance |

NOTE

In this report, “\$” refers to United States dollars.

| | |
|-------------------------|---|
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KNOWLEDGE AND SUPPORT TECHNICAL ASSISTANCE AT A GLANCE

| | | | |
|---|---|--|------------------------|
| 1. Basic Data | | Project Number: 50396-001 | |
| Project Name | Supporting Finance Sector and Private Sector Development in the Pacific (formerly Supporting Financial Sector and Private Sector Operations in the Pacific) | Department /Division | PARD/PLCO |
| Nature of Activity | Policy Advice | Executing Agency | Asian Development Bank |
| Modality | Regional | | |
| Country | REG | | |
| 2. Sector | | ADB Financing (\$ million) | |
| ✓ Finance | Banking systems and nonbank financial institutions | | 0.33 |
| | Finance sector development | | 0.34 |
| | Small and medium enterprise finance and leasing | | 0.33 |
| | | Total | 1.00 |
| 3. Strategic Agenda | | Climate Change Information | |
| Inclusive economic growth (IEG) | Pillar 1: Economic opportunities, including jobs, created and expanded | Climate Change impact on the Project | Low |
| 4. Drivers of Change | | Gender Equity and Mainstreaming | |
| Governance and capacity development (GCD) | Organizational development | Some gender elements (SGE) | ✓ |
| Knowledge solutions (KNS) | Application and use of new knowledge solutions in key operational areas Knowledge sharing activities Pilot-testing innovation and learning | | |
| Partnerships (PAR) | Implementation Private Sector | | |
| Private sector development (PSD) | Conducive policy and institutional environment Promotion of private sector investment | | |
| 5. Poverty and SDG Targeting | | Location Impact | |
| Geographic Targeting | No | Nation-wide | High |
| Household Targeting | No | | |
| SDG Targeting | Yes | | |
| SDG Goals | SDG8 | | |
| 6. Risk Categorization | | Low | |
| 7. Safeguard Categorization Safeguard Policy Statement does not apply | | | |
| 8. Financing | | | |
| Modality and Sources | | Amount (\$ million) | |
| ADB | | 1.00 | |
| Knowledge and Support technical assistance: Technical Assistance Special Fund | | 1.00 | |
| Cofinancing | | 0.00 | |
| None | | 0.00 | |
| Counterpart | | 0.00 | |
| None | | 0.00 | |
| Total | | 1.00 | |

I. INTRODUCTION

1. Finance sector and private sector development is critical to the long-term prosperity of the Pacific region. Pacific region developing member countries (DMCs) of the Asian Development Bank (ADB) have developed, or are developing, their own finance sector and private sector strategies as part of their national development plans and are initiating and implementing a range of finance sector and private sector-oriented reforms.

2. This technical assistance (TA) will focus on (i) identifying critical structural constraints to finance sector development and thus private sector growth in Pacific DMCs; (ii) supporting development and processing of new projects that promote financial inclusion, investments, and private sector development; and (iii) facilitating effective engagement by ADB in these sectors.¹ Under ADB's Pacific Approach, Pacific region operations will enable value creation by supporting private sector growth and investment through legislative and financial reforms, private sector operations, and the promotion of financial inclusion.² The TA is included in the regional operations business plan, 2017–2019 for the Pacific and projects developed under this TA will be aligned with national development plans of the Pacific DMCs as well as existing work in this area.³

II. ISSUES

3. The underdeveloped finance sector has been a major constraint in the emergence of vibrant private sectors, impeding generation and flow of capital to productive sectors. This has created a perpetual reliance on public spending and external aid to support economic growth. Savings mobilization in the Pacific is low due to high fees, low deposit interest rates, and geographic remoteness, while private sector investment is constrained by structural issues and capacity limitations of financial institutions. Consequently, over half of the population in the Pacific remain outside the formal financial sector and a capital-constrained private sector is unable to generate sufficient employment and wealth creation. This is manifested in persistently low and fluctuating economic growth in the region.

4. The other significant barriers to private sector development identified in assessments conducted by ADB are (i) the high cost of providing public services; (ii) state intrusion in economic activity through outdated regulations and widespread government ownership of key services, such as power generation; (iii) communal land ownership and unclear land tenure; (iv) high labor costs resulting from thin labor markets, regulations, and the crowding out of businesses and individual investors by the public sector; (v) barriers to women's economic empowerment; (vi) outdated business laws that do not suit the needs of modern commerce that take place over substantial distances; and (vii) the failure to subject businesses and state-owned enterprises to the discipline of a competition framework.⁴

5. ADB and its partners have supported the private sector and finance sector development predominantly through the Private Sector Development Initiative (PSDI), the Pacific Business Investment Facility (BIF), the Samoa Agribusiness Support Project (SABS), and the Papua New

¹ The TA first appeared in the business opportunities section of ADB's website on 24 April 2017.

² ADB. 2016. *Pacific Approach, 2016–2020*. Manila.

³ ADB. 2016. *Regional Operations Business Plan: Pacific, 2017–2019*. Manila.

⁴ P. Holden, M. Bale, and S. Holden. 2004. *Swimming Against the Tide? An Assessment of the Private Sector in the Pacific*. Manila: ADB. ADB has documented the barriers to finance sector and private sector development in the region in the private sector assessments completed for the Cook Islands (2015), Fiji (2014 update [unpublished], 2013, 2006), the Marshall Islands (2003), Papua New Guinea (2015, 2008), Palau (2017, 2007), Samoa (2015, 2008), Solomon Islands (2016, 2005), Timor-Leste (2015), Tonga (2012, 2008), and Vanuatu (2009).

Guinea Microfinance Expansion Project (MEP). PSDI focuses on helping Pacific region DMCs improve their business environments by removing business constraints, fostering entrepreneurship, promoting business formalization, and raising productivity. BIF provides business advisory services to established small and medium-sized enterprises (SMEs) to raise commercial finance for their growth plans. Since its establishment, BIF has supported the raising of \$5.7 million for 12 companies. The SABS leverages commercial financing for agribusinesses in Samoa by providing collateral, supplemental capital, and advisory support. Since the project inception in 2014, eight agribusinesses received commercial funding with SABS support. The MEP promotes the microfinance sector in Papua New Guinea by delivering financial literacy training to individuals and small businesses, partial risk-sharing of microcredit portfolios, and supporting institutional structures for sustainable development of the microfinance sector.

6. While PSDI, BIF, SABS, MEP, and other TA projects succeeded in achieving targeted outcomes, there is a strong necessity to broaden ADB's intervention in view of persistent underdevelopment of the finance and private sectors in the Pacific. To create a sustained impact in the region, ADB needs to support DMC's to develop a cohesive set of finance and private sector development strategies to guide key initiatives, as well as serve as a road map for ADB's assistance program, based on a deeper understanding of sectoral constraints and lessons learned from existing operations. Such strategies should guide ADB operations to support finance and private sector development in the Pacific region that (i) enhance financial inclusion and efficient financial intermediation, (ii) reduce business costs through regulatory and value chain interventions, (iii) finance bankable public-private partnership projects, and (iv) support Pacific economies in developing opportunities for niche and high-value products and services. Notwithstanding the sector assessment and strategy development work, ADB has identified a number of areas of critical importance that need immediate support, including value chain inefficiencies in key SME industries, lack of scale of domestic financial institutions to operate viable lending operations, and shortage of finance or insurance for protection of private sector assets after catastrophic events.

7. This proposed TA will provide support in addressing these issues across the Pacific Department's sector operations in finance and private sector development. The TA will align with current TA support managed by ADB's Pacific Liaison and Coordination Office for developing the finance and private sectors, which are sector focus areas of that office.

III. THE TECHNICAL ASSISTANCE

A. Impact and Outcome

8. The TA is aligned with the following impacts: development-oriented policies that support productive activities; job creation; entrepreneurship; creativity and innovation; and promoting the formalization and growth of micro enterprises and SMEs, including through access to financial services.⁵ The TA will have the following outcome: project and program financing to support Pacific region finance and private sector operations is increased.⁶

B. Outputs, Methods, and Activities

9. The TA will deliver the following outputs and associated activities over 2017–2019:

⁵ ADB. 2016. *Pacific Approach, 2016–2020*. Pacific Approach Results Framework, 2016–2020 (Appendix 1). Manila.

⁶ The design and monitoring framework is in Appendix 1.

10. **Output 1. Finance sector assessment conducted and intervention strategy developed.** The structure of the finance sectors in Pacific DMCs has gradually been evolving with the entry of new regional and domestic financial institutions, the repositioning of national development banks, and the opening of new distribution channels for mobile and digital financial technologies. There is a growing need for ADB to undertake high impact demonstration projects in the Pacific finance sectors to stay relevant, especially in view of multiple challenges such as global de-risking that affects remittance flows,⁷ vulnerability of financial institutions to repeated natural disasters, and lack of harmonization among the region's finance sector regulations that impedes regional integration initiatives.

11. There is strong demand from Pacific DMCs for assistance in developing national finance sector strategies to promote financial inclusion and enhance long-term stability and resilience. The small scale of the finance sectors in these DMCs reinforces a need to focus on regional cooperation and integration initiatives, making a regional approach to finance sector strategy development appropriate. Through this TA, ADB proposes to conduct (i) finance sector assessments of the major Pacific island countries, and (ii) draft finance sector development strategies that will guide the Pacific DMCs' key finance sector initiatives and will also serve as a road map for ADB's finance sector assistance program.

12. **Output 2. Finance sector and private sector operations projects developed.** The TA will support diagnostic work on critical finance sector issues confronting the Pacific. The three areas identified for immediate focus are (i) SME value chain finance, (ii) shared services platform for financial institutions, and (iii) private sector disaster risk finance. There is flexibility under this TA to expand into other areas at a later point.

13. **Small and medium-sized enterprise value chain finance.** There is a persistent lack of access to finance by SMEs as well as absence of critical industry value chain infrastructures such as large warehouses, export marketing and distribution hubs, and testing and quality control institutions which impede growth of key SME sectors that generate employment. Consequently, there is high demand from Pacific DMCs to replicate and expand ADB's Samoa AgriBusiness Support Project to their countries.⁸ The project supports agribusiness development throughout the agriculture value chain in two complementary areas: suitable financing instruments, and business support services.

14. Through this TA, ADB will conduct diagnostic work to identify the most appropriate approach for expanding the Samoa AgriBusiness Support Project to other Pacific DMCs, including by (i) looking at the use of cash collateral by financial institutions, the use of supplemental seed capital by financial institutions to directly support SMEs and providing business advisory services to SMEs (ii) evaluating supply-side issues in SME finance by building the capacity of financial institutions in assessing and managing SME lending risks; and (iii) identifying key SME industry value chain constraints and designing projects to address those constraints.

15. **Shared services for financial institutions.** One of the key constraints to increasing access to financial services by individuals and SMEs in the Pacific, especially in non-urban areas, is the difficulties faced by domestic financial institutions in scaling-up their operations. Developing

⁷ Derisking by global banks covers a variety of phenomena, ranging from wholesale reduction in financial services, an unintended consequence of regulatory efforts or business decisions, to a risk-based implementation of international standards (for example, correspondent bank relationship terminated owing to weak controls for anti-money laundering and combating the financing of terrorism in the respondent bank).

⁸ ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Grant to the Independent State of Samoa for the Samoa AgriBusiness Support Project*. Manila.

such capacity requires operating core transaction processing platforms and support operations which is costly for financial institutions. Being efficient and streamlined is even more important for smaller financial institutions with thin profitability and staff strengths but they have little capital to invest in creating such robust operational platform and back-office environments. A regional shared services project would look at helping small financial institutions to enable them to outsource some back- and middle-office processing functions to gain efficiency and cost savings. The TA will support diagnostic work to advance this proposal.

16. The benefits gained by small financial institutions from a regional shared services platform include improved efficiency and effectiveness, increased capability to scale up operations, freed up capital, and improved risk management.

17. **Disaster risk finance.** Failure of many SMEs in the Pacific is attributable to losses suffered from catastrophic events such as cyclones, tsunamis, and floods. Banks incur post disaster loan losses from non-repayment by SMEs and are reluctant to make further lending at a time when these SMEs need finance the most for recovery. Inability of banks to insure their portfolio against disaster risks is a contributing factor to their reluctance to extend finance to the affected SMEs. Portfolio risk insurance products remain undeveloped because of high costs, limited availability of reinsurance, inadequate national disaster risk mitigation, small size of insurable portfolio in individual countries, and a general lack of awareness.

18. To address the issues of scale and risk diversification for the affordable protection of SME assets, the TA will support a diagnostic study to assess the feasibility of a regional risk-pooling platform. This platform will pool disaster-related risks from insurance companies and commercial banks across the region and transfer these pooled risks to international markets.

19. **Output 3: Generation and sharing of knowledge on finance and private sector development supported.** The knowledge program of ADB's Pacific Department seeks to (i) deepen ADB's strategic understanding of the development challenges in the Pacific region, (ii) engage in policy dialogue, (iii) support ADB's engagement in the countries and in the region, and (iv) facilitate learning and knowledge sharing from experience in the Pacific and other regions. The TA will support the generation and sharing of knowledge on finance and private sector development, consistent with the Pacific Department's knowledge program and in line with the diagnostic and knowledge work undertaken under output 1.

C. Cost and Financing

20. The TA is estimated to cost \$1,000,000 which will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF 6). The key expenditure items are listed in Appendix 2. The participating governments will provide counterpart support in the form of counterpart staff, office accommodation, office supplies, and other in-kind contributions.

D. Implementation Arrangements

21. ADB will administer the TA; select, supervise, and evaluate consultants; procure goods; organize workshops; and provide staff to act as resource persons in workshops. The TA will be implemented over 28 months, starting in July 2017. Should the need arise, ADB will seek additional financing for this TA from cofinanciers or trust funds. ADB will obtain a written confirmation of no objection before starting or financing any proposed activity in a selected DMC.

Implementation Arrangements

| Aspects | Arrangements | | |
|---|--|--|-----------|
| Indicative implementation period | July 2017–October 2019 (28 months) | | |
| Executing agency | ADB | | |
| Implementing agencies | ADB | | |
| Consultants | To be selected and engaged by ADB | | |
| | Individual consultant selection | 20 person-months of international and 25 person-months of national consulting services | \$770,000 |
| Procurement ^a | To be procured by ADB | | |
| | Shopping | Goods | \$20,000 |
| Disbursement | The TA resources will be disbursed following ADB's <i>Technical Assistance Disbursement Handbook</i> (2010, as amended from time to time). | | |
| Asset turnover or disposal arrangement upon TA completion | All equipment will be turned over to the executing agency upon TA completion. | | |

ADB = Asian Development Bank, TA = technical assistance.

^a Communications equipment, computers, printers, and other miscellaneous equipment to support TA implementation. Source: Asian Development Bank.

22. **Consulting services.** ADB will engage 20 person-months of international (up to five positions) and 25 person-months of national (up to five positions) consulting services in the following areas: economic analysis, business and market analysis, finance sector development strategies and policies, private sector development strategies and policies, institutional and organizational change, capacity development, knowledge management and communication, and monitoring and evaluation. Output-based, lump-sum contracts with a provision for fixed out-of-pocket expenditures will be used in most cases. ADB will engage the consultants in accordance with the Guidelines on the Use of Consultants (2013, as amended from time to time).⁹

23. ADB will monitor and evaluate the TA against the performance indicators in the design and monitoring framework (Appendix 1), and will disseminate good practices and lessons learned throughout TA implementation. The Pacific Department's publication series, *Issues in Pacific Development*, will be used to disseminate TA activities where relevant. The main lessons will be incorporated into the TA completion report.

IV. THE PRESIDENT'S DECISION

24. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$1,000,000 on a grant basis for Supporting Finance Sector and Private Sector Development in the Pacific, and hereby reports this action to the Board.

⁹ Terms of Reference for Consultants (accessible from the list of linked documents in Appendix 3).

DESIGN AND MONITORING FRAMEWORK

| Impact the TA is Aligned with | | | |
|---|--|--|--|
| Development-oriented policies that support productive activities, decent job creation, entrepreneurship, and creativity and innovation, and promote the formalization and growth of micro, small, and medium-sized enterprises, including through access to financial services (Pacific Approach Results Framework, 2016–2020) ^a | | | |
| Results Chain | Performance Indicators with Targets and Baselines | Data Sources and Reporting Mechanisms | Risks |
| Outcome Project and program financing to support Pacific region finance and private sector operations is increased | By 2020: Three new projects or programs covering finance or private sector operations (2017 baseline: two active projects) ^b | Approved projects | No request for follow-on ADB support from Pacific region DMCs for financing finance and private sector operations |
| Outputs 1. Finance sector assessments conducted and intervention strategy developed 2. Finance sector and private sector operations developed 3. Generation and sharing of knowledge on finance and private sector development supported | By 2019: 1a. Financial sector assessments of key Pacific DMCs conducted 1b. ADB's financial sector intervention strategies are developed 2a. Three diagnostic studies undertaken to build project and program pipeline (2017 baseline: 0) 2b. Four sector and thematic assessments undertaken (2017 baseline: one) ^c 3. Three <i>Issues in Pacific Development</i> published (2017 baseline: one) ^d | 1a. Financial sector assessment reports 1b. Report outlining ADB's financial sector development strategy 2a. Diagnostic studies 2b. Sector and thematic assessments 3. <i>Issues in Pacific Development</i> publication series | Political instability and personnel changes in key government agencies Lack of timely delivery of inputs by the government Lack of alignment of support with government national development plans |
| Key Activities with Milestones | | | |
| 1. Output 1: Financial sector assessments conducted and intervention strategy developed | | | |
| 1.1 Identify key countries for financial sector assessments, define assessment scope and methodology (to be completed by June 2018). | | | |
| 1.2 Conduct sector assessments aligned with national development priorities (to be completed by June 2019). | | | |
| 1.3 Develop financial sector intervention strategy based on lessons learned from existing operations and ADB's institutional capability (to be completed by June 2019). | | | |
| 2. Output 2: Finance and private sector project pipeline built | | | |
| 2.1 Identify areas for diagnostic studies and for sector and thematic assessments (to be completed by June 2019). | | | |
| 2.2 Engage governments and other stakeholders to discuss the diagnostic studies, the sector and thematic assessments, and the potential for new investments (to be completed by June 2019). | | | |
| 2.3 Undertake diagnostic studies and sector and thematic assessments (to be completed by June 2019). | | | |

| |
|--|
| <p>2.4 Support policy dialogue on diagnostic studies and on sector and thematic assessments (to be completed by June 2019).</p> <p>3. Output 3: Generation and sharing of knowledge on finance and private sector development supported</p> <p>3.1 Identify areas to support the generation and sharing of knowledge based on government and other stakeholder requests (to be completed by June 2019).</p> <p>3.2 Engage with governments and other stakeholders to develop knowledge products or seminars (to be completed by June 2019).</p> <p>3.3 Prepare knowledge products and undertake outreach for these products through country and regional seminars (to be completed by June 2019).</p> |
| <p>Inputs</p> <p>ADB: \$1,000,000 (grant)</p> <p>Government: The participating governments will provide counterpart support in the form of counterpart staff, office accommodation, office supplies, and other in-kind contributions.</p> |
| <p>Assumptions for Partner Financing</p> <p>Not applicable.</p> |

ADB = Asian Development Bank, DMC = developing member country, TA = technical assistance.

^a ADB. 2016. *Pacific Approach, 2016–2020*. Pacific Approach Results Framework, 2016–2020 (Appendix 1). Manila.

^b ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Grant to the Independent State of Samoa for the Samoa AgriBusiness Support Project*. Manila; and ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Administration of Grant to Papua New Guinea for the Microfinance Expansion Project*. Manila.

^c ADB. 2017. *Pacific Approach, 2016–2020*. Private Sector Assessment (Appendix 3). Manila.

^d R. Rajah. 2016. Securing Sustainability: Nauru's New Intergenerational Trust Fund and Beyond. *Issues in Pacific Development*. No. 1. Manila: ADB.

Source: Asian Development Bank.

COST ESTIMATES AND FINANCING PLAN

(\$'000)

| Item | Amount |
|--|----------------|
| Asian Development Bank^a | |
| 1. Consultants | |
| a. Remuneration and per diem | |
| i. International consultants | 400.0 |
| ii. National consultants | 190.0 |
| b. Out-of-pocket expenditures | |
| i. International and local travel | 175.0 |
| ii. Reports and communications | 5.0 |
| 2. Printed external publications ^b | 3.0 |
| 3. Goods ^c | 20.0 |
| 4. Training, seminars, workshops, forum, and conferences | |
| a. Facilitators | 20.0 |
| b. Travel cost of ADB staff acting as resource persons | 15.0 |
| c. Venue rental and related facilities | 12.0 |
| d. Participants | 60.0 |
| 5. Contingencies | 100.0 |
| Total | 1,000.0 |

ADB = Asian Development Bank, TA = technical assistance.

Note: The TA is estimated to cost \$1,000,000, of which contributions from ADB are presented in the table above. The participating governments will provide counterpart support in the form of counterpart staff, office accommodation, office supplies, and other in-kind contributions.

^a Financed by ADB's Technical Assistance Special Fund (TASF 6). TASF is considered the most appropriate funding source given the link with ADB operations, and external financing will not be pursued at this point. Should the need arise, ADB will seek additional financing for this TA from cofinanciers or trust funds.

^b ADB will disseminate external publications arising from the TA as electronic documents by default. About 200 printed copies of each publication will be produced for Pacific region developing member countries and development partners, at an estimated printing and freight cost of \$3,000.

^c Goods refers to communications equipment, computers, printers, and other miscellaneous equipment to support TA implementation. All equipment under the TA will be turned over to the executing agency or implementing agency upon TA completion.

Source: Asian Development Bank estimates.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/LinkedDocs/?id=50396-001-TARreport>

1. Terms of Reference for Consultants