



In Search of Sustainability:
**The Provision of Rural
Financial Services in Solomon Islands**





Pacific Financial Inclusion Program

The Pacific Financial Inclusion Program (PFIP) is a joint program funded by the United Nations Capital Development Fund (UNCDF), United Nations Development Program (UNDP), the European Union/Africa, Caribbean and Pacific Microfinance Framework Program (EU/ACP), the Government of Australia (AusAID) and the Government of New Zealand (NZAID) through its financial contribution to the UNDP Pacific Centre. The mission of the PFIP is to increase the number of low income and rural households, micro and small enterprises in Pacific Island Countries (PICs) that have on-going access to quality and affordable financial services. The outcome of the Program is for 250,000 new clients in the target market segment to have new and/or improved access to appropriate, sustainable financial services including, but not limited to savings, money transfers, insurance and loans. The PFIP has several instruments to achieve its outcome, including (1) generating knowledge of the demand for and supply of financial services through research; (2) sharing knowledge through workshops and conferences; (3) providing direct expert advice or making expert consulting services available to stakeholders; (4) advocating the removal of constraints to financial inclusion and (5) providing financial support to partners that can help PFIP achieve this outcome.

Pacific Financial Inclusion Program

UNDP Pacific Centre

7th Floor, Kadavu House

414 Victoria Parade, Suva, Fiji

Tel.: +679 330 0399

Fax: +679 330 1976

Website: www.pfip.org



In Search of Sustainability:
The Provision of Rural Financial Services in Solomon Islands

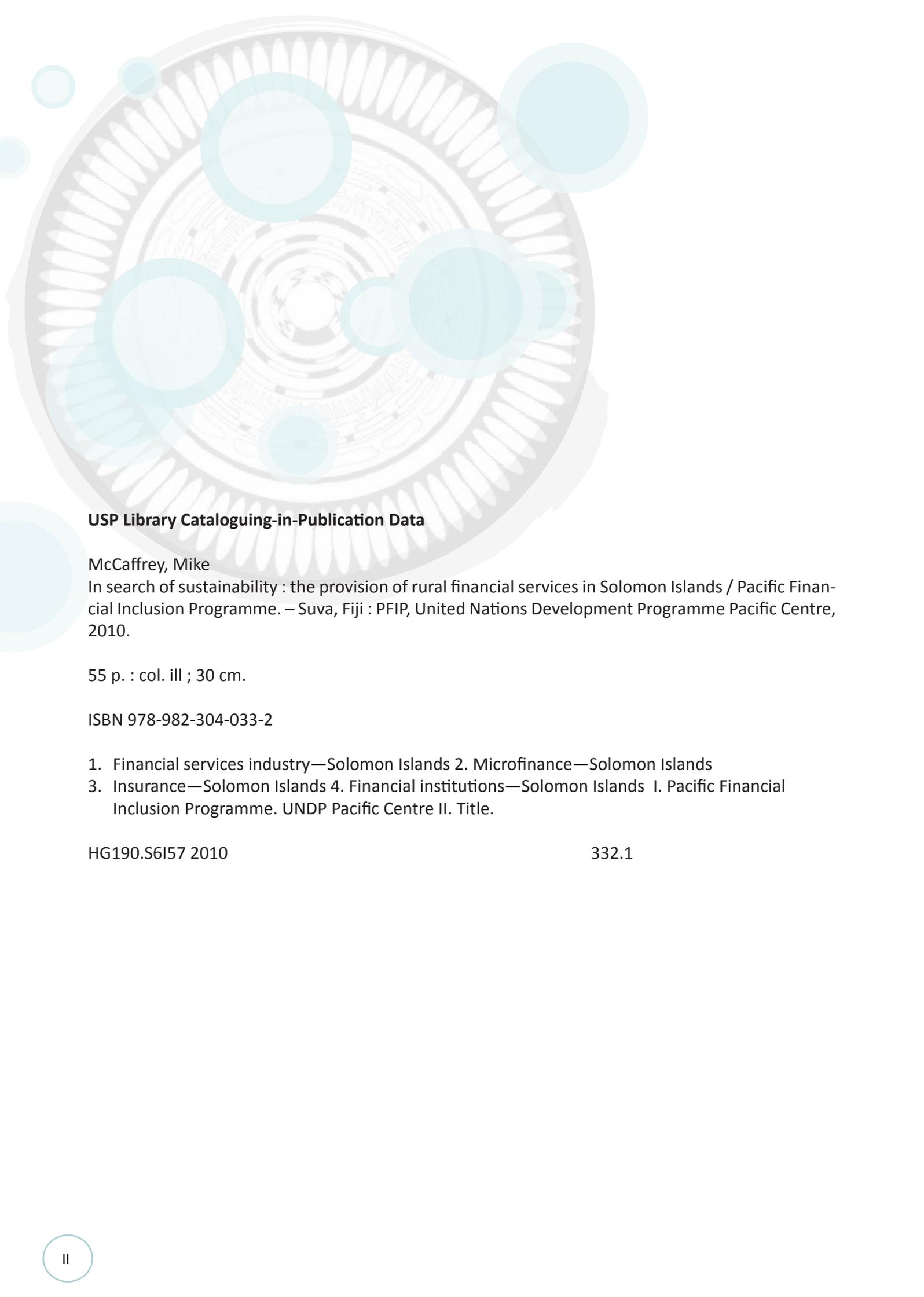
Mike McCaffrey

Drafted in cooperation with the Central Bank of Solomon Islands



November, 2010





USP Library Cataloguing-in-Publication Data

McCaffrey, Mike

In search of sustainability : the provision of rural financial services in Solomon Islands / Pacific Financial Inclusion Programme. – Suva, Fiji : PFIP, United Nations Development Programme Pacific Centre, 2010.

55 p. : col. ill ; 30 cm.

ISBN 978-982-304-033-2

1. Financial services industry—Solomon Islands
 2. Microfinance—Solomon Islands
 3. Insurance—Solomon Islands
 4. Financial institutions—Solomon Islands
- I. Pacific Financial Inclusion Programme. UNDP Pacific Centre II. Title.

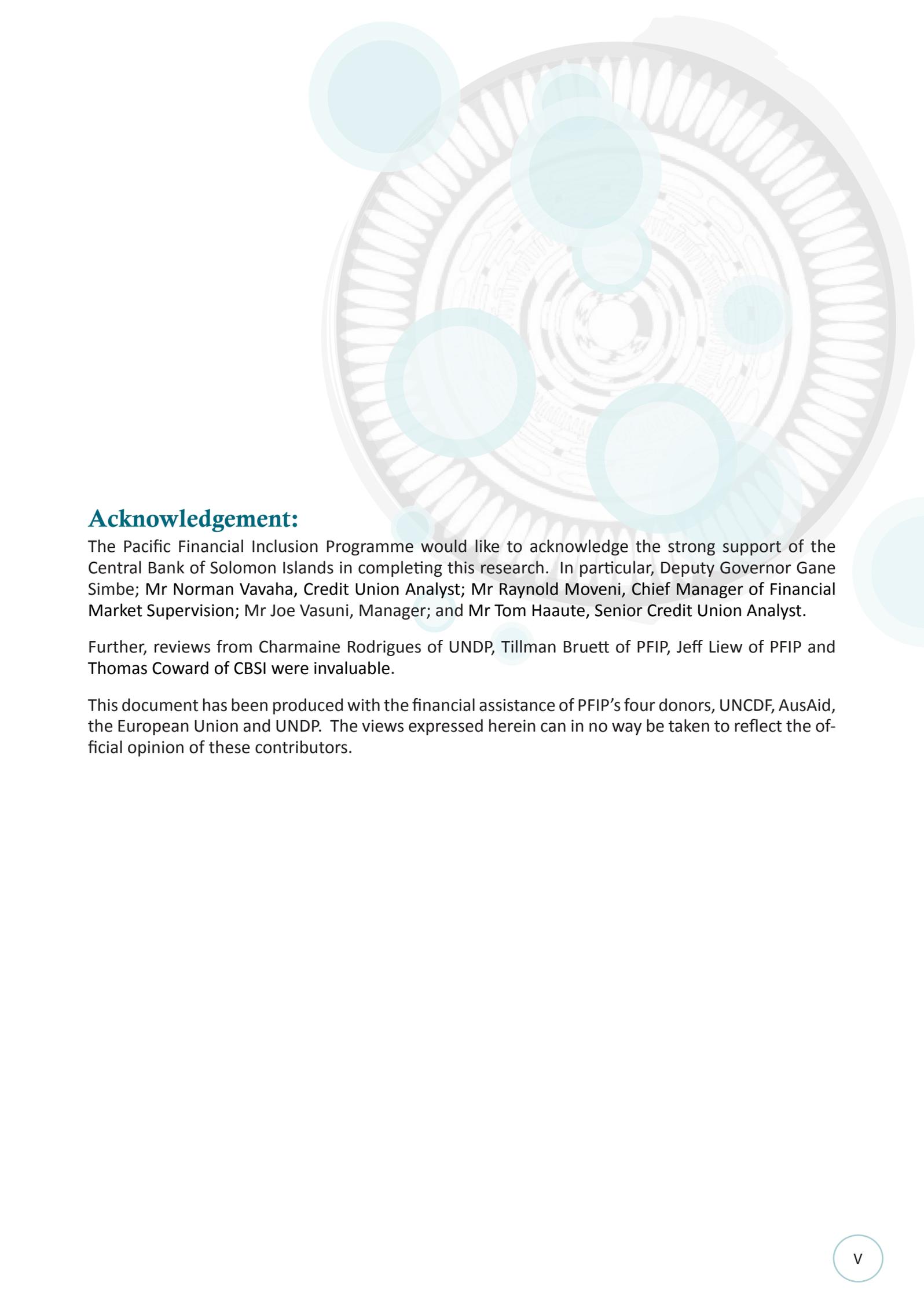
HG190.S6I57 2010

332.1

Contents

1.	Executive Summary	1	8.1.1	Bank of the South Pacific	29
2.	Scope of Paper	1	8.1.2	Australia New Zealand Banking Group	30
3.	Background	2	8.2	Public Private Partnerships	30
3.1	History of Rural Finance	2	8.2.1	ANZ Rural	30
3.2	Contemporary Theory of Inclusive Finance	3	8.2.2	ANZ/SIPC agreement	32
3.3	The Necessity of Innovation	4	8.2.3	Small Business Finance Scheme	32
3.4	History of Rural Finance in Solomon Islands	4	8.2.4	Global Environmental Facility – Sustainable Energy Financing Project	33
3.5	2005 Conference on Rural Finance	5	8.3	Credit Unions	33
4.	The Setting for Financial Services in the Solomon Islands	6	8.4	Savings Clubs	34
4.1	Demographics	6	8.5	Other Informal Mechanisms	35
4.2	Poverty Rates	7	8.5.1	Cooperatives	35
4.3	Income Inequality	7	8.5.2	Money Lenders	35
4.4	Gender Inequality	7	9.	Opportunities for Improvement	36
4.5	Financial Literacy	8	9.1	Retail Provider	37
4.6	Political System	9	9.1.1	Improving a Local Model	37
4.7	Recent History	10	9.1.2	A Greenfield	38
4.7.1	The Tensions 1998 - 2003	10	9.1.3	Mobile Money	39
4.7.2	RAMSI and Recovery 2003 to 2010	11	9.2	Raising Capital & Finding Technical Assistance	39
4.8	Economic Overview	12	9.3	Delivery Networks	39
4.8.1	International Trade	12	9.3.1	Solomon Islands Postal Corporation	40
4.8.2	Labour Market	13	9.3.2	Provincial Councils of Women	40
4.8.3	Credit Market	13	9.3.3	The School System	41
4.8.4	Official Development Assistance	14	9.3.4	Sustainable Livelihoods Programmes	41
4.9	Physical Infrastructure	15	9.4	Appropriate Products	42
4.10	Telecommunications	16	9.4.1	Microcredit	42
4.11	Business Environment	17	9.4.2	Microsavings	43
5.	The Regional Setting for Financial Services	18	9.4.3	Microinsurance	43
5.1	Western Province	19	9.4.4	Money Transfers	44
5.2	Malaita	20	9.5	Clients	45
5.3	Guadalcanal	20	Appendix 1:	Types of microloan products	46
5.4	Rural Solomon Islands: The case of Santa Isabel	21	Appendix 2:	Types of microsavings products	47
6.	The Enabling Environment and Support for Financial Services	22	Appendix 3:	Types of microsavings products	49
6.1	Legal and Regulatory Framework	22	Appendix 4:	Map of Potential Points of Service on Guadalcanal & Malaita	50
6.2	Central Bank of Solomon Islands (CBSI)	23	Appendix 5:	Map of Potential Points of Service on Western Province	51
6.3	SME Training	24	Appendix 6:	Map of Potential Points of Service on Isabel	52
6.4	Trade Unions	24	Appendix 7:	Persons Consulted	53
6.5	Credit Union Foundation of Australia	24			
6.6	Solomon Islands Credit Union League	25			
6.7	The Credit Union Revitalisation Project	26			
6.8	Microfinance Resource Centre (MRRC)	26			
7.	Financial Sector Overview	26			
7.1	Commercial Banks	26			
7.2	Insurance Companies	27			
7.3	Credit Unions	28			
7.4	Solomon Islands National Provident Fund (SINPF)	28			
8.	Rural Finance and Microfinance	29			
8.1	Formal Financial Sector	29			

- 
- Figure 1: Country Map
 - Figure 2: The Framework of Financial Inclusion
 - Figure 3: 2005 Microfinance Conference Summary of Recommendations
 - Figure 4: Rural/Urban Demographics
 - Figure 5: Breakdown of Foreign Trade
 - Figure 6: ODA by top five Donors
 - Figure 7: Notable Physical Infrastructure Projects
 - Figure 8: Costs of Telecommunications
 - Figure 9: Important Telecommunications Dates
 - Figure 10: Doing Business in Solomon Islands Ranking
 - Figure 11: Geographic Developmental Comparison
 - Figure 12: Tripod Structure of Isabel
 - Figure 13: Status of Financial Inclusion Legislation & Policy
 - Figure 14: Commercial Bank Infrastructure
 - Figure 15: The Names of the Nine Reporting Credit Union
 - Figure 16: SWOT analysis of rural finance in Solomon Islands
 - Figure 17: Credit Union Summary Statistics (December 2009)
 - Figure 18: Savings Clubs currently reporting to SICUL
 - Figure 19: An Inclusive Finance Framework for Opportunity
 - Figure 20: Solomon Island Postal Corporation Agencies



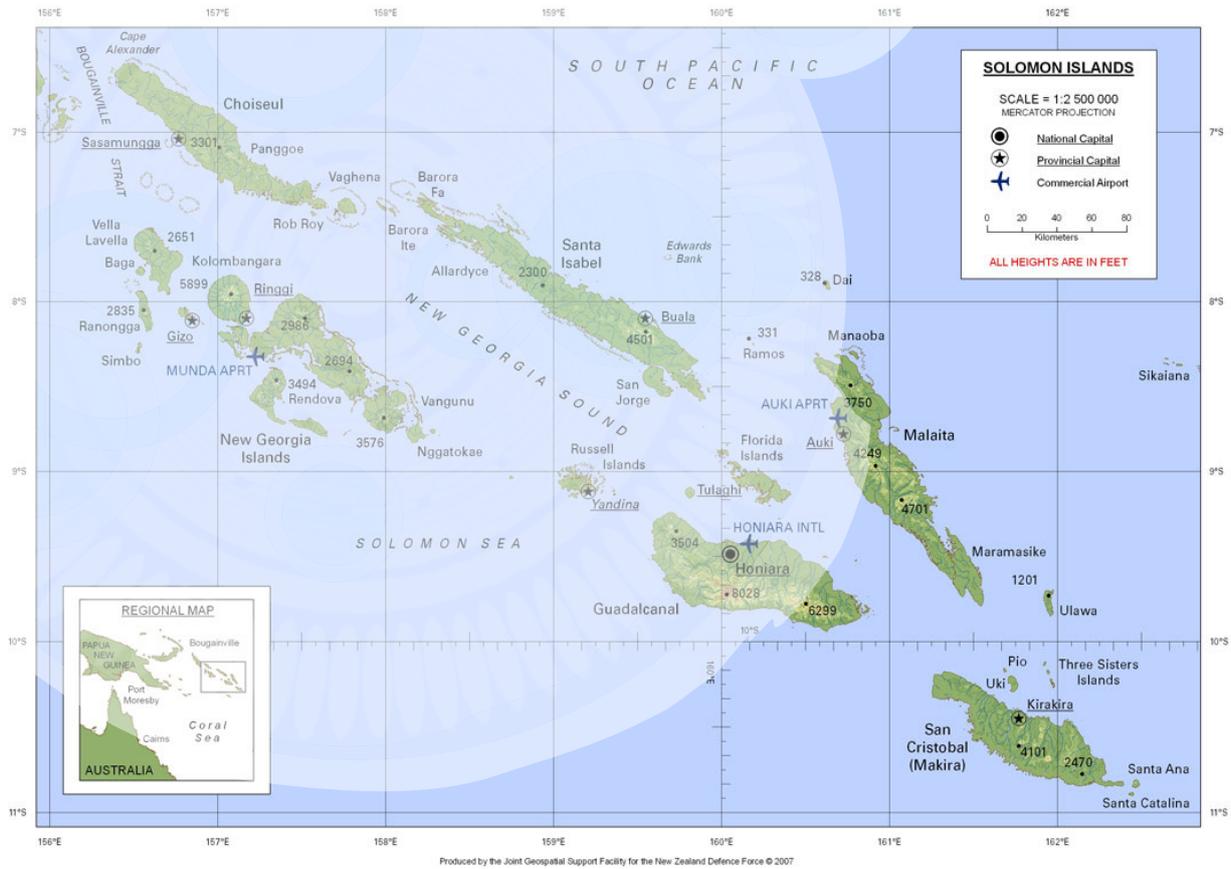
Acknowledgement:

The Pacific Financial Inclusion Programme would like to acknowledge the strong support of the Central Bank of Solomon Islands in completing this research. In particular, Deputy Governor Gane Simbe; Mr Norman Vavaha, Credit Union Analyst; Mr Raynold Moveni, Chief Manager of Financial Market Supervision; Mr Joe Vasuni, Manager; and Mr Tom Haate, Senior Credit Union Analyst.

Further, reviews from Charmaine Rodrigues of UNDP, Tillman Bruett of PFIP, Jeff Liew of PFIP and Thomas Coward of CBSI were invaluable.

This document has been produced with the financial assistance of PFIP's four donors, UNCDF, AusAid, the European Union and UNDP. The views expressed herein can in no way be taken to reflect the official opinion of these contributors.

Figure 1: Country Map



Note: The boundaries and names shown on this map do not imply official endorsement or acceptance by the United Nations.

Abbreviations

ALP	Agricultural Livelihoods Programme
AML/CFT	Anti-Money Laundering / Combating Financing Terrorism
ADB	Asian Development Bank
ANZ	Australia and New Zealand Bank Corporation
ATM	Automated Teller Machine
AusAID	Australian Agency for International Development
BSP	Bank of South Pacific
CBSI	Central Bank of Solomon Islands
CLIP	Cocoa Livelihoods Improvement Programme
CISIS	Coconut Industry Secretariat of Solomon Islands
CSP	Community Sector Programme
CUFA	Credit Union Foundation Australia
CURD	Credit Union Revitalisation Project
DBSI	Development Bank of Solomon Islands
EFPOS	Electronic Funds Point of Sale Device
EU	European Union
FAO	World Food and Agriculture Programme
FSP	Financial Service Provider
FEMM	FORUM Economic Ministers Meeting
GNI	Gross National Income
GDP	Gross National Product
GPPOL	Guadalcanal Plains Palm Oil Limited
HIES	Household Income and Expenditure Survey
HDI	Human Development Index
IFRS	International Financial Reporting Standards
IFAD	International Fund for Agricultural Development
ILO	International Labour Organisation
IMF	International Monetary Fund
IFM	Isatabu Freedom Movement
KYC	Know Your Customer
MFI	Microfinance Institution
MRRC	Microfinance Resource Centre
MoF	Ministry of Finance
MNO	Mobile Network Operator
MPG	Money Pacific Group
NBSI	National Bank of Solomon Islands
NCW	National Council of Women
ODA	Official Development Assistance
OSS	Operational Self Sufficiency
PEDF	Pacific Enterprise Development Facility
PFIP	Pacific Financial Inclusion Programme
PNG	Papua New Guinea



RAMSI	Regional Assistance Mission to Solomon Islands
SC	Savings Clubs
SME	Small and Medium Enterprises
SBFS	Small Business Finance Scheme
SBEC	Small Business Enterprises Centre
SMEC	Small to Medium Business Centre
SINPF	Solomon Island National Provident Fund
SICCI	Solomon Islands Chamber of Commerce and Industry
SICUL	Solomon Islands Credit Union League
SBD	Solomon Islands Dollar
SIG	Solomon Islands Government
SIPC	Solomon Islands Postal Service
STL	Solomon Islands Telekom Limited
SPBD	South Pacific Business Development
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
USD	US Dollar
WOCCU	World Council of Credit Unions

1. Executive Summary

Despite several attempts to provide financial services in rural areas in Solomon Islands, there has never been a model that follows global best practices or has reached sustainability on a significant scale. Despite the daunting infrastructure, political, economic and demographic impediments to doing so, sustainable models for providing rural finance have been developed all over the world including in the Pacific in neighboring Papua New Guinea, Samoa and Vanuatu. Approaches taken in other parts of the world, such as adequately supported Greenfield institutions, links with post offices and branchless banking technologies are still new to the Pacific; however they may offer the best chance to promote greater financial inclusion in Solomon Islands.

There is significant potential to offer financial services in places such as the area surrounding Honiara, the Auki-Malu'u Corridor (Malaita), and the Noro-Munda-Gizo Triangle (Western Province). These places have relatively high population densities, modern infrastructure and active economies relative to the rest of the country, and offer a small but potential market for lending. There is undoubtedly a need to bring in one or more new financial service providers, and support them financially, until they become operationally sustainable.

Outside these enclaves, there are only marginal areas of economic activity and limited financial activities. Microcredit will be challenging in rural areas without a basis of economic activity. Any new model should focus heavily on deposit taking and domestic money transfers in these areas. Some credit unions and savings clubs concentrated in Isabel province have proven resilient and may also offer an indigenous, immediate strategy for offering financial services in these very rural areas.

In order to design strategies for providing financial services in rural areas, stakeholders need to come together to take a fresh look at the problems and possibilities. As is happening elsewhere in the Pacific, many different actors will have to collaborate to address the myriad of constraints. The best way to do this will be to bring stakeholders together to have an inclusive discussion which prioritises goals and assigns agencies to implement and monitor them.

Focus Box 1: Financial services providers at a glance (June 2010)

- Three international retail commercial banks, BSP, ANZ & Westpac with 13 branches, 9 agencies and 34 ATMs, and approximately 129 EFTPOS terminals
- ANZ mobile banking has two vans used to provide banking services in rural areas
- Credit Corp Ltd in Honiara, with 2009 after tax profit of SI\$ 2.5 million (US\$ 312,500)
- The Solomon Island National Provident Fund (SINPF), a superannuation fund mandatory for salaried employees and optional for self employed, with 84,608 contributing members
- Development Bank of Solomon Islands (DBSI) now under court administration
- 175 credit unions registered, of which nine report with up to 4,010 active members
- 292 registered savings clubs, of which 18 report with up to 359 members
- Three insurance companies (one life insurer, two general insurers) and six intermediaries (three brokers and three corporate agents)
- One licensed Money Transfer agency (Western Union)
- Eight currency exchange bureaus

2. Scope of Paper

This report comments on all levels of the financial ecosystem in Solomon Islands, with a particular focus on the micro-level, specifically the retail financial services being provided in rural areas. It begins with a brief history of rural finance in Solomon Islands and then outlines the current situation. The general conclusion is that there is no sustainable provision of rural financial services in Solomon

Islands and that do so would involve substantial changes on all levels, a coordinated effort among stakeholders, and smarter investment in sustainable solutions. A few general recommendations are offered at the end, with a suggestion that stakeholders themselves need to take ownership of this effort.

The discussion on the history of rural financial services around the world and in Solomon Islands is to show the importance and possibility of sustainable rural finance as the starting point for stakeholders. Sustainability, and even the belief in it, has been the big missing link in previous models even while it is unanimously considered a best practice around the world. At the same time, the paper puts forward the depth and complexity of some of impediments to sustainable rural finance models, in order to make the argument that any solution will have to be designed and implemented by an array of stakeholders from various positions around Solomon Islands. A comprehensive situational analysis is also offered on the status of rural finance in Solomon Islands that stakeholders can use as a departure point to decide what further information is needed, and where resources should be directed.

Research for this paper was done over a three week consultancy to Solomon Islands. The provinces of Guadalcanal, Western Province, Malaita and Santa Isabel were visited with the logistical support of the Central Bank of Solomon Islands (CBSI). This paper is heavily cited in order to give readers the opportunity to engage in further research as they find it relevant.

3. Background

3.1 History of Rural Finance

There has been substantial work done in rural finance since the 1950s. With the Green Revolutions in Latin America and Asia in the 1960's, rural credit was increasingly directed towards farmers to help them buy new seeds, fertilisers and other technologies which improve yields. Commonly, governments or donors would try to provide cheap credit by subsidising lending in a number of ways. By the 1970s it became apparent that many of these programmes were failing. In 1973, the U.S. Agency for International Development (USAID) published the "Spring Review of Small Farmer Credit" which reviewed 42 country studies and concluded that most of them were not financially viable, and therefore exposed to uncontrollable external shocks. This is the first time that real doubts were raised on a large scale about the impact and viability of rural finance programmes. In 1985, USAID produced a synthesis of 50 rural finance programmes in Africa, Asia, and Latin America that took place in the period from 1973-1985. Results were conclusive, showing that subsidies were often the undoing of rural finance projects and projects that paid market rates for their own capital, and had lending rates high enough to cover capital costs, were successful.¹ Since the time of this publication, practitioners around the world have come to a consensus that rural finance must strive for sustainability.

Nobel Laureate Joseph Stiglitz co-authored a paper in 1990² that helped advance the theoretical understanding of why subsidised lending programmes were not working. He pointed out that in many cases subsidised lending programmes fail to displace money lenders charging much higher interest rates. He explains this through his theory of informational asymmetries, describing how in rural credit markets these asymmetries make high interest rates necessary to cover costs. Therefore sim-

¹ Lieberman, Joseph M. (1985). A Synthesis of A.I.D. Experience: Small Farmer Credit, 1973-1985. USAID. Accessed on: (May 12th 2010) http://pdf.usaid.gov/pdf_docs/PNAAL074.pdf

² Hoff, Karla & Stiglitz, Joseph E. (1990). Imperfect Information and Rural Credit Markets-Puzzles and Policy Perspectives. The World Bank Economic Review, Vol. 4, #3. Accessed on: (May 12th 2010) http://www-wds.worldbank.org/external/default/WDSContentServer/1W3P/IB/1990/09/01/000009265_3980630181123/Rendered/PDF/multi_page.pdf

ply providing a subsidised option will not create a more efficient market, as if there had previously been monopolistic pricing. Further, it is now understood that while low income people are price sensitive to interest rates, that is not often the primary factor influencing their choice of financial product; rather the reliability of the service and flexibility of the product often makes it more attractive to people than simply a lower price.

The implication is then that policy efforts to increase market efficiency should be focused on providing finance by creating an enabling environment and incentives for it, rather than subsidising the cost of credit.

3.2 Contemporary Theory of Inclusive Finance

The United Nations Capital Development Fund (UNCDF) defines inclusive financial sectors as a continuum of financial institutions that together offer appropriate financial products and services to all segments of the population. To operate effectively, inclusive financial sectors need to be supported by sound policy, legal and regulatory frameworks. Overall they are characterised by:

- access at a reasonable cost of all households and enterprises to a broad range of financial services including savings, short and long-term credit, leasing and factoring, mortgages, insurance, pensions, payments, local money transfers and international remittances;
- sound institutions guided by appropriate internal management systems, industry performance standards, performance monitoring, institutional transparency, accountability and sound prudential regulation;
- financial and institutional sustainability as a means of providing access to financial services over time; and
- multiple providers of financial services, wherever feasible, so as to bring a cost-effective, wide variety of alternatives to customers.

Today, practitioners analyse the issues surrounding rural finance in four categories listed below:

Figure 2: The Framework of Financial Inclusion

Analysis Level	Actors	Responsibilities
Macro	Central banks, government officials	Legislation, regulation, supervision, physical infrastructure
Meso	Credit bureaus, auditors, tech service providers	Knowledge sharing, training, networking, technical support
Micro	Banks, credit unions, microfinance institutions, insurers, MNOs, Post Office	The provision of sustainable financial services
Client	Population of a country over age 15	Understand how to use different mechanisms to best manage and invest their money

All major organisations working with microfinance now consider sustainability fundamental to their strategies. UNDP’s microfinance policy has a “vision of creating sustainable access to financial services for poor and low-income people³”, The European Communities’ microfinance programme is dedicated to supporting “the development of sustainable microfinance institutions (MFIs)⁴”, and AuSAID’s 2010 microfinance strategy is focused on expanding microfinance institution’s “outreach to

³ UNCDF & UNDP. Partnerships in Inclusive Finance: UNDP Microfinance Policy. Accessed on: (May 12th 2010) http://www.uncdf.org/english/microfinance/undp_policy.php

⁴ European Union. (2008). Mid-term Evaluation of EU/ACP Microfinance Framework Programme. Accessed on: (May 12th 2010) http://ec.europa.eu/europeaid/where/acp/regional-cooperation/microfinance/documents/eu_acp_microfinance_mtr_exec_sum_en.pdf

the poor in a sustainable and cost-effective manner⁵. CGAP's "Key Principles of Microfinance" explain that sustainability is required for a microfinance institution to reach significant numbers of people and provide ongoing financial services to the poor⁶. This comes from extensive experience in countries around the world.

Once it is understood that sustainability must be central to any model for financial services provision, it then becomes necessary to explore the innovative models around the world that have found ways to make this work in different country and cultural contexts.

3.3 The Necessity of Innovation

Microfinance has grown beyond traditional microcredit. Other products and services, particularly savings and microinsurance, have broad appeal to clients who may not be willing or able to borrow and repay a loan. In addition to new products, microfinance institutions are constantly making strategic partnerships, developing new scalable delivery mechanisms, designing better repayment methods, improving their marketing strategies, expanding their product lines, and innovating new client educational curriculums. Money transfer services have become a major microfinance offering with "mobile money" pioneers such as M-Pesa in Kenya reaching ten million clients in the first three years of operations.

Implementing some of these techniques and technologies will be crucial to improving rural financial services in Solomon Islands. There are some very real challenges that have impeded their development to this point, not the least of which is political and social instability. These include a geographically dispersed population, low levels of financial literacy, restrictive legislation, undeveloped physical infrastructure, and high levels of poverty. There are models that have developed in other countries around the world from which much can be learned in the pursuit of a sustainable solution for Solomon Islands.

3.4 History of Rural Finance in Solomon Islands

Rural financial services in Solomon Islands have been and are being provided, but not sustainably. In 1991, Solomon Islands had 88 bank branches and agencies throughout the country; in late 1998 the credit union movement was approaching 19,000 registered members; and currently ANZ rural banking has a similar number of active clients. Hence there have been large scale services offered, however they have all been dependent on heavy subsidies and therefore inherently unstable.

CBSI Deputy Governor Mr Gane Simbe aptly breaks the history of financial services in rural areas into four distinct phases⁷. The first occurs from 1985-1991, and is characterised by heavy government subsidies to the Development Bank of Solomon Islands (DBSI) and National Bank of Solomon Islands (NBSI), which expanded their branch networks and extended their lending deep into rural areas, unconstrained by cost or repayment rates. This period comes to an end with the Solomon Islands Government's (SIG's) sale of their 49% stake in NBSI to the Bank of the South Pacific (BSP), which rapidly began closing branches to stop hemorrhaging money.

The second phase takes place from 1991-1998 and focuses upon credit unions. Credit unions actually came to Solomon Islands in 1968 and operated for years in the margins, championed by a few leaders such as Dudley Tuti of Isabel. In 1986 the Credit Union Act was passed, forming the Solomon Islands Credit Union League (SICUL) in 1987, but it was not until the International Fund for Agricul-

⁵ AusAID. (2010). Financial Services for the Poor: A strategy for the Australian aid programme 2010-15. Accessed on: (May 12th 2010) <http://www.ausaid.gov.au/publications/pdf/financialservices-fullstrategy.pdf>

⁶ CGAP. (2004). Key Principles in Microfinance. Accessed on: (May 12th 2010). http://www.cgap.org/gm/document-1.9.2747/KeyPrincMicrofinance_CG_eng.pdf

⁷ Simbe, Gane A. (2007). Status of Microfinance in Solomon Islands. CBSI [Unpublished].

tural Development (IFAD) Loan in April 1991 that the movement gained any momentum. During its peak SICUL had 18 full-time officers and supported 165 credit unions⁸. The goal of the project was to grow the movement to 300 credit unions with 44,000 members, when SICUL would become financial viable. Before this could happen, SIG went into arrears and IFAD suspended disbursements in 1997, forcing SICUL to halt promotion and rural outreach. In 1998 the *tensions* began and SICUL was reduced to a skeleton staff of a general manager and audit manager.

The *tensions* dominate the third phase from 1999-2003, when economic activity in rural areas was greatly disrupted and there were large migrations of people, mainly from Guadalcanal to Malaita. CBSI passed the Financial Institutions Act of 1998 right at the beginning of this phase, and then focused implementing the policy, as well as finally defining SIG debt to CBSI as a non-performing loan and reducing staff at DBSI in preparation for its abatement of lending. The Regional Assistance Mission to Solomon Islands (RAMSI) landed in August 2003, which ended this phase of turmoil and began the fourth phase.

The current phase, beginning in 2004, was catalysed and subsequently characterised by the 2005 Micro Finance conference held by CBSI and the Credit Union Revitalisation Project (CURD). This phase is replete with continued attempts to revitalise financial services outside of Honiara without much success. CURD and the conference are examples of carefully researched initiatives with strong and clear recommendations that were never implemented. There have been many projects launched since 2004 that ignored the 2005 Microfinance Conference conclusions and failed to capitalise upon lessons learned from previous periods.

3.5 2005 Conference on Rural Finance

In September 2005, CBSI spearheaded a conference that was focused on the provision of financial services outside of Honiara. It was meant to take stock of the situation after the ethnic tension and help map a path forward. The conference was attended by government policy makers, private sector stakeholders, the donor community and local NGOs. The observations recorded during the conference were honest and constructive, and the recommendations focused on some of the biggest, most pressing impediments to the expansion of financial services in rural areas, but almost none of the issues have been solved to date.

One of the major conclusions of the conference was that subsidies to rural finance have been expensive, tend to be badly managed and are subject to political interference. Therefore it was the “dominant view” that “subsidies should be temporary, highly transparent and strictly limited”⁹. This was a clear change in mindset that rural financial services can be supported in nascent stages but then must develop their own operational foundations.

⁸ Kaye, Peter. (2005). Credit Union Revitalisation Project: Stage Two. Pacific Enterprise Development Facility.

⁹ Central Bank of Solomon Islands. (2005). Report on the National Conference on Revitalizing Rural Finance in Solomon Islands. Pg. 6.

Below is a short summary of the recommendations that were made during the conference:

Figure 3: 2005 Microfinance Conference Summary of Recommendations

2005 Recommendation ¹⁰	Current Situation in 2010
1. Create an enabling environment for private sector growth	Solomon Islands decreased its ranking again this year eight places to 104th of 183 countries on the IFC 2010 Doing Business Ranking.
2. Reform a litany of acts	Not Done. (See: Legislation/Regulation Section)
3. Microfinance unit be established in CBSI	Currently staffed by two specialists who work with the credit unions
4. Expansion of electronic and telecommunication delivery models for financial services	There has been limited and uncoordinated success here, but the telecommunications infrastructure has not allowed the development of very reliable services, and 80% of people in SOI still lack electricity ¹¹ .
5. Increase Financial Literacy	There have been a number of small uncoordinated initiatives, and one larger unevaluated one. There is still a need to organise the efforts and pair them with available financial services.
6. Leverage Public Private Partnerships	ANZ/SIG rural banking initiative has helped in crease financial inclusion, but is not even close to sustainable.
7. Subsidies, while sometimes necessary, are expensive and therefore should be transparent, temporary, and strictly limited.	These stipulations seem to be ignored in all projects designed to extend financial services to rural areas.
8. Improve Supportive Infrastructure	Telecommunications only cover about 10% of the population, electricity about 20%, roads are regularly impassable in the rainy season, shipping and air travel are very expensive.

These recommendations are in line with today's best practices, but unfortunately they were never implemented.

4. The Setting for Financial Services in the Solomon Islands

4.1 Demographics

Overall, the status of financial inclusion and financial literacy in Solomon Islands is poor. Honohan (2007)¹² estimates that only 15% of the total population has access to financial services. Most of these people live in urban areas and have very different socio-economic situations from those in rural areas. In rural areas, expenditure per capita is less than half of that in urban areas, and education levels are inferior. This is important to point out because it means that a distinctive approach will have to be taken for rural populations, which comprise the vast majority of the overall population.

¹⁰ Ibid

¹¹ Craine, Stewart, & Andrews, Harry. (2009). Bright, Clean, Affordable: Modern Lighting for Microfinance Clients around the Globe. Barefoot Power, Australia.

¹² Honohan, P. (2007). Cross Country Variation in Household Access. World Bank. Pg. 20. Accessed on: (May 18th 2010) http://siteresources.worldbank.org/INTFR/Resources/Cross_Country_Variation_In_Household_Access.pdf

Figure 4: Rural/Urban Demographics (2006)¹³

Area	Households	Population	Percent
Urban	12,488	85,498	16.0
Rural	74,246	448,174	84.0
Solomon Islands	86,734	533,672	100.0

Approximately 95% of inhabitants are ethnically Melanesian. Thirty three percent of inhabitants belong to the Anglican Church of Melanesia, followed by another 19% who are Roman Catholic and a further 17% who are South Seas Evangelical. In 2010, life expectancy is 60 years. The population is fairly young with 38.8% still below the age of 14 years, and only 3.5% above 65 years of age.¹⁴

4.2 Poverty Rates

Solomon Islands is amongst the least-developed countries in the world, ranked by the UNDP as 135 out of 182 countries in the 2009 Human Development Index (HDI). For the period from 1990 through 2007, GDP per capita actually decreased on average by 1.5% per year and is measured at US\$ 784 per capita in 2007 on a purchasing power parity basis.¹⁵ The World Bank calculated GNI per capita to be US\$ 1,010 in 2008. In terms of abject poverty, 10.6% of the population falls below the Food Poverty Line (Absolute Poverty Line), and 22.7% of Solomon Islanders have expenditures less than that of the Basic Needs Poverty Line¹⁶.

4.3 Income Inequality

Solomon Islands has a Gini¹⁷ coefficient of (0.361)¹⁸, which shows that inequality is relatively low compared to regional counterparts like PNG (0.509)¹⁹ and Fiji (0.460)²⁰, and below the average (0.441)²¹ value for its peers in the UNDP medium human development category. Solomon Islands has a rural Gini Coefficient of (0.316), which when compared to the urban Gini of (0.286)²² shows that income inequality in rural areas is actually higher than in urban areas²³. While it is unclear why this is observed, possibilities include that many rural people have high levels of income that are not measured in cash, and therefore not calculated, and/or that there actually is some very concentrated rural development focused on natural resource extraction (gold, nickel, timber, fish).

4.4 Gender Inequality

The status of women in Solomon Islands is significantly lower than that of men. It is evident that they have been marginalised from educational, political and economic systems. Women appear to be generally less functionally literate and have less numeracy than men²⁴ and only comprise 31% of the formal workforce²⁵. From the national to the village level, women have largely been excluded

13 Household Income and Expenditure Survey (September 2006): Part One National Report. Solomon Islands Statistics Office, Department of Finance and Treasury. Honiara, Solomon Islands

14 CIA. (2009). World Factbook: Solomon Islands. Accessed on: (May 12th 2010) <https://www.cia.gov/library/publications/the-world-factbook/geos/bp.html>

15 UNDP. (2009). Human Development Report. Accessed on: (May 4th 2010) <http://hdr.undp.org/en/reports/global/hdr2009/>

16 UNDP & National Statistics Office of Solomon Islands. (July, 2008). Analysis of the 2005/06 Household Income & Expenditure Survey. Suva, Fiji.

17 The Gini index lies between 0 and 1. A value of 0 represents absolute equality and 1 absolute inequality.

18 Household Income and Expenditure Survey (September 2006): Part One National Report. Solomon Islands Statistics Office, Department of Finance and Treasury. Honiara, Solomon Islands.

19 UNDP. (2009). Human Development Report. Accessed on May 4th 2010. <http://hdr.undp.org/en/reports/global/hdr2009/>

20 This calculation is from 1990/91. ADB. (2000). Poverty: Is it an Issue in the Pacific? http://www.adb.org/Documents/Reports/Poverty_Issue/chap5.pdf

21 This was calculated by taking the average value of the 75 countries with Gini values in the UNDP Medium Level of Human Development group, as shown in the 2009 Human Development Report.

22 Household Income and Expenditure Survey (September 2006).

23 This claim has come under scrutiny, as there is some debate about the methodology used in the HEIS.

24 Ibid. Pg. 55.

25 This is calculated from the percent of SINPF members that are women.

ed from leadership roles. There are currently no women in the National Parliament and there has only been one female MP in the history of independent Solomon Islands. Even in the five provinces where women have matrilineal land tenure, men predominantly hold decision making roles, and control economic activities including those based on land agreements²⁶. Encouragingly, however, in recent years women have been elected to the Provincial Governments in the provinces of Isabel (2), Rennell and Bellona (1), Makira (1) and Western (1).

Economic empowerment is extremely important in an environment like Solomon Islands where gender based violence is commonplace. The Solomon Islands Family Health & Safety Study reports that, “64% of women aged 15-49 who had ever been in a relationship reported experiencing physical and/or sexual violence by an intimate partner”²⁷.

4.5 Financial Literacy

Financial literacy is the foundation of any functioning financial system. In rural regions, a UNDP study found that 75% of villagers had a very low level of literacy and 45% of villagers had a very low level of numeracy²⁸. UNDP’s financial literacy campaign was implemented by local trainers and reports to have trained 28,000 people on Guadalcanal by the end of 2007, but was never independently evaluated. Stage II of the training was provided to eighteen villages on Guadalcanal, and the delivery model was fundamentally changed to use special trainers who traveled to the different villages to give the trainings instead of using local trainers in the different sites. This second stage was evaluated in 2008, and it was concluded that the financial literacy training workshops have enhanced the financial competence of those villagers who participated (more people budget, keep financial documents, and save money).²⁹ There is a second phase planned and funded but there have been long delays in coordinating efforts between UNDP Solomon Islands and the Ministry of Finance (MoF).

Non-profit organisations such as Tetepare Descendants Association and Adventist Development and Relief Agency (ADRA) are planning trainings. CBSI does a yearly event on financial literacy, and have taken the reins as champions of financial literacy in Solomon Islands. These programmes and others would benefit from coordinating training sessions with the provision of financial services, an evaluation of their effectiveness, and the development of a set of financial literacy materials that can be used by other organizations in different areas who would like to conduct trainings.

Solomon Islands is a member of the Money Pacific Group (MPG), formed in 2008 when Pacific Finance Ministers, Central Bank Governors and donor partners from around the Pacific promulgated the Coombs Declaration. The group is founded on the recognition that by lifting the financial capability in the region, economic performance would be improved and there would be substantial social and financial benefits for individuals and families. Therefore MPG focuses on a set of four regional goals were also developed to guide national level actions and to monitor progress. These goals were endorsed by Forum Economic Ministers’ Meeting (FEMM) and South Pacific Central Bank Governors in 2009 and are elaborated below:

“That each Pacific island nation, through combined actions of the public and private sectors, achieve these goals by 2020:

1. all children to receive financial education through core curricula;
2. all adults to have access to financial education;

26 Maetala, Ruth. (2008). Matrilineal Land Tenure Systems in Solomon Islands: The Cases of Guadalcanal, Makira and Isabel Provinces. Pacific Islands Forum Secretariat (PIFS). Accessed on: (April 23rd 2010) <http://www.forumsec.org.fj/resources/uploads/attachments/documents/Land%20and%20Women.pdf>

27 Ministry of Women Youth & Children Affairs & National Statistics Office of Solomon Islands. (2009) Solomon Islands Family Health & Safety Study. Funded by UNFPA, AusAid & SPC.

28 Sibley, Jonathan. (2008). Solomon Islands Financial Literacy Impact Assessment: The Relationship between Adult Financial Competence and Household Wellbeing in Indigenous Rural Households in the Solomon Islands. UNDP. Pg 52.

29 Ibid.

3. simple and transparent consumer protection to be in place; and
4. halve the number of households without access to basic financial services.”

In June 2010, delegates from CBSI and the Ministry of Education attended a regional training in Samoa to help them formulate their national strategy and a curriculum to reach these MPG goals.

Providing financial services to women can provide a needed platform for greater empowerment. A 2008 multi-stakeholder report on violence against women notes, “Violence against women is exacerbated by the pervasive poverty and low status of women with respect to men...[and that] in the long run, economic empowerment of women will strengthen violence prevention efforts in Solomon Islands”³⁰. Finally, it is noted that women’s lack of access to cash and information is a “significant oppressing factor.”³¹ .

Studies have shown that financial literacy education is more effective when provided to women as compared to men because women are more likely to adopt better financial planning practices as a result. In addition, women usually manage the daily financial processes for the entire family such that their financial management skills positively impact all household members³².

The introduction of the provision of financial services will have to be done carefully though, so that it does not cause any short term decline in the well-being of women. Some traditional activities such as paying bride price are cited as practices that objectify women, yet might potentially be facilitated with greater financial access. Further programme planning would need to consider and mitigate the possibility that increasing a women’s access to economic resources may put her at risk to increased violence as the women’s partner feels increasingly disempowered and vulnerable.

It is therefore very important that progress towards financial inclusion involve both males and females, include substantial education, and is supported by comprehensive monitoring and evaluation. In 1998, SIG created a National Plan for Women. Today, there are a number of organisations around the country working to support women’s issues, and recently there does seem to be some positive developments. While The National Council of Women (NCW) has stayed small and grass-roots, the NCW has just completed a network of women’s resource centres in each of the provincial capitals around the country. In 2002 SIG ratified the Convention on the Elimination of All Forms of Discrimination against Women (CEDAW), but still have yet to report as obligated under the framework. Currently the Ministry of Women, Youth and Children’s Affairs is functioning again and RAM-SI houses a programme on Women in Government.

4.6 Political System

Solomon Islands gained independence from Britain in 1978 and remains a member of the Commonwealth. Solomon Islands is a constitutional parliamentary democracy. The National Parliament is unicameral and comprised of 50 members, elected from single member constituencies using the first-past-the-post voting system. The legislative branch is headed by a Speaker who is elected by Members of Parliament (MPs) from outside of parliament.

The Executive is headed by a ceremonial Governor General. In practice, the head of government is the Prime Minister chosen by the MPs in the National Parliament who form a majority. The Prime

30 The Commonwealth of Australia. (2008). Violence against Women in Melanesia and East Timor: Building on Regional and Global Promising Approaches. Accessed on: (April 26th 2010)
http://www.usaid.gov/publications/pdf/vaw_cs_full_report.pdf

31 Maetala, Ruth. (2008). Pg. 42.

32 Sibley, Jonathan. (2009). Financial Capacity, Financial Competence and Wellbeing in Rural Fijian Households. Pacific Financial Inclusion Programme, Fiji.

Minister selects his Cabinet from the MPs in the National Parliament (although they are formally appointed by the Governor General). Government can be changed through a “vote of no confidence” if the Prime Minister and his Cabinet can no longer maintain a majority in Parliament.

Solomon Islands has a provincial government system defined under the *Provincial Government Act 1997*. The Act established Provincial Assemblies for each of Solomon Islands nine provinces. The size of each Provincial Assembly varies according to the number of wards, typically between nine and 30 members. Similar to the National Parliament, each Provincial Government is headed by an executive (a Premier) who is elected by the Provincial Assembly. These Assemblies can pass ordinances as long as they do not contradict national legislation. Historically, provincial governments have suffered from a range of limitations including weak political and bureaucratic leadership, human resource and financial management. In addition, the role of provincial governments has been poorly defined, inadequately funded and their relationship with the National Government and the national bureaucracy has been blurred.³³ Nonetheless, following the signing of the Townsville Peace Agreement in 2000, it was agreed that Solomon Islands would explore options to change the Constitution to institute some form of federal government.

The Provincial Assemblies’ influence does not reach far beyond the provincial capitals, although it currently represents the furthest reach of government into rural areas. Beyond this, traditional and religious systems are dominant. While traditional chiefs are recognised in the Constitution, they are not formally integrated into the government system. Chiefs are sometimes organised under a Paramount chief for the province, but practices vary greatly by province. Some provinces, such as Isabel and Guadalcanal, had districts which were matrilineal rather than the customary patrilineal power structure. In some provinces a “big man” structure has replaced traditional chiefly leadership. Religious structures informally also play roles in rural areas in terms of service delivery, and they have a strong sense of legitimacy.

4.7 Recent History

4.7.1 The Tensions 1998 - 2003

The *Tensions* refers to a period of history in Solomon Islands from 1998-2003 in which there was significant ethnic violence, displacing as many as 35,000³⁴ people, taking the lives of over one hundred and destroying the economy. In 1998, militants led by the Isatabu Freedom Movement (IFM) had launched an aggressive campaign against Malaitans and settlers on the island of Guadalcanal. Many Malaitans fled to Honiara or back to Malaita. In response, the Malaitan Eagle Force had organised and retaliated with violence around Guadalcanal beginning in January 2000 and culminating in the June 2000 coup d’état. The Townsville Peace Agreement in October 2000 quelled major violence between the two groups for a time, but law and order continued to be a serious problem, undermining governance, and social and economic development.

During the period from 1998 through 2002, GDP in Solomon Islands decreased by 24%³⁵. The economic engines in Guadalcanal like the Gold Ridge Mine, and Guadalcanal Plains Palm Oil Ltd. (GP-POL) shut down due to the conflict. Further, timber harvesting, fishing, copra, and cocoa production greatly declined across the Guadalcanal plains, and business in Honiara was stymied by the militants flooding the city. Around 12,000 people from Guadalcanal fled to the countryside for safety. This ravaged credit unions, savings clubs, development bank loans, and credit repayments in general as

33 AusAID. (2004). Solomon Islands Provincial Government Information Paper. Accessed on: (June 18th 2010) http://www.ausaid.gov.au/publications/pdf/sols_provincial_gov.pdf

34 Friesen, Wardlow. (2002). Economic Impacts of the ‘Ethnic Tension’ in Solomon Islands. The University of Auckland, New Zealand. Accessed on: (May 5th 2010) http://www.devnet.org.nz/conf2002/papers/Friesen_Wardlow.pdf

35 AusAID. (2004). Solomon Islands: Rebuilding an Island Economy. Accessed on: (May 5th 2010) http://www.dfat.gov.au/publications/rebuilding_solomon/si_rebuilding_an_island_economy.pdf

people took outstanding balances with them. Further, government finances spun out of control as ministries spent without oversight, while extortion and corruption were rampant. Bad debt became unmanageable and in 2002, the Government defaulted on its interest payments. The Central Bank was widely considered to be one of the only institutions which functioned competently through the entire *Tensions* period.

Many financial institutions are still trying to recover from this disaster, and there is a need to implement strategies that allow them to move beyond the destruction to their institutions caused by the *tensions*. The *Tensions* provided the final blow to the Development Bank (DBSI), however, which officially failed in 2004. In 1981, 50% of DBSI's loan portfolio was already in arrears. By 1990 losses of SI\$6.6 million (US\$ 825,000) had to be written off and a further SI\$ 23 million (US\$ 2.88 million) in losses accrued by the end of 1993. Before 2000, DBSI had stopped lending and by year's end 2004 the DBSI had accumulated losses exceeding SI\$ 42 million (US\$ 5.25 million). However a major positive outcome from DBSI's failure was that its dismal performance led the SIG to conclude that development banking needed to be based on sound commercial and financial practices and to be free from government interference and political pressure³⁶.

4.7.2 RAMSI and Recovery 2003 to 2010

In early 2003, the Solomon Islands Government (SIG) requested assistance from the Pacific Islands Forum and Australia to address ongoing law and order problems. Subsequently, the Regional Assistance Mission to Solomon Islands (RAMSI) was deployed to Solomon Islands in July 2003. RAMSI continues to operate in Solomon Islands today.

Since the *tensions*, the SIG has been characterised by unstable coalitions, subject to frequent votes of no-confidence. In 2006, following the national elections and the selection of a Prime Minister, serious rioting occurred in Honiara burning down much of Chinatown. Subsequently, another Prime Minister was elected. A year later, in 2007, Prime Minister Manasseh Sogavare, was toppled in a vote of no confidence which resulted in the election of Dr. Derek Sikua as Prime Minister.

Elections were held in August 2010. Of the three major camps that formed in the aftermath of the election, the grouping associated with the former Prime Minister Sogavare won the close vote to elect Danny Philip (the former Deputy Prime Minister under Sogavare) as the new Prime Minister, narrowly beating the candidate supported by the grouping around Dr. Sikua.

Political parties are relatively new and very weak, and there are many allegations of money being given to politicians to switch alliances. A political party reform bill was tabled in 2010 that sought to limit the ability of members of parliament to switch political allegiances and topple governments, but it was not supported by a number of Government MPs, which resulted in the sacking of five Cabinet Ministers. The new Prime Minister said his government would actively support the country's Constitutional Reform process.

The fundamental causes of the ethnic strife are just now being addressed and it is widely agreed that without RAMSI's presence, the *tensions* would likely flare up again. In 2008-09, the Foreign Affairs Committee of Parliament held public hearings on the RAMSI intervention which allowed ordinary citizens to have their views heard. In 2009, a Truth and Reconciliation Committee was also established. Contemporary accounts of the *tensions* recognise it to be based more on socio-economic discrepancies than cultural or ethnic differences. From this perspective, the 2006 riots in Chinatown are seen as another manifestation of socio-economic inequalities. Poor governance, characterised both by inefficient bureaucratic processes and corruption, also continue to pose serious problems

³⁶ Statement by the Minister for Finance and Treasury Hon. Gordon Darcy Lilo on the Future of Development Bank in Solomon Islands, February 5th, 2007. Accessed on: (May 7th 2010)
http://www.parliament.gov.sb/files/hansard/8th_session/3rd_meeting/speechMOF5february2007.htm

for Solomon Islands recovery, costing citizens millions of dollars a year. Transparency International ranks the country 111 out of 180 in its Corruption Perceptions Index 2009 (PNG is 154)³⁷.

In 2010, the SIG is facing a budget shortfall and a pressing cash shortfall as the International Monetary Fund (IMF) estimates they have overestimated revenues for the year by SI\$100 million³⁸. The Asian Development Bank (ADB) and the European Union (EU) have both offered to help provide cash liquidity and budgetary support, but it is clear that financial support for the SIG for any projects should be viewed as uncertain over the long term. The Government's financial management continues to require capacity development.

Economic development continues to be a challenging area of reform for the Government. Despite MPs each receiving SI\$ 2 million (US\$ 250,000) each year as Constituency Development Funds and a range of programmes being implemented by the Provincial Government Ministry, little has been done to help build supportive infrastructure in places like Auki (the capital of Malaita), that would provide substantial economic opportunities for people outside of Guadalcanal. More provincial development would potentially relieve pressure on the capital, by decreasing the concentration of competition for resources on Guadalcanal. Japan has announced big plans to build a new market and wharf in Auki, but even if these plans are executed successfully, they would only be enclaves of modernity on Malaita.

4.8 Economic Overview

The IMF³⁹ predicts a moderate growth rate in 2010 of 3.4%, increasing to 5.2% in 2011⁴⁰. While these numbers are well under the 5.9% annualised economic growth rate since the end of 2003 ethnic *tensions*, they do represent a quick recovery from the 2009 Global Economic Crisis growth rate of around -2.2%. Growth has also been coupled with a significant decrease in inflation. After an inflationary spike in 2008 of 17% driven by the increase in food and fuel prices, consumer prices increased by 7.1% in 2009, and are predicted to slow to 4.8% in 2010, decreasing even further in the following years. Inflation is largely based on fluctuations in food and fuel prices.

Government debt at the end of 2009 was 31.7% of GDP, a reduction from 35.7% in 2008. Under the Honiara Club Agreement, the SIG aims to bring this percentage down to 20% of GDP by limiting borrowing to fund recurrent expenditures.

4.8.1 International Trade

Current account deficit was estimated at 21.1% of GDP in 2009, increasing from 16.4% in 2008. In the period from 2010-2015, the IMF predicts the current account deficit to hover around 30% of GDP. Foreign reserves stood at a healthy six months of import cover at the end of 2009. Solomon Islands runs an overall trade deficit of \$SI 103.8 million (US\$ 13 million), sending over 50% of exports to China, and importing over 55% of goods almost equally from Singapore and Australia⁴¹. The top five exports are all agricultural with timber receipts varying around 60-70% of total receipts. The trade balance is expected to deteriorate in the near future as unsustainable logging practices have

37 Transparency International Official Website. Accessed on: (July 8th 2010)
http://www.transparency.org/policy_research/surveys_indices/cpi/2009/cpi_2009_table

38 Speech by Prime Minister Sikua on March 30th, 2010 Accessed on: (May 18th 2010)
<http://www.pmc.gov.sb/content/prime-minister-explains-sig-financial-situation>

39 The figures in this paragraph are from IMF, unless otherwise noted. ADB Calculates 2009 GDP growth at 0.4%, and predicts a 2% increase in 2010, and a 3% growth in 2011. Further they compute CPI in 2009 at 8%, and estimate 7.3% in 2010, and 6.2% in 2011. Asian Development Bank. Asian Development Outlook 2010: Solomon Islands. Pg.254. Accessed on: (May 3rd 2010) <http://www.adb.org/Documents/Books/ADO/2010/SPC.pdf#page=5>

40 International Monetary Fund (2010). World Economic Outlook (WEO): Rebalancing Growth. Accessed on: (May 3rd 2010)
<http://www.imf.org/external/pubs/ft/weo/2010/01/pdf/text.pdf>

41 The Economist Intelligence Unit. (January 2010). Country Report: Solomon Islands. London, United Kingdom.

already lead to a decrease in available concession areas. The World Food and Agricultural Organization (FAO) predicts natural forests will be exhausted by 2015⁴². The below table illustrates how dependent the economy is on global commodity prices for their exports, and how exposed they are to fuel and food price fluctuations for their imports.

Figure 5: Breakdown of Foreign Trade⁴³

Exports by Value	Percent of Total	Imports by Value	Percent of Total
Timber	60%	Fuel	26%
Copra	11%	Machinery	24%
Palm Oil	11%	Food	20%
Fish	8%	Manufactured Goods	13%
Cocoa	5%	Chemicals	7%
Overall Percent of Trade	95%	Overall Percent of Trade	90%

4.8.2 Labour Market

There are no current official unemployment rates in Solomon Islands. The last survey was conducted in 1999 with the census and showed that only 31.9% of the population over fourteen years of age was unemployed⁴⁴. The ADB notes that job creation has not kept pace with the increase in the labor supply, with only one in every six “school-leavers” finding paid employment, meaning the youth unemployment rate could be 45%⁴⁵. CBSI currently uses Solomon Islands National Provident Fund (SINPF) numbers and the frequency of job advertisements as proxies. These numbers do not capture the fluctuations in underemployment rates, or any employment in the informal economy in which most Solomon Islanders participate. Figures from the CBSI December 2009 Quarterly Report show SINPF with 84,608 contributing members, a decline of 8% from the previous quarter. Printed job advertisements showed a more pronounced decline of 27% from the previous quarter⁴⁶.

CBSI reported that over a quarter of SINPF members are engaged in agriculture (26%), with manufacturing (15%), public administration (12%), education (12%) and wholesale/trade (12%) sectors following behind⁴⁷. If the population over 14 years old is at 57.7%⁴⁸, this suggests that of the estimated 530,669 citizens, there are approximately 221,588⁴⁹ adults (72% of the adult population) in Solomon Islands without formal employment.

4.8.3 Credit Market

Credit to the private sector was SI\$ 1,223 million (US\$ 153 million) at the end of 2009⁵⁰ compared to a total of SI\$ 816 million (US\$ 102 million) in demand deposits held in commercial banks. Domestic liquidity has fluctuated significantly of the past few years in Solomon Islands, and there is currently significant excess liquidity in the economy. At the end of 2009, free liquidity was SI\$ 274 million (US\$ 34 million), which was 366% higher than it was the previous year⁵¹. CBSI sold its own “Bokolo-

42 Pauku, Ricard. L. (2009). Solomon Islands Forestry Outlook Study. Food and Agriculture Organization of the United Nations (FAO) regional office for Asia and the Pacific. Bangkok, Thailand.

43 Data is from 2008. Central Bank of the Solomon Islands. (December, 2009). 2009 CBSI Quarterly Review. Vol 22 #4. Pg. 39-41. Accessed on: (May 4th 2010) <http://www.cbsi.com.sb/fileadmin/publications/qr/2009/QR-DEC09.pdf>

44 World Bank. Accessed on: (May 4th 2010) <http://data.worldbank.org/country/solomon-islands>

45 ADB. (December 2009). Fact Sheet: Solomon Islands. Accessed on: (May 4th 2010) http://www.adb.org/Documents/Fact_Sheets/SOL.pdf

46 CBSI. (2009). December 2009 Quarterly Report.

47 CBSI. (2008). Annual Report. Accessed on: (May 4th 2010) <http://www.cbsi.com.sb/fileadmin/publications/ar/AR-2008.pdf>

48 CIA World Factbook: Solomon Islands.

49 This is just equal to: $(530,669 \times 0.606) - 84,608 = 236,977$

50 CBSI. (2009). December 2009 Quarterly Report.

51 Free Liquidity equals Total Liquid Assets minus Required Reserve Assets. Figures are from: CBSI. (2009). December 2009

bills” to remove some it from the system.

Real deposit rates have remained negative, and prime lending rates have averaged around 7-8% despite these liquidity shifts. The difference between the lending rates and the deposits rates offered by commercial banks was approximately 14.5% at the end of 2009, making it one of the highest in the region⁵². The reasons for this large differential is controversial, but is probably dependant on the cost of doing business, perceived political instability and possibly, a lack of competition in the lending market, and capital constraints.

4.8.4 Official Development Assistance

Development in Solomon Islands is largely funded by the international donor community. In 2009 the SIG spent SI\$ 182.6 million (US\$ 22.8 million) on development which was diversely invested in rural constituencies, the census, eliminating school fees, and reforestation projects to name a few. However, this is a small portion of the total amount of overseas development assistance (ODA) received by Solomon Islands. In 2008 official ODA was US\$ 244 million, which is 30.8% of GNI and US\$ 349 per capita.⁵³ ODA as a percentage of GNI has been steadily decreasing over the past few years as GNI growth has outstripped that of ODA.

Donor agencies use an array of supportive mechanisms to catalyse development: the EU contributes large amounts in fiscal budget support; Japan and New Zealand aid programmes complete large infrastructure projects; The Republic of China (Taiwan) provides large amount of cash to the government, (amounting to 93.2% of the total cash budgetary support received from abroad in 2009⁵⁴); the multilateral community including, the United Nations, the ADB and the World Bank all contribute large amounts of resources yearly as well. Eclipsing all of this development activity is the Australian led RAMSI programme which has spent over a billion Australian dollars in SI in the last six years⁵⁵. Of Australia’s A\$ 223 million (US\$ 205 million ⁵⁶) aid to the Solomons in 2009, 58% was spent by RAMSI⁵⁷. The table below lists the five largest donors to Solomon Islands. Note that Australia provides approximately 83% of total ODA which is one of the highest proportions in the world.

FOCUS BOX 2: The Catch 22 of Rural Finance

The lack of reliable infrastructure to support the delivery of financial services is one of the greatest impediments in Solomon Islands. ANZ continues with its rural banking programme by delivering banking services with a reinforced truck and a four wheel drive vehicle. While this is greatly appreciated by rural clients, there are still a significant amount of days during the year when the roads are too bad for their vehicles. In Malaita most of their customers were along the road connecting the capital Auki with a northern population centre called Malu’u. The connecting road was so bad that people of Malaita lodged complaints. Finally, tired of waiting for outside help, they implemented make-shift repairs themselves. While the road was then passable, they started levying “tolls” on passing vehicles, which sometimes amounted to hundreds of dollars. ANZ refused to pay these tolls as they were not being levied legitimately. The government finally decided to send an official team to repair the road, but they were chased off by the community members before they could even start working. The community members were now attached to the income they were receiving in “tolls”. Ironically their earning money like this was precluding them from accessing any financial services to invest it. ANZ, now unable to operate without paying these passage fees, decided to suspend service along this corridor. There is hope that this situation will be resolved in the near future.

Quarterly Report.

52 CBSI. (2009) 2009 Annual Report. Pg 59.

53 The World Bank. (2009). World Development Indicators. Accessed on: (May 4th 2010)
<http://data.worldbank.org/country/solomon-islands>

54 CBSI. (2009) 2009 Annual Report. Pg 40.

55 The Australian. (April 22nd, 2010). Wisdom Rules in the Solomon Islands. Accessed on: (May 5th 2010)

<http://www.theaustralian.com.au/news/features/wisdom-rules-in-the-solomons-islands/story-e6frg6z6-1225856583969>

56 Exchange rate of one AUD equals 0.86 USD used.

57 The Australian. (November 28th, 2009). Islanders look for RAMSI exit strategy. Accessed on: (May 5th, 2010)

(<http://www.theaustralian.com.au/news/opinion/islanders-look-for-ramsi-exit-strategy/story-e6frg7e6-1225804532935>)

Figure 6: ODA by top five Donors

Official Development Assistance (ODA)⁵⁸

Donor	US\$ (Millions)
Australia	\$ 193.80
New Zealand	\$ 19.80
Japan	\$ 12.40
Asian Development Bank	\$ 6.20
European Community	\$ 5.20

*Figures listed are an average from the years 2007 and 2008.

4.9 Physical Infrastructure

There is no sector of infrastructure in Solomon Islands that has reached contemporary standards of development. Of the Solomon Islands' 1500 kilometers of road only 40 kilometers are paved. Only a quarter of the countries bridges are in good condition only about a fifth of the population has access to electricity. In rural areas, less than half of the population has access to safe drinking water⁵⁹. There are twenty domestic airfields and two main sea ports, at Noro and Honiara, which can handle the large containers used by international shipping companies.

Literature on rural financial services often cites these statistics as reasons why services are expensive or impossible to provide. The lack of reliable physical infrastructure definitely does present real challenges (See Focus Box 2). Historically there has been little coordination in the development of infrastructure, leading to very little synergy between different economic development efforts. However, the New Zealand aid Programme is currently chairing a committee made up of ADB, World Bank, AusAID, EU and Japan to increase communication and coordination of projects. The largest ongoing projects are listed below.

Figure 7: Notable Physical Infrastructure Projects

Project Name	Leading Agencies	Project Value (US\$ in Millions)	Project Time Frame	Project Location
DMSP	ADB with EU	Approx. \$ 18M	2009-2018	Nationwide (seaports)
TSDP	ADB with AusAID	Approx. \$17M	To begin in 2011	Nationwide
SIRIP I	ADB with AusAID & New Zealand aid	Approx. \$21M	2007-2011	Focus on Makira & Guadalcanal
SIRIP II	ADB with AusAID	Approx. \$15M	2009-2012	Focus on Guadalcanal
Auki market and jetty project	Japan (JICA)	Approx. \$10M	To Begin in 2010	Auki Market & Jetty
ITSDP	AusAID	Approx. \$3M	2010-2011	Nationwide
ESIMSA	ADB with EU	Approx. \$1.5M	2009-2010	Nationwide

Since this supportive infrastructure can so significantly dictate the success of economic activity in an area, its development should be monitored closely, so that the implementation of supportive financial services can closely shadow infrastructure development. A national map of currently planned projects and their focus would greatly help solve this informational asymmetry.

58 OECD. (2009). Accessed on: (June 9th 2010) www.oecd.org/dac/stats

59 Ministry of Development Planning and Aid Coordination. (2007). Solomon Islands: Agriculture & Rural Development Strategy. Honiara, Solomon Islands. Accessed on: (May 5th 2010) http://siteresources.worldbank.org/INTPACIFICISLANDS/Resources/442114-1180930407961/ARDS_Summary.pdf

4.10 Telecommunications

Solomon Telekom Limited (STL) was the monopoly provider of telecommunications in Solomon Islands until December 2009 when bemobile of Papua New Guinea was awarded a second operating license. This was made possible by the passing of the Telecommunications Act (2009), which also created the Telecommunications Commission as the industry regulator. The Act also stipulates that no third operator may offer services before the first of April 2011, when the market will become fully liberalised. However the Telecommunications Commission has stated that it will open bidding for a third license in 2010, which will facilitate a winning provider to roll out services in April 2011.

Solomon Telekom Limited (STL), a joint venture between the SINPF (64%), Cable & Wireless (32%) and the Government, currently offers mobile phone services covering 10% of the population or 60,000 people. Until very recently, the small STL network was overloaded and very unreliable. In the beginning of 2010, STL had to officially stop selling SIM cards as their network could not handle any new subscribers. In February 2010 STL publically apologised to customers and the general public and announced the investment of SI\$ 100 million (US\$ 12.4 million) in a new and improved network in partnership with Huawei Technologies. The new service offers data through a 3G network in Honiara and Auki and an upgraded 2G network in the other areas of the country. In April 2010, STL implemented the new network and has resumed selling SIM cards at SI\$55 (US\$6.88).

Prices for telecommunications are hard to compare across countries and providers because of different rate structures and market conditions. However, the price of telecommunications in Solomons Islands has been a topic of common complaint among those who live and work there. Figure 8 shows that while current prices are expensive compared to the highly competitive market in Fiji, they are only higher than those in PNG for SMS text services. Experience in almost all surrounding Pacific countries predicts that these rates will decrease significantly with the introduction of more service providers.

Figure 8: Costs of Telecommunications⁶⁰

	Mobile to Mobile call per Minute	Cost of Sending an SMS	Calling a landline
Solomon Islands	0.19 USD/Minute	0.13USD/SMS	0.25 USD Trunk Charge
Fiji Islands ⁶¹	0.05USD/ Minute	0.05USD/SMS	0.20 USD Trunk Charge
Papua New Guinea ⁶²	0.37USD/Minute	0.09USD/SMS	0.55 USD Trunk Charge

The license awarded to bemobile created a significant amount of controversy. It is a spin-off from the state company Telikom PNG, which still owns half of it. Other shareholders include a Hong Kong investment fund and American mobile phone operator Trilogy International Partners. bemobile has struggled in its home market for the past few years, overwhelmed by the entrance of Digicel which rapidly captured the dominant market position. Most outside observers expected the license to be awarded to Digicel, the leading mobile network operator (MNO) in the Pacific region. While it is not officially clear what all the reasons may have been for this unexpected choice, the Prime Minister suggested that Digicel was not awarded the contract because it had asked for tax breaks valued at tens of millions of dollars,⁶³ whereas others within the industry believe the disagreement came over the targets related to geographic coverage vs. population coverage.

60 Rates are given for Digicel in PNG and Fiji, and are given for communicating with another Digicel customer. Digicel was used as opposed to Vodafone or bemobile for ease of comparison.

61 Prices are for peak time, Digicel to Digicel, prepaid plans. Exchange rate used was \$1USD = 2 FJD. Accessed on: (April 22nd 2010) <http://www.digicelfiji.com/en/plans/its-simple-5-cent-per-unit-calls-5-cent-sms>

62 Prices are for peak time, Digicel to Digicel, prepaid plans. Off peak prices are US\$0.18 for a mobile to mobile, and US\$0.36 for a call to a landline. Exchange rate used was: \$1USD = 2.68 Kina. Accessed on: (April 22nd 2010) http://www.digicelpng.com/en/plans/digiflex/flex_tariffs

63 The Solomon Times. December 22nd 2009. Accessed on: (May 9th 2010) <http://www.solomontimes.com/news.aspx?nwID=4770>

There is some evidence that bemobile did not consider itself a serious contender, and did not have board approval to pay for the license when it was awarded⁶⁴. bemobile officially launched its service in late August 2010, several months behind schedule and shortly before this report went to print. Pricing and network information was not yet available. bemobile provided a US\$ 10 million dollar performance based bond to the government to be released in phases as it meets it agreed upon targets. In order to recover these funds it had to launch within 6 months (by 18 June 2010), and cover 81% of the population within 21 months of the issuance of the operating license (21 September 2011). The government fined them US\$ 1.5 million in July for missing this first deadline. bemobile is now operating under a completely new senior management team (several of which are former Digicel employees) and appears to be aggressively pursuing its new franchise.

Figure 9: Important Telecommunications Dates

Reference Date	Activity	Portion of Bond at Risk
18 June 2010	bemobile must have a commercially available network covering an area in which 25% of population live	USD2.5m ⁶⁵
18 September 2010	bemobile network must cover an area in which 50% of population live	USD2.5m
18 March 2011	bemobile network must cover an area in which 75% of population live	USD2.5m
1 April 2011	Full market liberalisation. Anyone may launch service including the winner of third mobile spectrum license.	N/A
21 September 2011	bemobile network must cover an area in which 81% of population live	USD2.5m

This does not preclude Digicel from operating in Solomon Islands, as it could still enter in April 2011 and therefore may bid on the third contract offered in 2010, or possibly buy into an existing licensed operator.

Currently there is a new British Telecommunications Commissioner, Nicholas Williams, and the donor community has announced a multi-million dollar telecommunications technical assistance project that will support the telecommunications commission over the next five years⁶⁶. So the future for telecommunications in Solomons is hopeful, yet uncertain. While it is not currently at a stage of development to support the provision of financial services in rural areas, this will most likely change within the next year or two.

4.11 Business Environment

The lacklustre prevailing business environment in Solomon Islands has impeded general economic activity as well as financial providers who would serve otherwise functioning businesses. The IFC “Doing Business Ranking” measures the ease with which business can be done in 183 different countries and then ranks them. Overall in 2010 Solomon Islands ranked 104th, an eight place drop in ranking from the previous year. Of specific interest are its ranking of 172 for registering property, which

64 The Post Courier (March 3rd 2010). bemobile in SI ‘scandal’. Accessed on (May 9th 2010)

<http://www.postcourier.com.pg/20100303/wehome.htm>

65 Bemobile was fined US\$ 1.5 million for not achieving this by the deadline. The deadline for covering 25% of the population was extending to the end of August, at which point the remaining US\$ one million will be at risk of forfeit.

66 The project has been given approval by the World Bank, AusAid and the Pacific Regional Infrastructure Facility. The Solomon Times. (April 7th 2010). Solomons to Benefit from Telecommunications Project. Accessed on: (May 9th 2010) <http://www.solomontimes.com/news.aspx?nwid=5071>

is an infamous process in the country, and the rank of 167 for getting credit. These conditions guarantee significant delays to registering and operating a new business, or even attaining credit to expand an existing one.

Figure 10: Doing Business in Solomon Islands Ranking

Ease of...	Doing Business 2010 rank	Doing Business 2009 rank	Change in rank
Doing Business	104	96	-8
Starting a Business	111	104	-7
Dealing with Construction Permits	40	34	-6
Employing Workers	65	44	-21
Registering Property	172	174	+2
Getting Credit	167	165	-2
Protecting Investors	57	53	-4
Paying Taxes	48	47	-1
Trading Across Borders	82	78	-4
Enforcing Contracts	108	108	0
Closing a Business	107	107	0

Source: <http://www.doingbusiness.org/ExploreEconomies/?economyid=170>

5. The Regional Setting for Financial Services

Although there are nine provinces in Solomon Islands, there are very few areas that have significant supportive infrastructure, a reasonable amount of economic activity and a fairly high population density. These are generally considered prerequisites for the sustainable provision of financial services. However, even the areas that do display these characteristics are extremely isolated from one another, compounding the already difficult transportation and communication problems experienced in other island nations. The three obvious areas in the country which may be developed enough to support sustainable financial services are: the area surrounding Honiara, the Auki-Malu'u Corridor (Malaita), and the Noro-Munda-Gizo Triangle (Western Province) Each of these areas is briefly analysed below. A fourth area, Isabel Province, is analysed because of the savings club movement which may offer a possible alternative model for rural financial services for the many inaccessible areas in Solomon Islands.

Figure 11: Geographic Developmental Comparison

	Honiara	Malaita	Western Province	Santa Isabel
Population ⁶⁷ (530,669)	64,458	159,923	81,214	26,310
Avg. Population Density per km Squared ⁶⁸	2,232 (11 for Guadalcanal)	29	11	5
Median Annual Per Capita Expenditure (SBD) ⁶⁹	8,422 (Guadalcanal: 4,256)	2,600	3,546	3,343
Economic Centres surrounding settlements	Urban centre & connecting Corridor	Auki, Malu & Suavanao	Gizo/Noro & Munda Triangle	Buala, Hograno

67 Numbers are projections made by Solomon Islands National Statistics Office, based on the 1999 Census. Accessed on: (May 12th 2010) <http://www.spc.int/prism/country/sb/stats/Social/Popcen/Projection.htm>

68 Solomon Islands National Statistics Office. (1999). Solomon Islands National Census.

69 Household Income and Expenditure Survey (September 2006): Part Two Provincial Report. Solomon Islands National Statistics Office, Department of Finance and Treasury. Honiara, Solomon Islands. Pg. 3. Accessed on: (May12 2010) <http://www.spc.int/prism/Country/SB/Stats/Publication/HIES/HIES%20Provincial%20Report-Final.pdf>

Population Estimate per Economic Centre ⁷⁰	64,458 (Urban) + 23,793 (in the Plains) = 88,251	50,474	19,341	4,972
Mobile phone Subscribers per tower ⁷¹	N/A	Auki: 1537 Malu'u: 956 Kia: 300	Gizo: 2552 Noro: 1573 Munda: 994	Buala: 600 Hograno: 260
Land Tenure ⁷² (Guadalcanal)	Matrilineal	Patrilineal	Matrilineal	Matrilineal
Percentage of HH with Electricity at Home ⁷⁴	54.8% ⁷³	18.9%	45.9%	51.7%
Percent of Population within 1 hour of a town market	99% [^]	33.1%	46.9%	31.5%
Percent of Population within 4 hours of a market	100% [^]	86.6%	98.5%	60.6%
Percent of Population with a Bank near home	52.2% [^]	43.4%	52.1%	1.7%
Percent of Population with Bank Account	41.3% [^]	17.1%	33.5%	27.0%

5.1 Western Province

The Western Province is far to the north-west of Guadalcanal. It is comprised of eleven islands, and its landscape would probably provide the foundation for a healthy tourism based economy were it not isolated by poor transportation networks. There are no direct international flights and connections from Honiara cost \$US 325. There are boats from Honiara, but they are very slow and also relatively expensive. This has led to the development of a local economy between three enclaves of infrastructure in Munda, Noro and Gizo.

The ADB calculates the population of Noro to be over 4,500, and the amount of people easily connected by road between there and Munda to be over 8,500⁷⁵. The island of Gizo is relatively densely populated compared to the rest of the country, hosting about 170 people per km², with the town of Gizo accommodating over 3,500 people⁷⁶. This very conservatively puts 16,500 people in this productive triangle in 2007, with an exponentially larger number frequenting the triangle to access services and markets. In the province as a whole, the population growth rate is 3.2%, significantly above the national average of 2.8%.

70 Estimates are made from population projections made by ward from the National Office of Statistics for 2010.

71 Numbers were given by STL Regional Managers in March 2010. They are the number of subscribers registered to the tower which serves the denoted population area.

72 Maetala, Ruth. (2008).

73 This is the percentage for the settlements surrounding Honiara, and does not include the urban centre. This is also true for all following figures denoted with a " ^ ".

74 Figures in this row, and the subsequent four rows are taken from: The Australian National University. (2010). The People's Survey 2009. ANU Enterprise, Australia.

75 ADB. (2005). Solomon Islands Emergency Assistance Project: Social and Poverty Assessment New Georgia South Road, Western Province. Accessed on: April 21st 2010) <http://www.adb.org/Documents/IPSAs/SOL/41105/41105-SOL-IPSA.pdf>

76 ADB. (2007). Solomon Islands Road Improvement (Sector) Project: Supplementary Appendix D Ghizo Subproject, Western Province. <http://www.adb.org/Documents/Supplementary-Appendixes/39581/Supplementary-Appendix-D.pdf>

Gizo is where the provincial government sits, Solomon Islands Provident Fund (SINPF) has an office, and NGOs like Oxfam, UNICEF, and World Wildlife Foundation (WWF) have their offices. There is also a reasonably developed tourism infrastructure. Noro is the industrial capital of the province, hosting the country's second largest international port. There are some notable large employers like the Sol-tai cannery, one of the largest employers in the country, the National Fisheries Development Limited, the Kolombangara Forest Products Limited (KFPL) on the nearby Kolombangara island, as well as some government posts. The workers from these industries have created a high demand for secondary goods like fruits and vegetables, which are currently largely being imported from abroad. Munda is a sleepy town about 30 minutes away from Noro overland with a domestic airport, some tourism infrastructure, YWCA office, and the Tetepare Descendants Association main office. All three centres have BSP and ANZ branches or agencies and Automated Teller Machines (ATMs).

5.2 Malaita

In 1999, Malaita had a higher population than Guadalcanal. The National Statistics Office still projects that it is the most populous province (159,923 vs. 141,601)⁷⁷. The problem has been and still is that while there is a significant population on Malaita there is almost no formal economic infrastructure and very little formal economic activity. This is largely accepted as the reason for many Malaitans migration to Honiara, and the foundation of the subsequent *tensions*. Anecdotally it does seem that many Malaitans who fled Honiara during or after the *tensions* moved to Auki, Malu'u or the connecting corridor between the two economic centres. This area, referred to in this report as the "Auki-Malu'u corridor" seems to have relatively high population densities, a reasonable amount of infrastructure, and a significant amount of informal economic activity.

People in the area note the increasing amount of small shops being opened along the road from Auki to Malu'u. The market in Auki is surprisingly small and unimpressive, but the Japanese government has just committed to building a new market and improving the wharf. Most of the economic activity is agricultural, serving both the local markets, as well as being transported to Honiara, and in some cases exported. The branch manager at ANZ said that during the cocoa season between July and September their daily transactions regularly increase by two powers of magnitude. These transactions are almost all cashing checks from exporters, and the cash is then filtered into what appears to be a healthy informal economy. Most of ANZ rural's clients are along the Auki – Malu'u corridor. BSP also has a branch in Auki.

5.3 Guadalcanal

The economic and infrastructure development of Honiara resulted from Henderson Air Force base on Guadalcanal during WWII. Today Honiara hosts the country's largest domestic market, only international airport, and only density of paved roads. It is where most institutions have their central offices because of its superior infrastructure. Internal migration to Honiara has made it a culturally diverse place. It has also contributed to a large urban sprawl surrounding the city, slowly extending the boundaries of basic infrastructure outwards into the jungle and plains. However beyond the frontiers of these settlements, roads and general infrastructure are in poor repair alike to the situation in the rest of the country.

The Guadalcanal plains are one of the flattest, most fertile areas in the Pacific and a bastion of cash crops such as copra, cocoa, and more recently palm oil. Much of the produce consumed in Honiara and prepared for export comes from this area. However transaction costs are high, roads are often not passable, and there is little supportive infrastructure or means of reliable communication with outside markets. Besides the Guadalcanal Plain Palm Oil Ltd (GPPOL), all of this activity is done

⁷⁷ Numbers are projections made by Solomon Islands National Statistics Office, based on the 1999 Census. Accessed on: (May 12th 2010) <http://www.spc.int/prism/country/sb/stats/Social/Popcen/Projection.htm>

on a small holder basis, in the informal economy. This production is far away from the commercial bank headquarters in Honiara, so despite this population density and oasis of economic activity, most people do not access formal financial services. Due to disputed land titles and boundaries, most property in settlement areas is not insured, and only about 40% of people in the area have a bank account.

5.4 Rural Solomon Islands: The case of Santa Isabel

While places like the Noro-Munda-Gizo triangle, the Auki-Malu'u corridor, and the Honiara area probably have enough economic activity to support a financial service provider to use traditional microfinance, this is probably not the case for the rest of the country in the short term. Isabel is a noteworthy example of financial services in remote areas.

There are currently 292 registered savings clubs, with about 70% of them located in Isabel province, and about 80% of those operating in the Hograno district of Isabel⁷⁸. As shown in Figure 11, while only 1.7% of people on Isabel have access to a bank near their house, 27% of them have a bank account. This is a complete anomaly compared to other provinces where the ratio is inverted.

While much more research needs to be done to reach a comprehensive conclusion, there are also some unique factors about Isabel that have led to this development that will not be possible in other regions. There is a unique power sharing agreement in Isabel. As high as 90% of people there are members of the Anglican Church of Melanesia (ACM), the traditional system of chiefs is still very influential and the provincial government is respected.

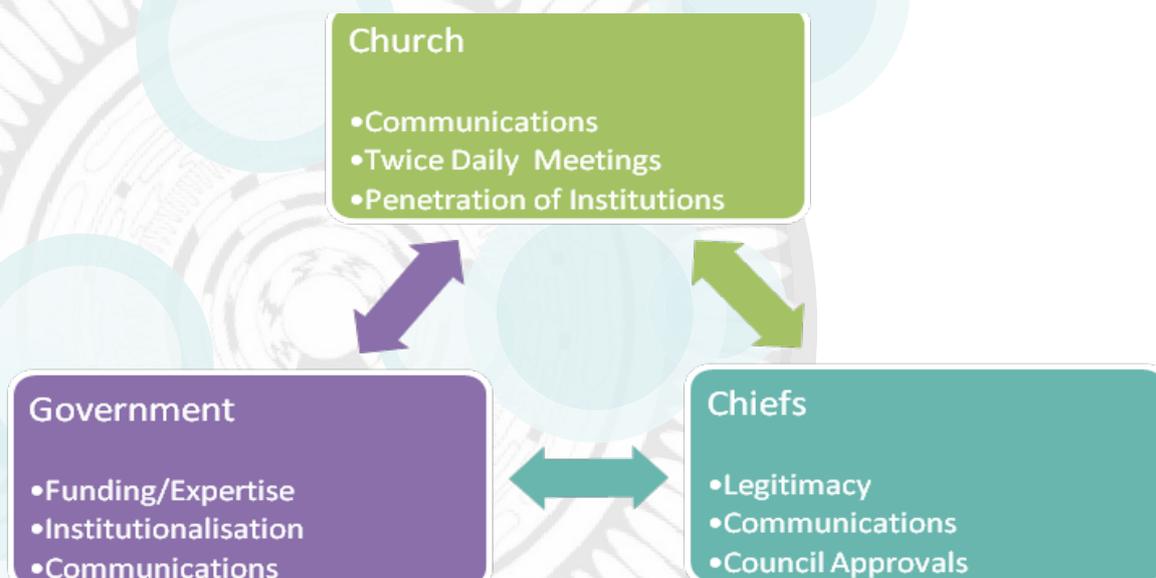
Together these three seats of power form the “Tripod”, which decides policy throughout the island. This works well in Isabel for two main reasons:

1. The people of Isabel are relatively united by language, culture, religion, economics, and their own isolation.
2. The population is small so some leaders have more than one affiliation, for example a religious chief or a chief elected to provincial governor,
3. The coordination between religious, traditional and governmental systems means chosen initiatives can very easily be transmitted through the Church's vast communication network, given legitimacy through the powerful traditional system, and funded or institutionalised by government.

In this way movements can develop quickly and reach sustainable levels relatively easily. The ACM has its members meet in the morning and evening every day. During these meetings there is always a time to convey messages and share news. This is where savings clubs have been promoted.

⁷⁸ Vavaha, Norman. Savings Club: A Source of Financial Service in Hograno. Solomon Star News, Weekend Magazine. Saturday, 10 April 2010.

Figure 12: Tripod Structure of Isabel



This enabling power sharing agreement has worked to promote the movement and facilitate its development, but has failed to effectively network it to outside resources, or institutionalise it locally. Therefore all the savings clubs and credit unions are small scale, and operate independently of each other. There is not training or technical resources available to them, much less many opportunities to invest accumulated funds. They are in need of support, as they have currently reached a developmental ceiling and will continue to hover here, or regress without assistance. (See section on Savings Clubs)

6. The Enabling Environment and Support for Financial Services

6.1 Legal and Regulatory Framework

Although individually analysing different acts and legislation affecting the provision of financial services in rural areas is beyond the scope of this report, it is obvious that there are some specific pieces of legislation that do need to be reviewed, and some that debatably need to be created. Fortunately this was all reviewed in the 2005 conference on microfinance and specific recommendations were made. Most of these have not been implemented to date. It should also be noted that it was strongly suggested the problem was not in the written legislation, but in the enforcement of it⁷⁹. For example credit unions are required to report to CBSI, but only nine currently do. Realistically it does seem that the current framework is lacking policies that reflect contemporary best practices and meaningful enforcement. The table below lists the suggestions from the conference and other literature as well as the current status of progress since then.

It is worth noting that a revised Credit Union Act has been fully drafted and has languished for years waiting for Ministry of Finance action.

79 CBSI. (2005). Report on the National Conference on Revitalizing Rural Finance in Solomon Islands. Pg 7.

Figure 13: Status of Financial Inclusion Legislation & Policy

Regulation/Legislation	Description	Status
Telecommunications Act (2009)	Has ended the Our Telekom monopoly. bemobile now also has a license to operate in SOI, and full market liberalisation occurs in 2011.	Telecommunications Commission is currently regulating the market, and has a commissioner in place.
Companies Act (2009)	Outlines process to start-up and register a new business	SICCI supports it, which is positive.
Counter Terrorism Act (2009)	Written to reform and amend AML/CFT legal framework	Enacted by Parliament
Currency Declaration Act (2009)	Written to reform and amend AML/CFT legal framework	Enacted by Parliament
Secured Transactions Law (2008)	Broadened the range of assets that can be used as collateral for loans to movable assets such as boats, cars, and farm equipment, however it is unclear if this has enabled more lending	There have been comments from the commercial banks that this has increased the cost of loans, with only marginal benefits to the credit market.
Credit Union Act of (1986)	The new draft will remove the 12% interest rate cap, and increase the min no of members in a CU to 300, if passed.	Has been rewritten by CBSI, and passed through the Economic Reform unit at MoF. Currently submitted to cabinet and pending approval.
AML/KYC Requirements	ANZ is using reduced KYC procedures for low risk clients in provincial branches, and especially in the rural banking programme.	ANZ mainly follows these guidelines from RBA, but BSP takes its cues from CBSI, and would like to see requirements lessened.
Financial Institutions Act (1998)	Designed to regulate commercial banks, and only has very general language about non bank financial institutions	Revisions not yet being done, but 1999 revision done to regulate pyramid schemes under this act.
National Provident Fund Act (1976)	Operational and management stipulations considered out of date.	Revised version with economic reform unit at MoF and then will go to cabinet.
Cooperatives Act (1968)	Cooperatives feel it needs to be updated.	There is no current review underway.
Trustees (Charitable) Act (1925)	Does not have provisions for MFIs or other specialised financial service providers	New draft being written by SolLaw law firm with support of ADB.
Microfinance Legislation	Deposit mobilisation is restricted to regulated FIs or CUs. No minimum capital or reserve requirements for MFIs	A specific act addressing non bank financial service providers was suggested at the 2005 conference.
Land & Titles Act (1969)	Review to facilitate title registration, transfer and to see if supportive language is required for the recognition of matrilineal land rights in some provinces.	There is no current review underway.

6.2 Central Bank of Solomon Islands (CBSI)

In 2009, under the International Financial Reporting Standards (IFRS), the Central Bank made a profit of SI\$ 40.9 million (US\$ 5 million). This was lower than in 2008, reflecting reduced revenues resulting from the global financial crisis and increased costs, mainly the increased printing of money. Total assets were SI\$ 1,396 million (US\$ 174.5 million) in 2009, and liabilities increased drastically to SI\$ 1,081 million (US\$ 135 million). CBSI assesses and approves all non-trade and trade payments up to SI\$30,000 and SI\$50,000 respectively as part of their exchange rate control operations⁸⁰.

⁸⁰ CBSI. (2009) 2009 Annual Report. Pg 51.

CBSI has appointed itself a champion of financial literacy in Solomon Islands, and does a Money Smart day once a year in Solomon Islands to promote the concept. It has more recently spearheaded initiatives to promote financial inclusion in general. In 2009 CBSI co-hosted a learning event on mobile money, joined the Pacific Central Bank's Financial Inclusion working group to create an enabling regulatory environment for inclusive finance. In 2010, CBSI provided research and logistical support to this study and sent a senior manager to the primer microfinance training in the world in Turin, Italy. Moving forward, CBSI has some important roles to play in ensuring that access to appropriate financial services is significantly increased in Solomon Islands.

6.3 SME Training

There are a number of technical support agencies and associations of note. There are three organisations doing small business training called Small to Medium Enterprise Business Centre (SMEC), MASE Business Training Centre, and Small Business Enterprise Centre (SBEC). They all offer similar services and are officially coordinating under an agreement they signed together with the Ministry of Commerce in April 2009. SMEC focuses on helping people prepare documents for loan applications, advising them on starting up businesses and providing training workshops. SBEC opened in 1998 and receives 90% of funding from the New Zealand Aid programme. It focuses on teaching people how to start their own businesses, through a two week long training course costing SI\$ 300 (US\$37.50) in urban areas, with discounts given for rural workshops. SBEC provides follow-up training for twelve months after the course and used to also provide loans to graduates of the programme, but the New Zealand Aid Programme refuses to keep funding them as there was an extremely low repayment rate. MASE is a locally owned business established in July 2007. Its products are focused on technical trainings for businesses that have been operating for over 6 months. It offers courses from two days at SI\$ 390 (US\$ 48.75), to certificates in business administration for SI\$ 4,790 (US\$ 600).

The partnership between MASE SMEC and SPEC is funded with SI\$ 500,000 (US\$ 62,500) from the Ministry of Commerce, and has the goal of administering training in all 50 constituencies in Solomon Islands with the objective of opening 30 new businesses in each constituency each year. SBEC will use its Start Your Own Business (SYOB) curriculum to train those wishing to start businesses, MASE will contribute its Start and Improve Your Business (SIYB) programme to target existing businesses, and SMEC will provide financial capacity training to both developing and established businesses. There has been no monitoring or evaluation of this partnership programme to date to measure any impact it might be having.

6.4 Trade Unions

There are 14 trade unions affiliated to the Solomon Islands Council of Trade Unions and two major employer associations, namely the Chinese Association and the Federation of Employers. Unfortunately the details of these organisations are beyond the scope of this report. However the Solomon Islands Chamber of Commerce and Industry (SICCI), which is registered as a trade union, is noteworthy. SICCI has around 75 members representing 80% of the formal private sector workforce. While the largest companies in the country are members, approximately 55% of the members have fewer than nineteen employees and therefore are of moderate size. In 2009, SICCI reported an income of SI\$817,500 (US\$102,188), of which about 20% comes from donor funding. Besides advocating for a better enabling environment for business, they also provide networking events, and offer advice to those wishing to start new businesses.

6.5 Credit Union Foundation of Australia

CUFA provided extensive comments countering many of the original comments of this report related to their support of the credit unions. The authors have chosen to minimize the section on CUFA

*support given its concerns over its original content. Additional information may be found on CUFA's website.*⁸¹

The Credit Union Federation of Australia (CUFA) has operated in SI for many years. AusAID has funded CUFA to work in Solomon Islands since 2003. Until 2009-10, the focus was on SICUL and its member credit unions. AusAID noted it did feel that CUFA's work plans were ambitious in the past given the resources and environment but did not have detailed reports to share on the activities or outcomes of CUFA's work. As of the writing of this report, the AusAID Solomon Islands office was not aware of CUFA's current work in the country.

CUFA had an expatriate technical assistant permanently based in Solomon Islands providing assistance to SICUL and the larger credit union movement for a period of eighteen months. Since his departure CUFA has employed two local staff who are primarily responsible for visiting savings clubs, reporting to CUFA and encouraging other savings clubs to report. Both have been involved with the Credit Union movement in the past but noted they had minimal experience in training, providing technical assistance and are not tasked to provide either. CUFA has provided technical assistance incountry through visiting technical staff. SICUL reported that these visits have been two to three times per year and may include a workshop for partners.

The new project commencing in 2010-11 focuses on building the capacity of the grass-roots financial cooperatives, the savings clubs. CUFA commenced providing direct support to the savings clubs in January 2010. CUFA is providing "support and guidance to develop their financial accountability and operational transparency to help develop trust within the communities."

6.6 Solomon Islands Credit Union League

While SICUL has been technically functioning since 2003, it has not been doing field visits or providing any significant technical support to CUs. It has been operating without any technical experts on credit unions on staff, and its operating cost has been paid primarily by the interest from the one million SBD (US\$ 125,000) in treasury bills that CBSI is holding in trust for SICUL. The current yield on the bills is 4%, or about SI\$ 120,000 (US\$ 15,000) per year. CBSI signed an MOU with SICUL in the last week of March 2010 which promised SI\$ 257,020 per annum total support budget for the next three years, of which SI\$ 86,720 is the total remuneration package for the General Manager and the remainder for the operational cost support.⁸²

Currently, SICUL does not analyse CU reports that are received. It simply checks to see if all the fields have been filled in, and if they are complete, they are filed into the database. They also sell materials, like manuals on how to organise a CU or savings club, and the forms that CUs need in order to do their monthly reporting. The major problem with this system is that most members of CUs and SCs cannot read very well if at all, and have very low numeracy. They therefore have little use for written text in English. Further, the materials all seem too expensive for the value they offer and it is very difficult to turn in the monthly financial reports, so sometimes the few organisations that are reporting will actually wait months for someone to travel to Honiara to take all the reporting forms.

SICUL recently employed a new General Manager in early 2010 who is working diligently to revive SICUL's activities and working with the board to formulate a new strategic plan for SICUL. Having a manager will be a great help as they have to begin the process of rebuilding trust with the CUs, and developing a line of support services that really add value to CUs and help them stabilise and evolve. The strategic plan will be essential to enhance SICUL's role as a supportive body rather than

81 <http://www.cufa.com.au/>

82 From the General Manager of SICUL, Selwyn Talasa.

just a reporting agency. World Council of Credit Unions (WOCCU) best practices state that CU federations like SICUL should be member driven and membership to them should be optional. This would suggest that going forward CBSI would take on the role of reviewing financial reports for oversight, whereas SICUL membership may be voluntary and in return for the benefits obtained through SICUL. Products the league offers and the prices they charge for them should also be determined by members.

6.7 The Credit Union Revitalisation Project

This CURD project was approved by CBSI in 2004 and led by Pacific Enterprise Development Facility (PEDF) of the International Finance Corporation (IFC). It was designed to assess the status of credit unions after the tensions, identify problems, and formulate a strategy for revitalisation and growth of the movement. The result was two reports (Stage one and two) that include very helpful recommendations, such as to update the Credit Union Act of 1986, differentiate the roles of SICUL and CBSI, and make SICUL sustainable. Nobody contacted in the course of this study was even able to locate a copy of the Stage One Report. However, the Act has been formulated although not enacted by SIG. SICUL is not yet sustainable. It appears that it was difficult to collect reliable data, as there are only incomplete statistics reported and no supportive details listed anywhere in the reports (See section 7.3 on credit unions for more information).

6.8 Microfinance Resource Centre (MRRC)

CUFA funded and assisted with the Microfinance Rural Resource Centres (MRRC) project and assisted SICUL in obtaining EU funds (SI\$100,000) for this project. The purpose of the MRRC was to open five centres in Malaita and two in Isabel. According to the EU project document, this was to also include five microenterprise funds and training. The model was founded on volunteer work locally, and education and funding oversight by SICUL with coordination and monitoring (and some financial support) from CUFA.⁸³ MRRC does not appear to have achieved its goals. A visit to the MRRC in Kilusakwalo revealed a leaking roof and no written or other resources. The MRRC in Busurata is now being used as a community rest house and contains no resources. In Buala the former treasurer is safekeeping much of the furniture in his house, and the former manager has gone back to his village. Representatives of SICUL and the former Malaita MRRC coordinator had no information on the MRRC in Malu'u or those in the East and West. Unfortunately, many of the savings clubs these MRRCs were meant to serve have also closed or are operating on a very small scale⁸⁴. No mention was made by anyone interviewed of a microenterprise fund.

7. Financial Sector Overview

7.1 Commercial Banks

There are three commercial banks in Solomon Islands, namely ANZ, BSP and Westpac. Of the three, only ANZ and BSP have infrastructure and networks extending beyond Honiara. BSP and ANZ have a handful of branches around the country and BSP also has an extensive agent network. Both banks have significantly expanded their ATM networks to provinces, but it has been very expensive to service them and keep them cashed up. ANZ also operates its rural banking service via vans. In general, the commercial banks report not being able to break even on operations outside of Honiara. Despite this physical presence outside of Honiara, there is still very little uptake of their services.

⁸³ Discussions with CUFA indicate that CUFA was not aware of the details of this agreement, which was managed solely by SICUL.

⁸⁴ Three of the four savings clubs associated with the Kilusakwalo MRRC were closed and the fourth may also have been. The former president was not aware of any large savings clubs or credit unions functioning in the area, and said many had been closed due to lack of technical support.

Figure 14: Commercial Bank Infrastructure (June 2010)

	ANZ	BSP	Westpac	Total
Branches	5	7	1	13
Agencies	1	8	0	9
ATMs	20	12	2	34
EFTPOS	72	2	55	129

It is possible to make a few generalisations about the three commercial banks' strategies toward financial inclusion and identify some common impediments to the success of those services that they all share. Below are common observations that were made repetitively from different stakeholders around the country:

- there are too many fees for deposit services;
- forms are written in English, and require more information than rural people usually have available;
- there is no marketing in rural areas or wide scale efforts to educate people about services;
- deposit accounts only offer negative real interest rates;
- long lines in branches and unfriendly/unhelpful staff;
- services are not provided close enough to residence/place of work.

All commercial banks are pursuing the expansion of electronic banking services as a cost effective means to extend their services. Westpac and ANZ have focused on EFTPOS (Electronic Funds Transfer/Point of Sale) devices but had trouble with the connecting phone lines, the capacity of retail operators, as well as the unwillingness of retailers to pay fees for the systems and be subject to the detailed records produced by the systems. The systems are heavily concentrated in Honiara and are not currently interoperable. However there are current discussions between all three commercial banks to have interoperable EFTPOS and ATM services. BSP is currently exploring GPRS EFTPOS, which will run on a mobile network and bypass the need for landline connections. This obviously will depend of the future development of the telecom network.

7.2 Insurance Companies

The insurance industry is still relatively new in Solomon Islands. The Insurance Commission was not founded until 1985, and has since been dissolved so that the Governor of the Central Bank now regulates the insurance market. In this brief history there have been a couple significant efforts to extend insurance coverage to the larger population. The first was Life Mutual Insurance Company's effort to provide life insurance to SINPF members as well as the general public, which had financial difficulties and was closed in 1998. Solomon Islands Mutual Co. offered an array of insurance products to SINPF members and the general public, but then lost its business license in 2005 due to noncompliance with the Insurance Act (1985). It is currently operating in Honiara, but not on a very large scale.

The major brokers are BJS United and MAT. Tower Solomon Islands and QBE Solomon Islands are branches of Tower New Zealand Limited and QBE International Insurance Limited respectively. Tower takes up small to medium risks while QBE branch underwrites larger policies. Tower has given thought to developing an agent network, but has not yet formalised anything. Total assets for the insurance industry in Solomon Islands stood at SI\$ 94 million (US\$ 11.75 million) at the end of 2009. In 2009 the insurance industry reported SI\$ 12.2 million (US\$ 1,525,000) in after tax profits, an increase from the reported SI\$ 8.3 million (US\$ 1,037,500) in 2008. This was mainly due to a 20% growth in premiums, reflecting higher rates and some new businesses opening policies. Currently 91% of policies are in general insurance rather than life insurance.

7.3 Credit Unions

Credit Unions are quasi-formal institutions in that they are governed by a specific act and are required to register with the government. All nine reporting credit unions are based in Honiara (See figure 12). These nine have limited membership to those actually employed the associated umbrella organisation. Only the largest CU, SI Public Employees Union CU, was visited during research for this report. It adheres to the 12% APR lending cap that has limited the growth of all CUs, offering a general loan and educational loan product at this ceiling rate. This interest rate cap also limits its ability to pay dividends, or competitive interest rates on deposits. Contributions are deducted from members' paychecks and contributions are made directly on behalf of the members by the Ministry of Finance (MoF). SI Public Employees Credit Union noted they were not working with SICUL or CUFA. The below table shows that these reporting CUs have a maximum of 4,010 active members, when compared to the 84,608 contributing members to SINPF, that means that even within the formal labour force, only 5% of people participate in a registered credit union.

Figure 15: The Names of the 9 Reporting Credit Union⁸⁵

Name of CU	Membership	Total Assets (SBD)	Market Share
Bokolo CU	87	\$1.6 m	4%
RSI Police CU	513	\$4.5m	12%
Solomon Airlines Staff CU	121	\$1m	3%
FFA Staff CU	42	\$0.9m	2%
SI NPF Staff CU	88	\$0.8m	2%
SI Public Employees Union CU	2378	\$19.7m	53%
SI Nurses CU	402	\$5.5m	15%
SI Health Workers CU	330	\$3.1m	8%
Melanesia Crusaders CU	49	\$0.2	1%
Total	4010	\$37.2m	100%

Note: All these are Honiara based Credit Unions

7.4 Solomon Islands National Provident Fund (SINPF)

SINPF is a major source of investment and liquidity in Solomon Islands. It currently has one billion dollars (US\$ 125 million) in investments, of which 70% is invested domestically. SINPF, like many provident funds in the Pacific, has a mandate for domestic development, and has played a past role in increasing financial inclusion. Formerly it channeled funds to rural areas through DBSI in a scheme called "Money Grow". This stopped when DBSI started experiencing financial troubles. Since then SINPF has experimented with different insurance schemes for both members and the general public and currently offers life insurance to all members.

SINPF has approximately 140,000 members with positive balances in their accounts, yet only 84,608 of whom are currently making regular contributions. Members are generally based in Honiara, but SINPF also has offices in Auki and Gizo where there are also relatively large concentrations of members who access their accounts. Withdrawals fluctuate between SI\$40-80 million a year. At age of fifty, anyone can begin scheduled withdrawals. Withdrawals can be made earlier for medical reasons, if one decides to retire and is 40 years of age or if they are made redundant they can withdraw a third of their balance above SI\$10,000. There is a voluntary option for self-employed workers, but it is not very popular. SINPF is interested in participating in the expansion of financial services to rural populations, and maintains that any initiative should be institutionalised and borrowing must be affordable.

⁸⁵ Table Provided by CBSI, numbers are from year end 2009.

8. Rural Finance and Microfinance

Table 16: SWOT analysis of rural finance in Solomon Islands

Strengths

- Strong support of CBSI and donor community
- Recognition of the importance of financial literacy
- Demand for savings is high (as evidenced by voluntary savings clubs and ANZ Rural Banking)
- Wide range of economic activities in rural areas, and numerous sustainable livelihoods programmes supporting them
- Historical demand for MF programmes (rural banking, savings clubs, credit unions)
- There are some innovative models on small scale seemingly working well
- Recognition of need for improvement and willingness of stakeholders to work together
- SIPC has a large network

Opportunities

- New Our Telekom 2G network around SI and 3G in Honiara.
- New services from bemotion
- Donor focus on basic infrastructure improvement (roads, wharfs)
- Honiara, the Gizo-Noro-Munda triangle, and Auki-Malu'u corridor are population centres with significant economic activity and few financial services
- Leverage of current rural networks to provide financial services
- No competition for a Greenfield
- Interest of SIPC in financial inclusion
- Increased donor commitment and funding available for new approaches
- Financial education efforts of multiple players

Weaknesses

- Difficult enabling environment for business
- The formal financial sector is focused on salaried workers
- Government, NGOs have set a dangerous precedent by giving handouts and offering loans that they did not collect
- Lack of appropriate products and services
- Weak microfinance support institutions
- Lack of accurate data and knowledge-sharing among organisations
- Extremely expensive transportation, and unreliable communications network
- Few large networks or associations
- Savings clubs lack support
- Credit Unions with weak regulation and hampered by interest rate cap
- Very low financial literacy

Threats

- Events surrounding the 2010 elections have an uncertain outcome
- Unstable macroeconomic environment, only recently stable inflation, low GDP growth, high poverty rates
- Archaic land tenure systems, land unavailable for collateral
- If RAMSI leaves, there could be more turmoil.
- Deteriorating infrastructure
- Economic downturn in 2015 when timber is exhausted
- Government intervention in private finance
- Inability of stakeholders to coordinate
- Extending financial services without financial education could be detrimental

8.1 Formal Financial Sector

8.1.1 Bank of the South Pacific

BSP provincial branches and agencies serve small business owners and salaried professionals almost exclusively. Agencies take deposits and facilitate withdrawals, but do not extend loans, while provincial branches provide most of the services offered in Honiara. All branches offer loans, and salaried workers can use balances in their SINPF accounts as collateral, all branches also offer money transfer services through Western Union agents.

The fee structure on accounts is most often cited as the major impediment to non-salaried workers. Know your customer (KYC) regulations also play a role, and even though BSP is using reduced KYC procedures, they believe there is still a significant impediment to people without salaries. BSP states they would gladly lower KYC requirements if CBSI were to lower the current guidelines.

BSP does not currently have a business model that allows it to expand financial access to those who

do not currently have bank accounts in rural areas in a profitable manner. Major costs incurred currently are communications, low efficiency per transaction in branches, servicing equipment like ATMs, and transporting cash. However, it is actively exploring and implementing new technologies that allow it to expand access at greatly reduced costs. BSP recently finished the installation of its 11th ATM and is now shifting its focus to GPRS⁸⁶-EFTPOS systems, and then will evaluate implementing the SMS⁸⁷ banking product that is functioning in PNG. It is not clear if these new channels will be used to recruit the unbanked; BSP's SMS banking product was designed to service existing customers. At the same time this expanded network may provide the infrastructure to launch a more aggressive rural banking campaign as is current underway in PNG or may be an attractive platform for other service providers.

8.1.2 Australia New Zealand Banking Group

Branches offer savings, loans, and insurance products which are targeted at salaried professionals such as teachers and nurses and small businesses in provincial capitals. ANZ utilises CBSI approved KYC requirements for opening accounts, allowing letters from community leaders, or introductory letters from staff count towards their 100 point requirement⁸⁸. However it is still difficult for people living in villages, many of whom do not have a suitable identification, to open bank account or access their other services.

To be eligible for a loan, the applicant must have a stable, verifiable income or, in the case of Rural Banking, a regular savings history at least equal to 50% of the value of the loan in savings. This coupled with the few other requirements seems enough to deter most clients, and lending is therefore done almost exclusively from offices in Honiara. Loan applications go through a centralised approval process which takes three to five days on average. Lending rates are generally between 14-22% annual flat, which are roughly in line with competing commercial banks.

ANZ has begun promoting products from its partner Tower insurance in their branches, but products are designed for relatively affluent clients. Products include Motor Vehicle, Home, Travel, and personal loan insurance (credit life). These products do not seem to be very popular so far in provincial branches and are not designed to address the risks that low income people in rural settings face. The only product which might interest them is the Home Insurance, however due to unsecure land tenure issues, most are not eligible.

8.2 Public Private Partnerships

8.2.1 ANZ Rural

ANZ Solomon Islands was provided a copy of the draft report. Per their request, much of the information provided by ANZ on its rural banking is not included in this report. The information in this report is from secondary sources, including the CBSI. The author regrets the lack of information on this very interesting programme.

ANZ rural banking began in November 2005 on Guadalcanal, expanded to Malaita in September 2007 and is operated with a grant of SI\$ 3.9 million (US\$ 487,500) from the Solomon Islands government. After large growth rates at the beginning of the service, recent numbers have been more muted and monthly transactions have declined. At the end of 2009, ANZ was serving more than 15,000 depositors, over half of whom were on the Guadalcanal Plains. Customers maintained an average of

86 General Packet Radio Services (GPRS) is a packet-based wireless communication service that allows data transfer with a continuous connection to the internet for mobile phone and computer users.

87 Short Message Service (SMS) is the common term used to describe Instant Messaging available on mobile telephones

88 The 100 point system is imported from Australia in response to AML/CFT policies, where new clients must produce different proofs of identification that add up to 100 points.

SI\$ 600 in these accounts (US\$ 72) and it was growing. Initially two types of accounts were offered. The primary difference was access to ATMs and the minimum balance requirements. For the basic rural banking savings account, there is no minimum balance or monthly fee, but a withdrawal fee for clients per transaction (initially S\$ 6).

The number of loans at the end of 2009 was very low, well below one hundred. Numbers of new loan applications are low and while this may be a reflection of economic factors, it was also noted that loans are not being actively promoted by ANZ rural staff, who lack incentives to do so. There have been some problems with loan repayment; while ANZ Solomon Islands did not want to release any numbers on default, the sister programme in Fiji had to write off over 60% of its portfolio⁸⁹. Lending is an important part of the rural banking product, as it has the potential to generate revenue. However, a new repayment mechanism needs to be designed based on microfinance theory that ensures a reasonable rate of collection.

ANZ mobile banking units were expected to take three years to cover costs out of revenues, with micro loans and personal loans being the main source of revenues. Despite its impressive outreach among savers since early 2008, it will not meet this goal. Funding support from SIG expires in mid-2010, and ANZ has over the past 18 months implemented reforms to provide a more cost effective service. Since transportation costs are so high in their model, community visits have been reduced to once a fortnight from the previous weekly visits and the number of stops they make along routes have also been reduced and confined to the more populated hubs.

Experience in Fiji highlights that vehicle based banking is a high cost model for service delivery and can be frustrating to clients when schedules are disrupted or visits are scaled back to manage expenses. ANZ is committed to Rural Banking but will need to significantly invest in a new rural strategy to change the viability of the service.

The service has had to combat significant challenges, which has made it very expensive. For example:

- clients are served individually, and meander to trucks upon arrival keeping staff waiting. There are not lines like in branches, which help tellers serve a maximum amount of customers per day;
- mobile tellers use lap tops or satellite phone to call headquarters and enquire about client's account balances;
- the array of products offered and nuances of each, leave staff explaining details of the products when they could be serving other customers;
- Vehicles used are expensive to maintain and fuel;
- sometimes community members bring in large bags of coins that take the tellers a long time to count by hand;
- community members have been stopping trucks and demanding "tolls" for fixing the roads (See Focus Box 2).

Given these challenges, ANZ is committed to providing this service, which is really important to rural professionals such as small business owners and teachers who would otherwise have to spend a great portion of their income on accessing their money. It is fair to say that ANZ management views rural banking as part of ANZ's corporate social responsibility rather than a business line and there have not been significant efforts to increase revenues generated from the service. ANZ reports that it continues to look for ways that rural banking can expand its services for the long term, but nothing concrete has been proposed or reported to date. There seems to be an opportunity to differentiate the prices for their deposit taking services between low value community savings accounts,

⁸⁹ Pacific Financial Inclusion Programme (PFIP). (2009). Fiji Financial Service Sector Assessment. United Nations Development Programme (UNDP). Suva, Fiji.

and the relatively high value rural professional accounts. The latter in many situations are just using ANZ Rural as a money transfer service, having them bring their wages out from the city to their post. This is a valuable service as it saves GPPOL workers and teachers alike a significant amount of money in transaction and transportation costs. Therefore there is probably the opportunity to levy a higher price for this service.

8.2.2 ANZ/SIPC agreement

SI Postal Corporation (SIPC) has a total of 115 agencies across the country covering every provincial capital and leveraging general stores in rural areas to provide postal services. According to SIPC, the Partnership arrangement was initiated by UNDP through ANZ and with SIPC to use the SIPC postal network to provide deposit and EFTPOS services to rural customers. However EFTPOS service was later discarded and ATM machines were implemented in their place, removing the deposit taking functionality. SIPC has allowed ANZ to house ATMs in SIPC agencies in provincial areas. The current SIPC management signed a land rental agreement with ANZ for five year period expiring in 2012 for the lease of the land area occupied by the ATM machines. By the end of 2009, ANZ had installed seven ATMs around the country in SIPC agencies. While this is a beneficial service, SIPC would like to provide a greater array of financial services that extend beyond facilitating withdrawals. Specifically they would like to support deposit taking and domestic money transfers. They do have a Western Union office in their Honiara head office, and are developing their own strategy for further involvement, but are not yet sure what role ANZ would play in its development.

8.2.3 Small Business Finance Scheme

Many local businesses lack the required collateral to secure a loan from any financial service providers. Therefore, SBFS was reintroduced in 2007 to help small and medium enterprises (SMEs) access capital, with a focus on those SMEs that are engaged in rural or export business ventures. Funding is provided by the SIG, who deposited SI\$10 million (US\$ 1.25 Million) of seed-capital into a trust account at CBSI. CBSI guarantees participating financial institution's lending by providing an 80% guarantee on the unsecured portion of an approved loan. The participating financial institution then guarantees the other 20% of the loan, and administers it. Currently ANZ, WestPac and BSP all technically qualify to nominate loan candidates for the programme, but only ANZ and BSP have been actively using the programme.

Since inception in 2007, only 35 loans have been approved in the scheme. There has been a strong decline in nominations made by participating commercial banks (PCBs) beginning with twenty nominations in 2007, dropping to twelve in 2008, and only proposing three in 2009. Of the 35 loans, 15 were from Honiara and 33 are still currently outstanding. One loan has been paid off successfully and another is being claimed under the programme as the borrower defaulted on payments. At the end of 2009, the value of outstanding loans was SI\$ 4.257 million (US\$ 532,125), of which the SBFS scheme guarantees SI\$1.688 million (38%) and the commercial banks have exposure of SI\$ 0.422 million (10%), and the borrower absorbs the outstanding 52% of risk.

There have been some efforts by CBSI to evaluate the programme to ensure that it is both utilised and making an impact on rural income generation. A list of major critiques is below:

- the programme only subsidises current commercial bank products and does not create a new product directed at rural businesses and low income people;
- the minimum loan amount is too high;
- the process the PCB must go through to make a claim under the scheme is too costly and takes too long;
- even with the guarantee by SIG, the commercial banks still feel like they are too exposed to risk;
- there has been little to no promotion of the scheme, and therefore general awareness of it is low.

8.2.4 Global Environmental Facility – Sustainable Energy Financing Project

This is a partnership between: Global Environmental Facility, which provides capital; the World Bank, which lends the capital; ANZ, which administers the funding and provides loans; and CBSI, which assists with project implementation.⁹⁰ The World Bank identifies financial institutions with the interest and capacity to extend loans to businesses and individuals who would like to buy renewable energy systems. For qualifying institutions, the World Bank then guarantees 50% of any loan extended by the institution for renewable energy products from pre-approved retailers. At the end of 2009, there were three different approved retailers. This reduces the risk of lending in what is still considered a less proven industry.

At the end of 2009, ANZ bank was the only participating financial institution, reporting that to date only four loans had been processed and approved, three of which were loans to individuals amounting to SI\$ 130,000 (US\$ 16,250) and a loan to an SME called Willies Electronics (See focus Box 4) for SI\$ 1.2 million (US\$ 150,000). WB is currently looking for more financial institutions that have a reach into rural areas and also solid financial fundamentals, but is having a hard time identifying any to include in the project. In 2010, the project will focus on including pico-hydro systems and expanding the number of participating financial institutions to help deliver more renewable energy products.

8.3 Credit Unions

The below table shows that there are 175 registered credit unions, but most are probably not operating anymore. It is impossible to tell without visiting them individually, as they are not reporting to CBSI, and neither CUFA nor SICUL have been visiting them. The statistics in the following table therefore only represent the nine reporting CUs which are all employer based, and all based in Honiara. Figure 17 gives an analysis of the nine reporting CUs.

Figure 17: Credit Union Summary Statistics (December 2009)⁹¹

Balance Sheet Summary	Detail
Total Registered CU	175 Credit Unions
Number of reporting CU	9 Credit Unions
Total Membership	4,010 members
Total Assets	\$37.2million (SBD)
Total Loans & Advances	\$25.6million (SBD)
Total Cash	\$2.2million (SBD)
Total Investments	\$4.5million (SBD)
Total Fixed Assets	\$4.6million (SBD)
Total Liabilities (mainly savings Deposits)	\$2.9million (SBD)
Share Capital	\$23.9million (SBD)
General Reserve & Surpluses	\$10.4million(SBD)
Performance as of Dec. 09	
Total Income	\$3.5million (SBD)
Total Expenses	\$2.1million(SBD)
Net Profit	\$1.5million (SBD)

90 Progress Report to CBSI. (Submitted: March 25th 2010). Reporting Period: October to December, 2009.

91 Table Provided by CBSI, numbers are from year end 2009.

The status of credit unions is common in the Pacific, where many countries used to have large movements subsidised by government funds in rural areas, but failed to develop the management mechanisms, technical support systems or size to become sustainable. Rural credit unions, with geographical based memberships, have not been successful in Solomon Islands.

The only large CU, The Central Kwara'ae Farmers' Credit Union (CKF) mentioned in recent literature, has closed and the small ones now have no technical support and are not reporting to CBSI. The Central Kwara'ae Farmers' Credit Union (CKF) had around 3,500 members when it was functioning well, but for reasons the former president could not explain, people began to stop repaying loans, and in 2008 CKF stopped lending. They have no mechanism for writing off debt, or recapitalising, and have become indefinitely dormant. They still do have about 100 people paying membership fees, but the office now sits locked and they have not gotten any technical support from SICUL or any other agencies. It is unclear how crippling their financial position is, or if the quality of their records is adequate enough to determine this.

There are a few CU offices in Auki, but they were never open during our visit. There is also Kasakhou Credit Union based in Buala, Isabel, which has resorted to investing in productive activities to generate revenue, as past lending has led to low repayment. They currently have assets over SI\$ 100,000 (US\$ 12,500), but have had minimal technical support for many years. The president made a special request that they be supported with management and financial training and an audit, noting that he tried to find a private company to do so, but they were all too expensive. Even with its small size and limited capacity this was the largest, best functioning CU encountered during research for this report.

8.4 Savings Clubs

Historically, as more credit unions imploded and dissolved, savings clubs sprouted up in their place. Savings clubs did exist alongside CUs in rural regions during the "second phase" of financial services in the 1990s, and still do to a very limited extent. However, savings clubs were labeled as developing credit unions and not seen as the remnants of them, as many would be more accurately characterised today. Credit unions never developed adequate management structures, internal controls or lending practices, and as their assets grew, so did their problems.

When they failed, former members founded savings clubs with about four nuclear families to continue supporting each other to save. SCs are small enough that people all know and trust each other, and management is very transparent, yet big enough that they can save enough to contribute to community projects, and pay school fees. It is the lowest common denominator of financial services. The problems are basically that there is no return given on deposits, management is expensive since it is done on such a small level, there is no technical support, and security is low, as the savings are usually just hidden somewhere in a leader's house.

Further, most SCs are still extending loans to members, but not as a way to provide a return on member deposits. Most loans are given to members who are in need and must take a loan during a time of hardship. Repayment of the loans is not expected to be timely, and high proportions of savings clubs' deposits are tied up in loans outstanding. In this sense, savings clubs can be viewed as an emergency insurance fund, providing liquidity at a very low interest rate (premium) in times of emergency.

SCs do have the goal of growing their savings, and so they make investments, but often more akin to a productive cooperative than a developing credit union. Savings are often invested in a collective business instead of providing individual microloans. In the Western Province, Patu savings club

uses member savings to buy copra from members and surrounding villages, and then drives it to Noro and sells it there to an exporter at a profit. Other savings clubs take fruits, vegetables or fish to the urban markets. In Hograno, Isabel many savings clubs had plots of rice, kava, and taro that they care for as an SC. Across the island in Buala, there were clubs with kerosene stores, fish freezers, and one that had been slowly building a hostel over the past five years. While these microenterprises do seem to work, they are exposed to other risks like the fluctuation in tourism arrivals, or commodity or fuel prices. It is important to understand this part of savings club operations though, as it has implications for both how they should be regulated, and the type of support/training they would find most helpful.

Figure 18: Savings Clubs currently reporting to SICUL

Name of Saving Club	Province/State	Membership	ASSEST (SBD)
Belaha	Guadalcanal	25	\$38,959.44
T.T.N.G	Guadalcanal	15	\$5,210.00
Borooni	Makira	20	\$12,210.00
Elomana Community Vinako (ECV)	Western	50	\$13,794.10
Tirokou	Isabel	14	\$15,213.50
Segeo	Isabel	45	\$42,931.10
Ru'uma	Isabel	10	\$6,773.70
Nimaro	Isabel	10	\$16,967.00
Muno	Isabel	24	\$1,844.18
Kokoru	Isabel	11	\$4,459.00
Tore	Isabel	10	\$33,500.00
Jole Family	Isabel	17	\$20,000.00
Balo	Isabel	10	\$17,237.81
Kologara	Isabel	11	\$86,102.30
Europa	Isabel	15	\$2,279.87
Fago	Isabel	10	\$30,217.00
Teholo	Isabel	19	\$5,996.50
Kolomola Savings Club	Isabel	43	\$21,428.00
	Total Assets	359	\$387,332.69

Note: 83% of these SCs that report to SICUL are in Isabel.

8.5 Other Informal Mechanisms

8.5.1 Cooperatives

While the rural credit unions have failed, there are some large functioning productive cooperatives. The CKC Farmer's Cooperative had 1,000 members during its beginnings in 2004 but its membership declined when it had trouble recovering loans to members. In November 2007 they brought in new management which stopped issuing loans and turned a SI\$ 120,000 (US\$ 15,000) profit in 2008. With profitability there is some renewed interest in the cooperative, and management expects to pay member dividends in the coming years and to build membership. Currently there are 800 members, their cooperative store continues to generate profits and their general outlook seems positive.

8.5.2 Money Lenders

There are also a number of "payday lenders" operating in Auki. It is debatable whether they are operating legally or not, but they are offering loans at 20% flat a fortnight, which is equal to charging

520% annually. There are at least five known people doing this around Auki alone. In an interview with one of them he reported lending values of between SI\$ 100 - 2000 (US\$ 12.50 - 250) and on average around SI\$ 1000 (US\$ 125). He claimed he paid US\$ 1000 (US\$ 125) a year for a license to do this, and lends about SI\$ 50,000 (US\$ 6,250) a fortnight. If we assume that the other four are doing around the same amount of business, that means US\$ 31,250 in lending every fortnight, or US\$ 162,000 in revenue a year. This clearly shows that there is demand for lending to smooth consumption and that people are willing to pay interest rates well above what would probably be necessary for a microfinance institution to cover its costs.

9. Opportunities for Improvement

Given both the weak current status of rural finance, and the great amount of challenges facing its development, there are still some definite opportunities for progress towards developing a sustainable rural financial model. Partnerships between institutions in the public and private sector will be crucial in developing any model, and there will be definite roles to play for private sector financial institutions, government regulators and policy makers, donors and non-profit organisations around the country. This being said, any financially sustainable model will undoubtedly be based in Honiara, and then may later expand to other economic centres.

Figure 19: An Inclusive Finance Framework for Opportunity

Analysis Level	Actors	Opportunities
Macro	Central Banks, Government Officials	<ul style="list-style-type: none"> • Reform constraining acts/legislation • Ensure subsidies structures are temporary, highly transparent and strictly limited • Monitor progress & evaluate results • Provide technical advice & research
Meso	Credit bureau, auditors, tech service providers	<ul style="list-style-type: none"> • Network potential stakeholders • Support with technical assistance • Ensure new technologies are leveraged • Advocate for an enabling environment
Micro	Banks, credit unions, micro-finance institutions, insurers, MNOs, Post Office	<ul style="list-style-type: none"> • Investigate the provision of an array of products in rural areas. • Work to ensure that costs of rural programmes are covered by revenues. • Design products with the client's needs in mind • Invest in inventive models & technologies
Client	Population of a country over age fifteen	<ul style="list-style-type: none"> • Achieve widespread functional levels of financial competency • Conduct demand analyses to understand in depth financial needs in different areas • Conduct consultations to measure impact of services on well-being • Target women to increase their financial empowerment

Strategies designed for Honiara, the Auki-Malu'u Corridor, or the Gizo-Noro-Munda Triangle will probably not work in other areas of the country, where infrastructure is too poor and population density is too low. Therefore places like Isabel will probably have to rely on community based models until an institution can develop a cost effective way to extend services to such remote places. The below discussion is not meant to offer a definite answer to this complex problem, but just provide an initial analysis of some of the important dimensions that will have to be considered by national stakeholders as they themselves decide how best to proceed. Below five areas of focus are discussed:

1. Retail Provider
2. Raising Capital
3. Delivery Networks
4. Products
5. Clients

9.1 Retail Provider

In the absence of any strong provider, there are only two obvious options: a model already operating in country could be improved and a model operating in another country could be customised and

imported. There is not clear legislation dictating how a new institution would operate (i.e. a regulated institution or a non-profit) so the CBSI will have to determine what they feel comfortable with as options develop, but have so far shown general flexibility and support.

9.1.1 Improving a Local Model

Unfortunately there are no obvious candidates for this option, which could take the form of scaling up a small organisation that is showing potential or assist a large organisation to move down market and reach rural clients sustainable.

Commercial banks have an important role to play in the provision of rural savings. The two commercial banks have rural banking activities that are unsustainable. The history of financial services in Solomon Islands has shown that services that are not sustainable will eventually dwindle, and the decreasing rate of growth in ANZ rural banking may already be indicating this. The primary incentive for banks to provide rural savings services is the need for liquidity. Because commercial banks have generally not had much success in micro and small rural lending, that demand for liquidity must come from its urban consumer, corporate and government business.

FOCUS BOX 3: Anecdotal Indicators from the Informal Economy

It is largely recognised that a large portion of the Solomon Islands economy is informal. It is not taxed, reported, or measured, yet many would probably genuinely surprised if they were made to understand the magnitude of this activity.

This is the traditional "bread and butter" of microfinance institutions. People and businesses who have not played a part of the formal financial system because they did not want to or were not previously allowed to. Sometimes stories are told that help us understand the level of this activity. It has been noted that during the cocoa selling season from July through September, ANZ sees an exponential increase in cash withdrawals on a regular basis to cocoa farmers. That money then disappears into the informal economy. Further there are stories from the Western Province following the devastating 2007 tsunami, when local businessmen were bringing in suitcases full of money drenched in seawater to deposit in the bank's vault. Or directly proceeding and during the 2006 riots in Chinatown Honiara, Chinese business men were bringing bags of money into the banks every day, sending the maximum value they could abroad and depositing the rest in bank accounts. Today, commercial banks are receiving resistance from shops that do not want to implement EFTPOS systems, because they keep a record of all sales, which could then be audited later. Disregarding for a brief moment the amount of money that this costs the government in lost tax revenue, and the danger of having so much unaccounted for money in the system that could be used to buy political influence, this does show that there is a lot of cash moving around the country clandestinely, and there is probably significant demand for catered financial services to accommodate it. Informal solutions for informal systems.

To succeed in rural lending, banks need a clear strategy to incorporate sustainability as a goal, address the high cost structure of rural banking operations by streamlining procedures and staffing structure and make better use of existing technology (EFTPOS, mobile phones) to reduce cost. Rural services also need to be treated as a business line if it is to receive the necessary financial and human resources. BSP is experimenting with a new model in PNG along these lines. Should this prove sustainable in PNG then it is likely it could succeed in Solomon Islands. ANZ Pacific is in the process of developing a microfinance strategy for the Pacific, partly in response to the requirement by the Reserve Bank of Fiji that they do so in Fiji. A possible solution may be better segmenting ANZ Rural Banking's products and services as well as adding more revenue generation services to existing clients, such as money transfers or microinsurance. However, management throughout the region appears committed to finding a less costly solution to serving rural areas.

Only the employer-based credit unions show promise at present, some of which are sustainable. However the bigger ones are all based in Honiara with no outreach beyond the employees of their respective institutions, much less any rural outreach. They have no current support to monitor them or give them technical advice on how to improve their financial situation or institutional management practices. Further they are constrained by an interest rate cap and management capacity issues that would not allow them to fund large scale expansion, and probably not service most rural areas. There is an opportunity for these larger CUs to expand their membership to non-employees in Honiara and expand their product lines. There may also be an opportunity to enact the new Credit Union Act given the recent change in government.

9.1.2 A Greenfield

A number of organisations might have interest in starting operations in Solomon Islands. Among them are South Pacific Business Development (SPBD), currently operating in Samoa and Tonga, and Nationwide MicroBank in Papua New Guinea. Basix has also conducted a study.

SPBD is receiving support from IFC for its operations in Samoa and Tonga as well as support to look at a regional structure that could manage greater SPBD expansion into the Solomon Islands and Fiji. SPBD's model would be very expensive in Solomon Islands, as they rely on the developed infrastructure of Samoa to collect and disburse loans in vehicles. It is also limited to group lending to women's groups, which further limits the scope of operations. SPBD has a strong focus on microenterprise lending which is probably not going to be the most successful strategy in Solomon Islands, where consumption lending will have a higher demand and savings and money transfers will probably be the most popular services. At the same time, SPBD has managed to build a solid loan portfolio among its members—something no other MFI has accomplished in the region.

Nationwide is an expensive model and benefited from a high level of subsidies from donor agencies and the Government of Papua New Guinea. As a regulated bank, it provides deposit services to over 100,000 clients yet lends to less than 10,000 of them. This reflects the demand for savings as well as the challenges Nationwide has faced building a quality loan. It has persistent delinquency which has left it only marginally profitable. Its average loan size of US\$1,142 (Si\$ 9,136)⁹² is probably high for most Solomon Islanders. Its own expansion in PNG is still underway and it may be several years before it would be ready for an oversee operation. It is also likely it would face similar challenges in balancing a large demand for savings with comparatively small demand for loans.

UNCDF supported Basix of India to investigate the possibility of launching operation in the Solomon Islands, however they declined. They noted that they felt the intervention on a standalone basis would be costly, but they might explore start-ups or partnerships across the region along with Solomon Islands to spread the cost of the start up in terms of technical personnel.

⁹² As reported to MixMarket. The average loan size for SPBD Samoa is US\$216 (Si\$1,728).

9.1.3 Mobile Money

Mobile phone based services are a new phenomenon in financial services. In larger countries mobile network operators (MNOs) and some banks are now reaching millions of clients with fairly low cost money transfer services and safe place to store money. The range of products offered by MNOs is still fairly limited. Both Vodafone Fiji and Digicel Fiji have launched mobile money services and DataNets Ltd is piloting a similar product in PNG. Neither bemoobile nor Our Telekom currently have mobile money services. Experience shows that it takes high volume and reliable cash agents for such services to flourish, neither of which the two MNOs offer. Still, the advent of competition among MNOs is likely to lead to mobile money in the next few years. The challenge will be to use the platform to provide valuable services to rural clients.

9.2 Raising Capital & Finding Technical Assistance

There have been a number of institutions which have shown willingness to support the development of rural finance both technically and financially. Most recently the SIG provided SI\$ 3.9 million (US\$ 487,500) to ANZ to run their Rural Banking programme, and CBSI holds SI\$ 1 million (US\$ 125,000) in trust for SICUL. SINPF has substantial assets, a mandate to invest in the development of Solomon Islands, a history of involvement in the promotion of financial inclusion, and a current CEO with an interest in participating in the process.

Beyond the government, international donors like IFC and ADB specialise in capitalising ventures like these and both have shown significant interest in doing so in Solomon Islands. IFC is currently completing a feasibility study of funding a Greenfield operation or capitalising an existing model. RAM-SI has verbally mentioned interest in supporting the development of rural finance, but it remains to be seen to what degree. In terms of technical assistance, PFIP provides technical advice and works closely with CBSI and AusAID in country to improve financial inclusion. Further research needs to be done to more accurately measure the appetites for involvement of these large partner organisations.

Many different factors will determine the level of capital that needs to be raised for this venture. Everything from the expected growth rate, to the amount of client services and delivery methodology will affect this number. While the goal of the model will be to be sustainable, this often still entails technical and financial support at the beginning to get the institution to a level of operating revenue when it can continue perpetually. There is currently discussion in the donor community as to if there would be the requisite funding to engage in such a venture. As a reference point, in Fiji it is currently estimated that a Greenfield effort would cost around US\$ 2.5 million. As there are no obvious models to alter or upscale, this seems to be a probable option.

Greenfields work best when the technical partner is also an owner-operator rather than simply an advisor. There are also advantages to linking Greenfields with local financing, particularly local investors and lenders. Both BSP and ANZ face challenges serving their rural clients. It might be an interesting arrangement for any new institution to work closely with one or both of these banks and their clients.

9.3 Delivery Networks

The model that is best suited for a place like Solomon Islands where it is hard to travel around is agent or branchless banking. This means extending financial services without the “brick and mortar” of actually building banks in different locations. There are many different versions of this around the world using everything from small convenience stores, to post offices, to mobile phone networks. While the mobile network is developing rapidly, a number of already developed networks that can be leveraged to both quickly extend outreach and reduce costs of client acquisition. Appendix 3

briefly lists some of the most promising networks both nationally and regionally with a few indicators of their size and strength, but four should be highlighted here. Those are SIPC, the Provincial Councils of Women, the school system and large sustainable livelihoods projects currently being launched.

9.3.1 Solomon Islands Postal Corporation

SIPC commenced operations in 1997, is governed by the State Owned Enterprises Act (2007) and recently has taken on the mission of establishing a nation-wide postal financial network in Solomon Islands. They have developed a business plan and are seeking technical support from other postal agencies that have had experience doing this. SIPC is in conversation with Vanuatu Post to receive assistance designing a programme similar to their domestic Money Transfer services called “Quik Cash”. The current strategy is to focus first on providing international/domestic electronic fund transfers at an affordable cost, and then possibly rolling out deposit services in a second stage of development. SIPC is on schedule with their timeline set out in their 2010 business plan for the implementation of these services, which they hope to launch in 2011.

Post offices around the world have played an important role in financial services, either through dedicated postal banks or as a provider of money transfer services and as an agent of banks. While SIPC has one of the most extensive physical networks in the country (See Figure 20) and some staff that have experience with financial services (they have a Western Union in the Honiara branch), they are still dependent on external consulting for the design of these services and have some real challenges to overcome with the quality of their network. Specifically, many of their provincial branch buildings are in poor repair and they lack the minimum security they might need to do significant financial transactions. Rural staff would need significant training and the quality of the service will depend on the (current unreliable) telecommunications system between branches.

Figure 20: Solomon Island Postal Corporation Agencies

Province									
Malaita	Western Province	Choiseul	Guadalcanal	Makira Province	Isabel	Temotu	Central	Renbel	Total
31	26	16	12	9	8	7	3	3	115

9.3.2 Provincial Councils of Women

The National Council of Women (NCW) manages provincial councils of women in each of the nine provinces. Each of these nine provincial councils operates fairly independently from the National Council, apart from a yearly meeting and a SI\$ 300 (US\$37.50) yearly fee. Soropotimist Solomon Islands, AusAID’s Community Sector Programme (CSP), and the provincial governments have partnered to build a resource centre for each provincial council in their respective provincial capitals. These buildings are all now reportedly complete and the NWC is encouraging the provincial councils to administer each of them independently. The concept is for them to become sustainable by providing revenue to cover administration costs through renting of the conference rooms and office space. However, a visit to the Western Province resource centre found funding had run out before the building was finished and it was further left unfurnished, leaving the council to fundraise slowly to purchase the items that would make the centre a productive resource.

While each provincial council is large there are two types of members, financial members who pay a fee, and registered members who can come to meetings but cannot vote. In Western Province the council there reported having over 1000 registered members, of which maybe 800 were also finan-

cial members. While it is debatable how strong these networks of women are, and there is certainly a current lack of capacity to manage large scale financial services, they do have at least a widespread network, minimal experience collecting cash and making payments, and an office in each provincial capital. While they are probably not organised enough to provide the financial services themselves they could be a useful agent to a provider to disseminate information, and possibly to make and collect payments. The senior management of the Western Province Council of Women thought that their members would be extremely interested in appropriate financial services.

9.3.3 The School System

Unfortunately information on the strength and attributes of the educational infrastructure in Solomon Islands is beyond this report. It should be noted, though, that the educational system does penetrate rural areas around the countries and is being leveraged by some programmes already like the UMI Solar Farm Fresh Centres which sell produce to school employees. This network is also of note for three other reasons. The first is that there is already an obvious market for financial services in rural schools, which is teachers who need access to their wages. Therefore it is possible that a service could leverage this need to supplement revenue. Further, teachers at the schools are in general more educated than the greater rural populations and could serve as agents to administer small transactions.

The third reason is that CBSI and the Ministry of Finance have both endorsed the Coombs declaration, which states that all school children will have financial education through their core curriculum by 2020. While 2020 is still very far away, many Pacific Island countries such as Samoa, Tonga, Fiji and Cook Islands are already implementing financial literacy in their national curriculums. This would create a trifecta of physical infrastructure, potential administrators of the service, and financially literate clients. Further, financial literacy training best practices note that it should be provided in conjunction with financial services to reach its maximum impact.

9.3.4 Sustainable Livelihoods Programmes

One of the current buzz words in the Solomon Islands development community is “sustainable livelihoods”. This is being catalysed by AusAID’s recent disassembling of its Community Sector Programme (CSP) and launching the Agricultural Livelihoods Programme (ALP) in its place. While ALP is still not finalised, it is already operating, working with 1000 families, and is projected to be finalised by late 2010. It is expected to be an \$AUD eight million (US\$ 6.88 million)⁹³ project over a five year period. An important component of ALP is the Cocoa Livelihoods Improvement Programme (CLIP) which is currently based out of the Ministry of Agriculture and provides technical assistance to farmers. The obvious starting point would be formulating an agreement with the ALP, however there are many other livelihoods programmes such as Kustom Gadens, which are also of substantial size and could also help with client management and education.

The newly formed Coconut Industry Secretariat of Solomon Islands (CISIS) may be a potential partner once it is more developed. It is led by the International Trade Centre (ITC), and is comprised of farmers, traders/manufacturers, and Government. The purpose of CISIS is to revitalise the coconut industry by linking farmers with export markets and helping to develop other options besides copra that can generate income. CISIS currently estimates that 85% of the rural population has access to coconuts they could commercialise and therefore this project has a very large potential outreach. It will also be leveraging a lot of infrastructure which has already been developed, such as CEMA buying stations.

⁹³ Exchange rate of one AUD equals 0.86 USD was used.

It is easy to see how sustainable livelihoods projects could benefit from a financial services component, and how financial service providers (FSPs) could potentially leverage the knowledge and networks of sustainable livelihoods programmes to identify clients and facilitate payments. Currently sustainable livelihoods programmes do not have financial service components but realise the need for them, and would be excited about having a service provider offer financial options along with their programmes. These partnerships could be used by a financial service provider to help build up a client base in a new geographical area, or supplement activities in an area where the FSP already has a presence.

FOCUS BOX 4: Opportunities for Inventive Rural Finance

Although some of us do not realise it, cash is a technology that takes training to learn how to use effectively. This being stated, many of the concepts related to cash are understood in other contexts. Concepts like savings and investment are used when rural community members save part of their yearly harvest for later in the year, or invest in a baby pig so they can raise it and sell it for a profit. This realisation was made by David Iro of Willies Electronics, who has begun extending loans for solar powered lighting systems in rural Solomon Islands. Instead of requiring that loans are repaid in cash, he also accepts crops. He has set up “farm fresh centres” in strategic locations where farmers can bring in cash crops and the value of those crops will be then deducted from the outstanding balance of the loan they borrowed. The crops are then sold from the centres and cash is often then deposited in an ANZ rural bank account. While there are still no conclusive statistics available that will determine how successful and scalable this model is, it is definitely an example of innovative finance that is otherwise hard to find in Solomon Islands. As of March 2010, David had installed 303 solar systems and had 1739 households making payments to receive one in the near future. Households must first save 50% of the value of the system before it is installed. In September 2009, the World Bank Sustainable Energy Programme extended a five year 1.2 million SBD loan to Willies to help expand the programme.

9.4 Appropriate Products

Microfinance is often confused with microcredit. This is certainly true in Solomon Islands, as all large programmes from DBSI, to the credit unions, to ANZ rural have had loans as a focal point of their business, mostly specifically entrepreneurial loans as well. However, it is recognised around the world that this is only one product people in rural areas value, and in most cases it is relatively unimportant. In the highly acclaimed book, “Portfolios of the Poor”, the authors analysed financial diaries of 250 households and found that no household used less than four financial instruments during the year, and most used an average of 8-10⁹⁴. It will be very important for the provider of financial services to analyse a broader array of products that can be offered and will be demanded. Below the four most popular products in microfinance are briefly analysed in the context of Solomon Islands.

9.4.1 Microcredit

While people casually question the demand for credit in Solomon Islands, past credit programmes from DBSI, to the credit union movement, to modern day loan sharks have shown that there is actually a large demand; the problems are just the same ones seen in other parts of the world. It is hard to ensure repayment and information asymmetries are costly to overcome. Two misperceptions should be addressed here to paint a more accurate picture of the potential for credit in rural Solomon Islands. The first is that there is little economic activity taking place in rural areas and therefore there will be little demand for credit, and the second is that even given that there is significant economic activity occurring in rural areas, the people living out there do not demand credit.

⁹⁴ Collins, Daryl. Morduch, Jonathan. Rutherford, Stuart. & Ruthven, Orlanda. (2009) Portfolios of the Poor. Princeton University Press. Pg. 15.

The People's Survey 2009⁹⁵ conducted by RAMSI provides some useful data points for analysis. It reports that 30.2% of respondents had tried to start a business in the past two years⁹⁶. This is a strong indication that there is actually a significant amount of economic activity occurring in rural areas, especially when combined with figures from the past rural CU movement and present day loan sharks. The survey goes further to report that of the problems experienced by those who did try and start a business only 4.2% reported having their loan refused, and only 3% reported the lack of a bank as an issue⁹⁷. While these are intriguing numbers, and more specific research should be done on this, evidence collected through in country consultations and evidence from around the world indicates that this is largely because most rural people are using informal financial mechanisms to fulfil their needs for financial instruments, and not because they do not want loans or already have access to quality services.

Regardless of the potential deficiency of demand for entrepreneurial based credit, current research shows that most microcredit is actually used for consumption smoothing and not for small businesses. Therefore entrepreneurial activity should only be part of this analysis. The most likely outcome is that microcredit will play a central role in a financial service provider's product portfolio because of its potential for revenue generation, but it will not be the product that will catalyse client growth numbers. Rural Solomon Islanders are just waiting for a reliable credit product which they can easily access, understand and maintain.

9.4.2 Microsavings

This product was overlooked and marginalised in microfinance product portfolios for many years. When offered it was often extended with account fees, uncompetitive deposit rates, and withdrawal fees, as it is currently in the Pacific. Modern day best practices recommend that deposit products offer clients easy access to their accounts, including no maintenance or withdrawal fees. Beyond providing lending and investment capital, offering quality deposit products has other significant benefits. The major one is that savings accounts are demanded by the broadest proportion of people and therefore offer the quickest way to grow client enrolment. Not only can clients' capital be leveraged, but the clients themselves can then be offered services with higher profit margins, like credit or money transfer services. Microsavings will likely be the cornerstone of any new service provider in rural areas, as was observed with the ANZ rural service which currently has three orders of magnitude more savers than borrowers.

The well known Grameen Bank discovered the importance of having quality deposit services when it experienced capital difficulties, and decided to raise more through encouraging deposits. Through client consultations they designed Grameen II which offers a long term "pension" product paying relatively high interest rates and a flexible everyday account. While these improved products did drastically increase deposit accounts as they expected, they also significantly increased overall membership and borrowers.

9.4.3 Microinsurance

As noted earlier microinsurance is currently the fastest growing microfinance product in the world. Regrettably, until very recently there were no examples of it in the Pacific. Today there are nascent examples of credit life and a growing funeral policy in Fiji, but nothing beyond that. Like the traditional Wantok system, microinsurance is a form of social protection and if designed correctly, can compliment traditional forms of social protection. Many risks taken today in modern Solomon Islands were not envisioned when the Wntok system was first developed and microinsurance can help

95 The Australian National University. (2010). The People's Survey 2009. ANU Enterprise, Australia.

96 Ibid. Pg. 91.

97 Ibid. Pg 92.

mitigate these risks by providing bigger risk pools and greatly reducing transaction costs.

Just as in other Pacific Island countries, health care seems to be the paramount concern among those employed in the informal economy. A large 2004 International Labour Organisation (ILO) survey among workers in the informal economy in Solomon Islands showed that health care was the concern most mentioned by respondents⁹⁸. While hospital care is free, there are significant associated costs, including some diagnostic tests, travel to and from medical facilities and drugs. The ILO did a study of the Solomon Islands Police Staff Association (SINPA) Medical Insurance Scheme, and found that on average people were paying SI\$ 100 (US\$ 12.50) out of pocket per consultation. SINPA designed a policy that cost SI\$ 50 (US\$ 6.25) per month which covered the immediate family, and 35% of members opted into the programme. The programme reported being financially self-sustainable in 2005⁹⁹. This small example proves both that there is demand for such schemes, and that schemes can be developed for low premiums with low payouts.

While there is a dearth of research in this area, there is most likely significant potential for other microinsurance products in Solomon Islands. After health care, education costs, housing insurance and unemployment were listed as the greatest concerns in the 2004 ILO study. Further, when respondents were asked if they could contribute to a social security system that might cover some of these concerns 58% said yes, and a further 15% said maybe. This being said, nothing is being offered. Housing insurance has been too risky for insurers because of the lack of defined land rights outside of Honiara, and other property insurance because of the difficulty of verifying claims in rural areas. Solomon Islands might provide the perfect environment for index based crop insurance, as it would circumvent the claim verification issue, yet it is unclear if there is the requisite historical data available to design an accurate model.

9.4.4 Money Transfers

From international remittances to handing a child money to pay school fees, money transfers are an integral part of daily life in the Pacific. Characteristic of greater Melanesia, Solomon Islands does not receive a high value of international remittances as a proportion of its GDP. The 2009 Human Development Report¹⁰⁰ states that there were only US\$ 20 million dollars in remittances sent to Solomon Islands in 2007, or approximately US\$ 41 per capita. The international transfer market is still very expensive and undeveloped in Solomon Islands. Currently to transfer \$AUD 200 (US\$ 172) from Australia to Solomon Islands, one has to pay between \$AUD33.41 (US\$ 28.73) and \$AUD63.79 (US\$ 54.86)¹⁰¹, which is equal to 17%-32% of the value of the transfer. Figures are similar for transfers from New Zealand, except for the WestPac Pre-paid remittance card, which greatly reduces costs to around \$NZD1 per transfer. More innovative products like this can help further significantly decrease to costs of international remittances.

SIPC has realised that the domestic transfer market is probably much larger than the international remittance market, and has therefore chosen to focus there first. Domestic transfers are often done between urban workers, sending money back to family in the village, SINPF paying out member funds, and government paying public employees. ANZ rural's servicing of GPPOL, Goldridge is basically just providing a transfer product for private sector wages, as it does in the rest of the country for teacher and other public sector wages. Due to poor infrastructure and transportation systems in country, physically sending or collecting cash is very expensive for most rural people, and therefore

98 The study surveyed 500 people total from the nine different provinces, representing approximately 0.5% of the informal labour force. International Labour Organization (ILO). (2006). Social Security for all Men and Women: A source book for extending social security coverage in Solomon Islands. Suva, Fiji Islands. Pg. 70-73.

99 Ibid. Pg. 152-153.

100 UNDP. Human Development Report 2009. Accessed on: (May 17th 2010) http://hdrstats.undp.org/en/countries/country_fact_sheets/cty_fs_SLB.html

101 Send Money Pacific Website. Accessed on: (May 17th 2010) <http://www.sendmoneypacific.org/compareCosts.cfm>

there does seem to be ample demand here for an efficient domestic money transfer system. Ideally it would involve electronic transfers to keep the transportation of cash to a minimum in any model.

9.5 Clients

A distinctive approach will have to be taken for rural populations, which comprise the vast majority of the overall population. Any rural programme will have to be both founded on a strong financial literacy curriculum and largely community based, as infrastructure is still too poor for any frequent services to be provided from urban centres. There is a pressing need to do a baseline study of financial competency needs in rural areas to enable policy makers to craft targeted trainings to specific educational levels.

There will still have to be some external support to ensure that models have transparent and stable management structures, are financially responsible, and have opportunities to invest and grow their assets. How this support is given in a meaningful and cost effective way needs further discussion and research, but it is clear that something fundamentally different from the current SICUL and CUFA approaches is needed. Future support needs to be more than handbooks for people who have low literacy, and lessons for those who do not learn well in formal classroom environments. Training needs to be combined with continued monitoring to figure out if trainings are having an impact, and help people bridge the gap between gaining knowledge and implementing what they have learned.

Below is a list of some of some general advice that would greatly improve the provision of financial literacy training in Solomon Islands:

1. It is not enough to just do a training session. There must be a follow-up session or a way for attendees to access further information easily.
2. Training people who do not have access to financial services will have only a limited effect. Financial literacy training should always be given to those who already have access to services or will in the near future.
3. Trainings being given are too long. Training should be very focused on selected key concepts, and should rarely extend over an hour and a half.
4. Trainings are using formal education models. Most rural people did not make it too far in school and did not learn the basic classroom learning techniques such as taking notes, and actively processing knowledge written in front of them. Informal methods are going to work better. Activities instead of lessons, pictures instead of text, interactive instead of lecture based methodologies should be used.
5. Past trainings have not actively included women; however, future trainings need to¹⁰². Not only is it widely understood that women are the managers of resources in households, but they are much more likely to increase the financial competency of a household by attending training than their male counterpart.
6. Materials can be too advanced. Often the levels of both numeracy and literacy are overestimated in rural areas. Therefore they should, as much as possible, be able to be used by people who are not comfortable with numbers and letters. It should also be investigated further whether materials should be made in vernacular, as almost all are in English at this point. It has also been suggested to create modules for basic, mid-level, and advanced students¹⁰³.
7. Trainings can often be attended by more people if they are given in the evenings, when people do not have other engagements. This should be investigated on a case by case basis, but it is wrong to assume that just because people are living in rural areas that they are not busy during the days.

102 Sibley, Jonathan. (2009). Financial Capacity, Financial Competence and Wellbeing in Rural Fijian Households. Pacific Financial Inclusion Programme, Fiji.

103 Sibley, Jonathan. (2008). Solomon Islands Financial Literacy Impact Assessment: The Relationship between Adult Financial Competence and Household Wellbeing in Indigenous Rural Households in the Solomon Islands. UNDP. Pg. 84.



www.pfip.org