
Being Heard

The Results of the 2017 Survey of Businesses in
Papua New Guinea

INA Discussion Paper 105

Paul Holden, Paul Barker and Steven Goie

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The Results of the 2017 Survey of Businesses in Papua
New Guinea

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A Summary of the Survey

- Responses to the survey provide little evidence that the businesses environment is improving. PNG remains a challenging country in which to do business.
- Security is a large burden on businesses, amounting to 10% of total operating costs and has had a negative impact on investment decisions.
- Business confidence in the judiciary has declined substantially over the past 15 years
- The private sector regards government business relations as weak
- Private sector bodies are not perceived as communicating well with businesses regarding consultations with government.
- Foreign currency practices by the Bank of Papua New Guinea are reported as being a major impediment to the effective running of businesses and are damaging future investment and growth
- Corruption is becoming an increasing problem with a majority of firms reporting that they make “irregular payments” to government officials.
- Government services are perceived as being poor by a majority of businesses; roads, bridges and electricity services are regarded as particular problems.
- Concerns remain regarding political stability although fewer firms reported being affected by it.
- The lack of stability of government policies have a negative impact on most businesses.
- Few PNG firms outside the natural resource sector export. In the long run this will have a negative effect on the competitiveness of the PNG economy.

Chapter 1: Background

1. Commencing in 2002, a cross section of businesses in Papua New Guinea have been surveyed at 5 year intervals on key factors in the business environment in PNG and the problems and challenges that the private sector faces. This fourth, and most recent survey, was conducted in the second half of 2017. This document reports on the issues identified by the participants and compares their responses to the results of earlier surveys. The continuity of the surveys provides insights into how the business environment has evolved.

2. The report commences with a brief overview of recent developments in the economy, to provide an economic context against which the survey was conducted. It then summarizes some key conclusions of the earlier surveys. A discussion follows of the sampling processes and the key issues on which the survey focused. Each of these is then discussed in some detail. Where relevant, the answers are decomposed by sector and by business size. There are text boxes on the productivity of state owned enterprises in PNG and on the issues connected with the impact of foreign exchange rationing on businesses. The overall findings are then summarized in a conclusion.

Recent Developments in the Economy

3. When the previous survey was conducted in 2012, the PNG economy was experiencing the benefits of a resource boom, as GDP growth was accelerating – over the 2014 – 2015 period, PNG's real GDP growth was one of the highest in the world. The 2017 survey was undertaken against dramatic changes in the economy. The growth rate of GDP has declined abruptly and the IMF projects no more than very moderate growth over the next few years. Furthermore, the public sector debt has risen at an accelerating rate, and the IMF projects that compared with 2013, by the end of 2018, the external debt to GDP ratio will have risen by 60%.

4. On the positive side, inflation has been moderating sharply and is projected to fall further, interest rates on Treasury Bills have declined, and international reserve holdings have not fallen. The latter statistic may be misleading, however, as businesses report that foreign exchange to pay for imports is rationed and it can take weeks, or even months to obtain foreign currencies to settle import bills. This points to an overvalued exchange rate, something that the IMF flagged in its 2017 Article IV consultation report.

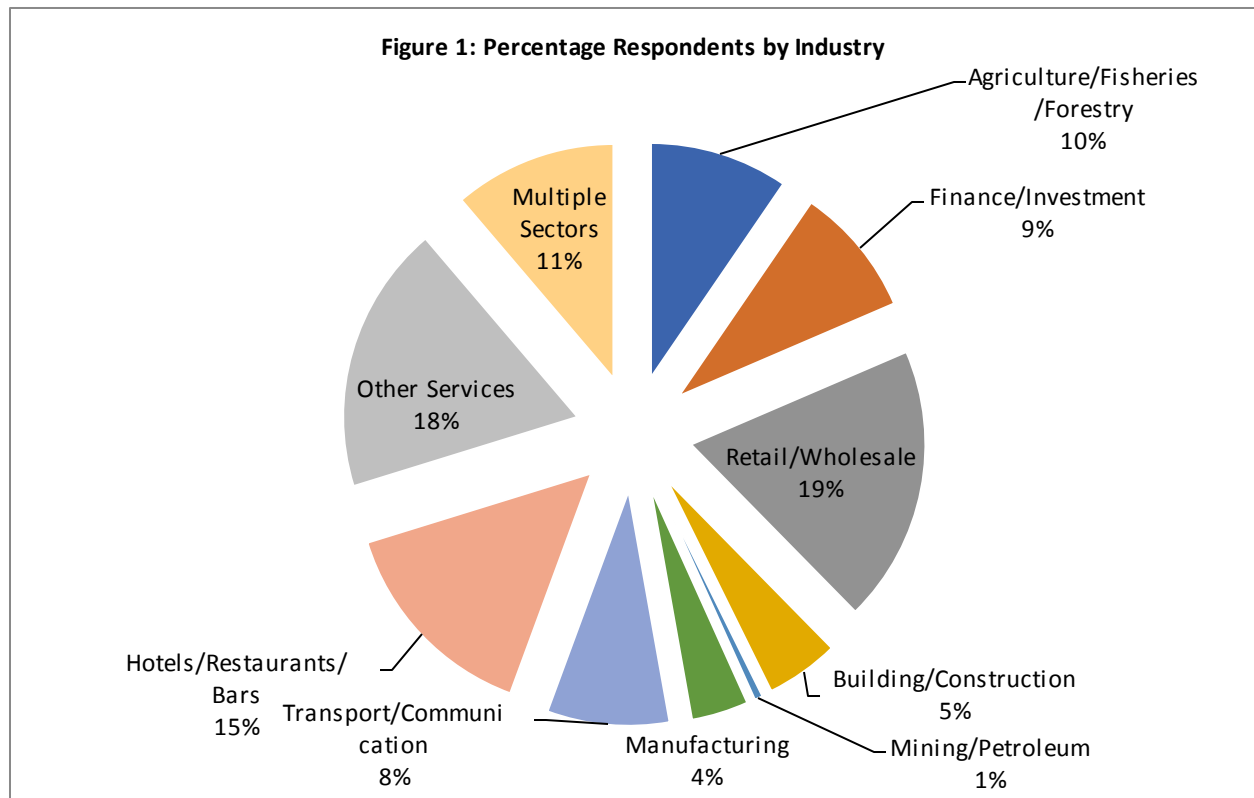
5. Since the last survey, the structure of the economy has changed dramatically. In 2012 - 2013, natural resources² constituted 13.6% of GDP. In 2017, it is estimated that this share had risen to 23.3%. This clearly has had substantial distributional effects, not only on the structure of the economy, but also on relative prices, the balance of payments, the exchange rate and investment opportunities. PNG businesses have had to adjust to the effects of these changes since the previous survey in 2012.

Chapter 2: The Survey Composition and Methodology

6. The survey was conducted between July and December 2017. In 2012, the sample size was 187 firms in the 2017 survey (compared with 130 firms in the 2012 survey). The respondents were drawn from a wide range of sectors and from 8 industry groups, plus a multisector group. Figure 1 shows the industry composition of the respondents. The largest sector responding constituted retail/wholesale businesses, followed by other services and hotels, restaurants and bars. Although mining and petroleum have grown sharply as a share of GDP, companies in this

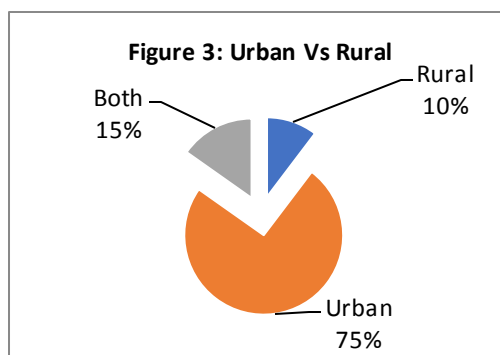
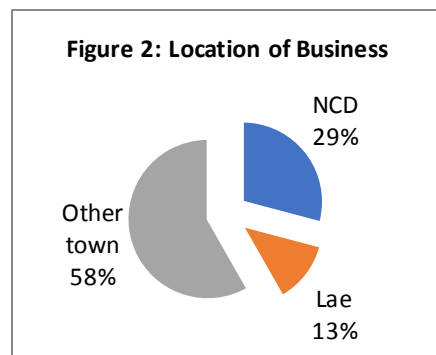
² Consisting of mining, quarrying, oil and gas

sector are among PNG's largest, so they make up a small proportion of the total number of

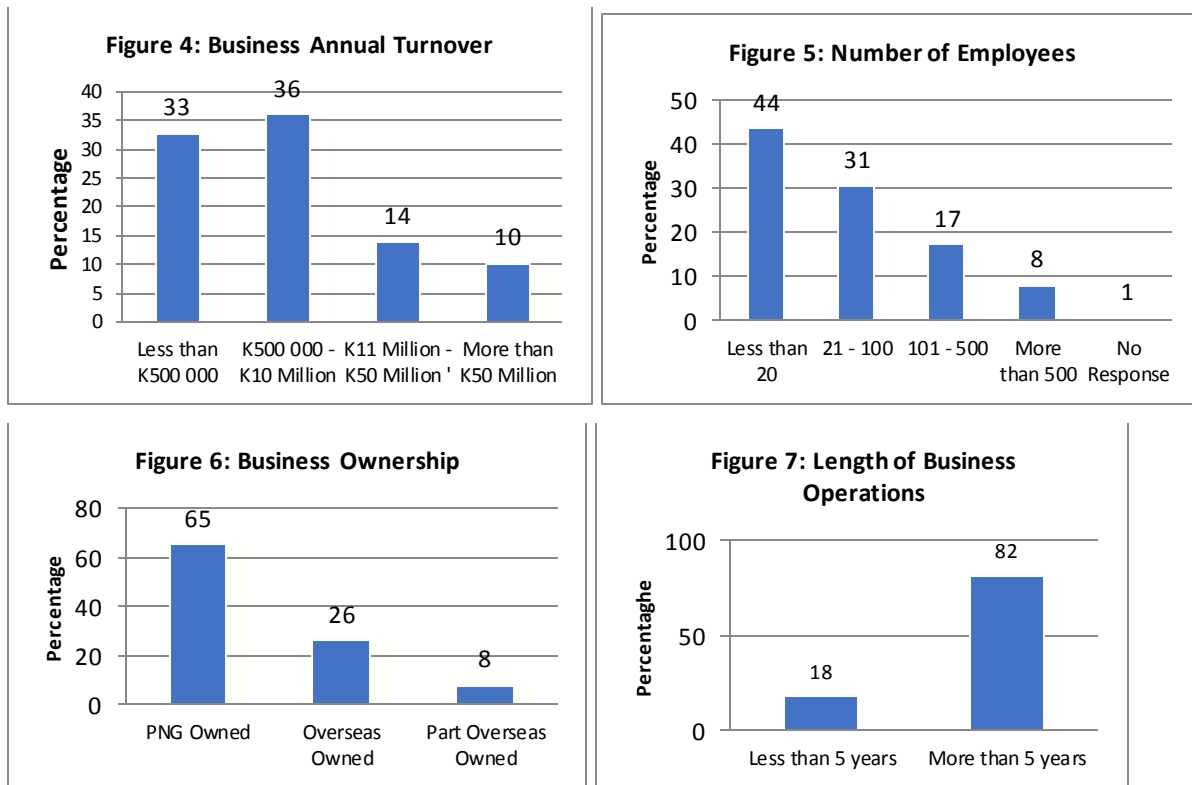


respondents.

The survey includes locally owned businesses, foreign owned businesses and those with mixed local/foreign ownership. Care was taken to survey businesses not only in Port Moresby, but also those in other cities and towns. In addition, both large and small businesses were included to ensure that the views of SMEs were represented. Only private firms were surveyed – state owned enterprises were not included in the sample. The location of businesses surveyed is shown in figures 2 and 3. Although only 29% were situated in the National Capital District, the majority indicated that they operate in urban areas. Most businesses in the sample are small or medium sized with 69% having an annual turnover of K10 million or less and 80% employing 100 workers or fewer workers (Figures 4 and 5).

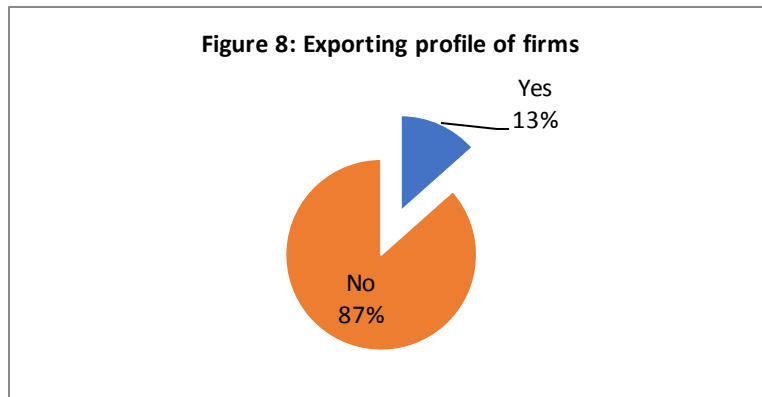


7. The survey respondents had been in business for a relatively long time; over 80% indicated that their businesses were more than 5 years old. They were mainly PNG owned (65%) with 26% foreign owned and 8% with split PNG/foreign ownership (Figures 6 and 7).



8. Only a small percentage of the respondents indicated that they exported (figure 8). This could be a sign that the private sector in PNG lacks dynamism. There is substantial evidence that exporting opportunities have led companies to upgrade their efficiency, develop new product lines, increase marketing efforts and actively seek new markets. A survey of Pacific firms in 2014, found that there was a substantial amount of exporting among Pacific island economies and that many of these exporters were small, with 20 or fewer employees. Size did not seem to be a barrier to engaging in exporting.³

³ David Atkin, Amit Khandelwal and Adam Osman, 2017, *Exporting and Firm Performance; Evidence from a Randomized Experiment*, Quarterly Journal of Economics, May 2017, pp 551-615, demonstrate the impact of exporting on firm performance in terms of improved productivity and quality and positive spillover effects on domestic production and knowledge transfer to local firms. See Paul Holden, 2014, *Export Dynamism in Pacific Island Economies, Analysis of a Survey of Exporters for Pacific Trade and Invest* for a discussion of the growth of exporting in Pacific island economies.



9. In the analysis that follows, the responses to the questionnaire are analyzed to focus on details of the issues that are of concern to PNG businesses. Selected responses to the current survey are also compared with those of the previous 3 surveys to track how the private sector perceived PNG's business environment in 2017, compared with 2012, 2007, and 2002. This identifies areas where progress has been made and where the business environment has deteriorated. Although some questions have changed slightly, there is sufficient consistency in the design and methodology used to allow comparisons to be made with a significant degree of credibility.

Chapter 3: Private Sector Views on the Business Environment Identified in the 3 Previous Surveys

10. The 3 previous surveys showed that while there was an improvement in the business environment over the 10 years surveyed, in all sectors, most companies regarded PNG as a challenging place in which to do business. There were some changes in the issues perceived as creating the greatest obstacles to investment and entrepreneurship, but in general many of the issues identified in 2002 were still regarded as significant problems in 2012. The identified constraints were:

- Business security and law and order, with low confidence in enforcement agencies and the judiciary. Most businesses employed private sector guards and security companies and indicated that crime and security measures imposed significant costs on their businesses;
- Government business relationships were identified as being a significant issue, with many of those surveyed indicating that they found public sector employees to be unhelpful. Many businesses reported that corruption was becoming an increasing problem and a majority saying that they had to make "irregular" payments to public officials;
- Infrastructure and infrastructure services were reported as constituting a major constraint, especially in the provision of electricity and transportation. The access and affordability of telecommunication services remained a major problem;
- Burdensome and complex regulations were a major deterrent to new investment. Many businesses complained that regulations and policies were changed without warning or consultation;

- Political uncertainty also impacted investment negatively, although its impact fell significantly between 2002 and 2012;
- On the positive side, businesses indicated that they had confidence in supporting institutions such as the Company Registrar and the Securities Commission as well as private professional bodies such as those that supported and maintained standards in law and engineering.

Chapter 4: Results from the 2017 Survey

11. Businesses were surveyed on wide variety of issues related to doing businesses in PNG. In order of priority, they were:

- Are they affected by government policies and regulation is?
- How are they impacted by security issues related to their businesses?
- How do they perceive government business relationships?
- How effective is the provision of services by government and state owned enterprises and how does this affect their businesses?
- What in their view are the most significant constraints to doing business and undertaking investment?
- What are their key priorities for reform?

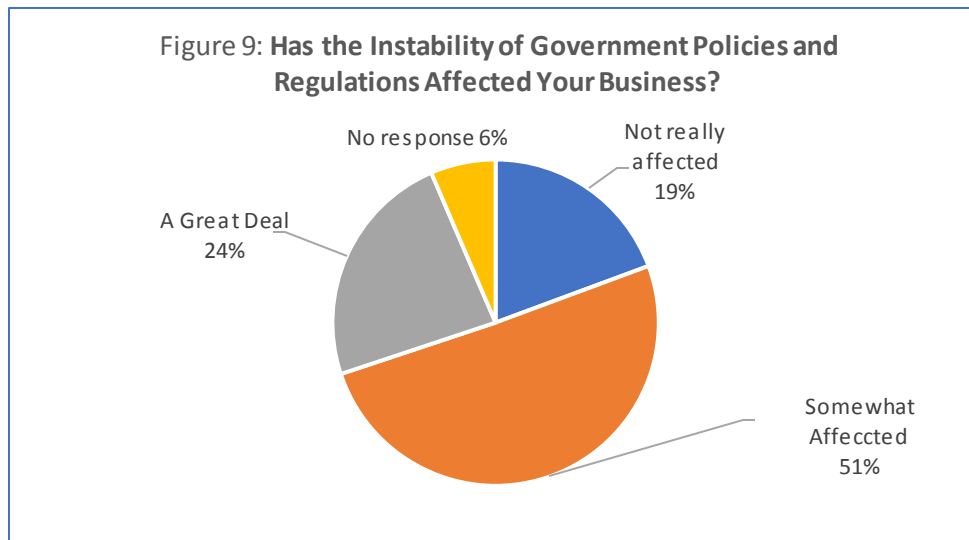
12. In the sections that follow, each of the main issues about which businesses were surveyed are discussed and analyzed.

The Impact of Government Policies, Regulations and Politics on PNG Businesses

13. Many of the building blocks for a strong environment for private sector development involve actions by the state. Paradoxically, the state has a crucial role in promoting investment and entrepreneurship, not through direct intervention, but rather through establishing a strong commercial legal framework, a sound system for the enforcement of contracts, good infrastructure, the provision of basic services and limited but predictable and effective regulation.

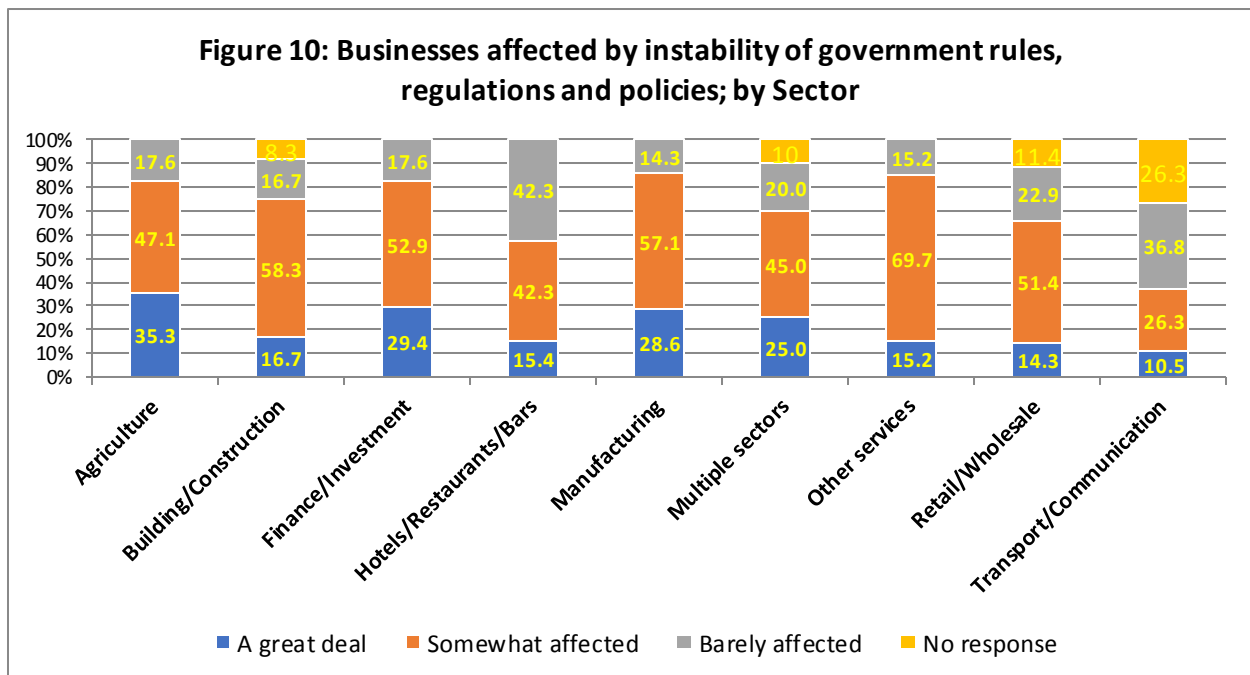
14. Businesses were asked to assess the impact of government policies and regulations on the running of their businesses and the effect that it had had on their investment decisions. An additional question was the extent to which policy and regulatory instability had affected them. They were also asked if political uncertainty, which had been a major issue in earlier surveys, was

a significant concern in the light of the continuity of government over the last decade. Regarding



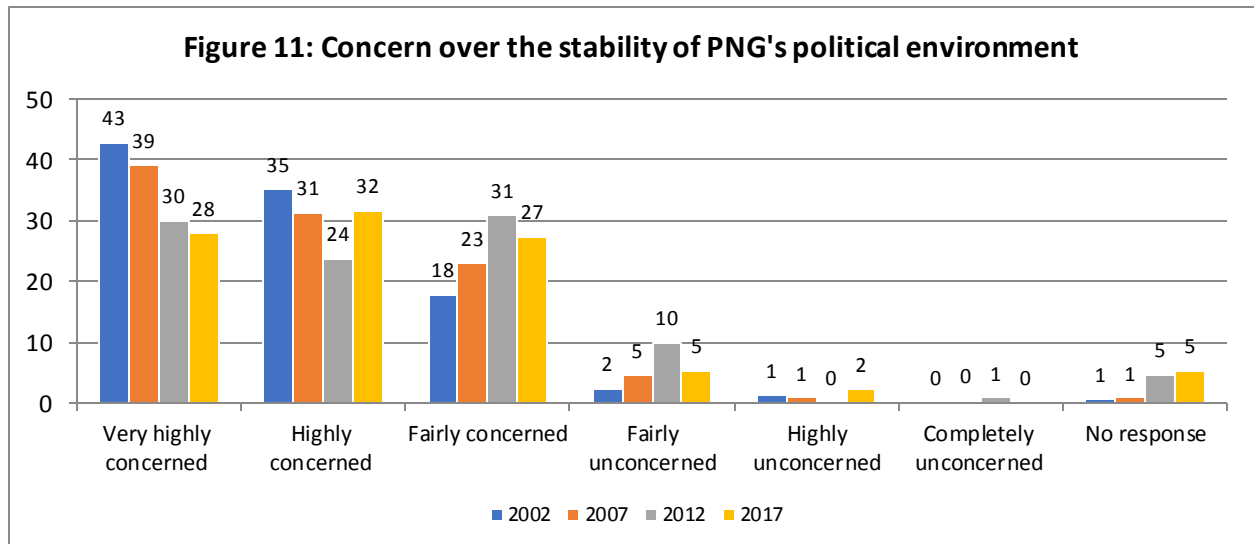
policy and regulatory instability, 76% of all business survey indicated that they had been either a great deal, or somewhat affected by this issue (figure 9).

15. The extent to which each sector viewed this issue as important varied widely as shown in Figure 10. Respondents in the agricultural sector identified this as being of the greatest concern, with 35% indicating that it affected them a great deal. Since government has targeted the sector as one that it would like to develop further, consideration should be given to ensuring greater policy consistency. The manufacturing sector also identified the issue as being of significant concern.

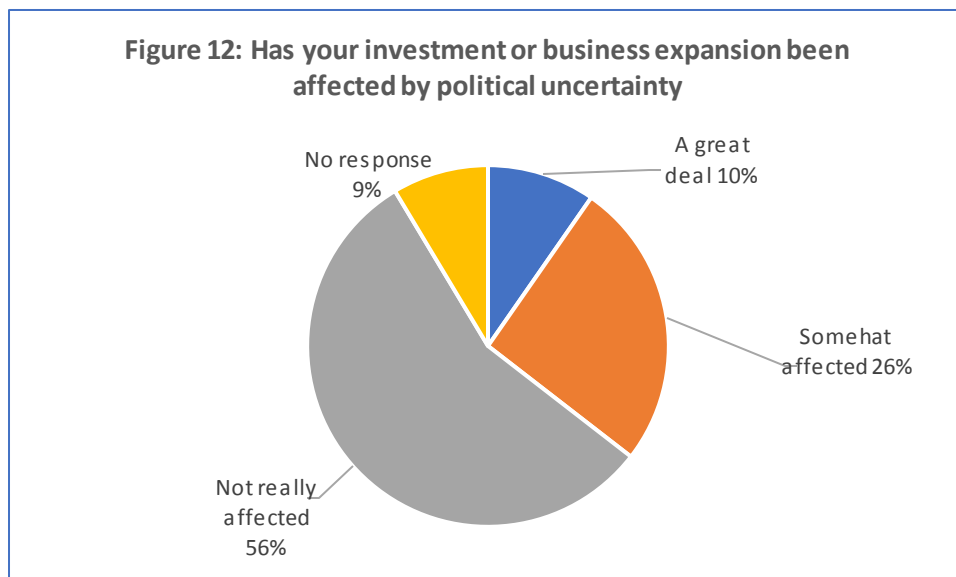


16. Surprisingly, after an extended period during which government did not change, a very substantial percentage of survey respondents expressed concern regarding political instability.

Those expressing very high concern, or high concern actually increased compared with the 2012 survey (Figure 11). The responses may, however, have been affected by the survey having been conducted during and shortly after the 2017 elections.



17. Although political uncertainty directly impacts business and policy uncertainty increases operating and investment risk, when asked if political uncertainty had impacted investment decisions or business expansion, over half said that it had not. Of those affected, 10% said that political uncertainty had had a substantial influence on their investment or expansion decisions, while 26% indicated that it had had some influence (Figure 12). While these latter 2 groups are in the minority, there is the possibility that expansion, investment and therefore business growth has been lost because of the perception of political instability.

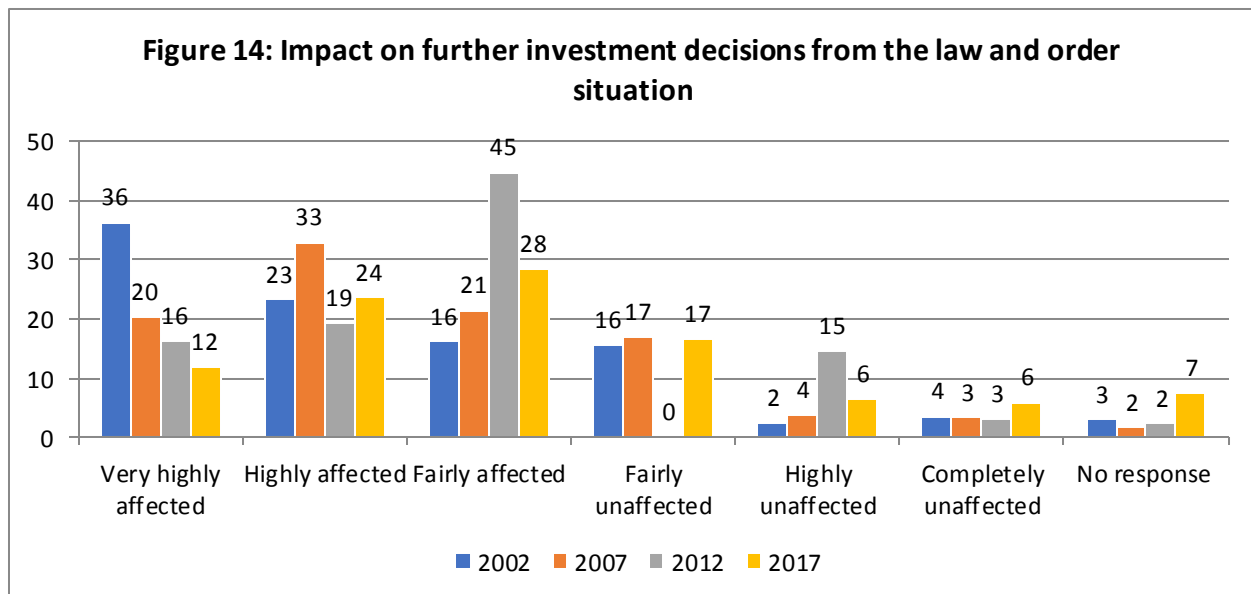
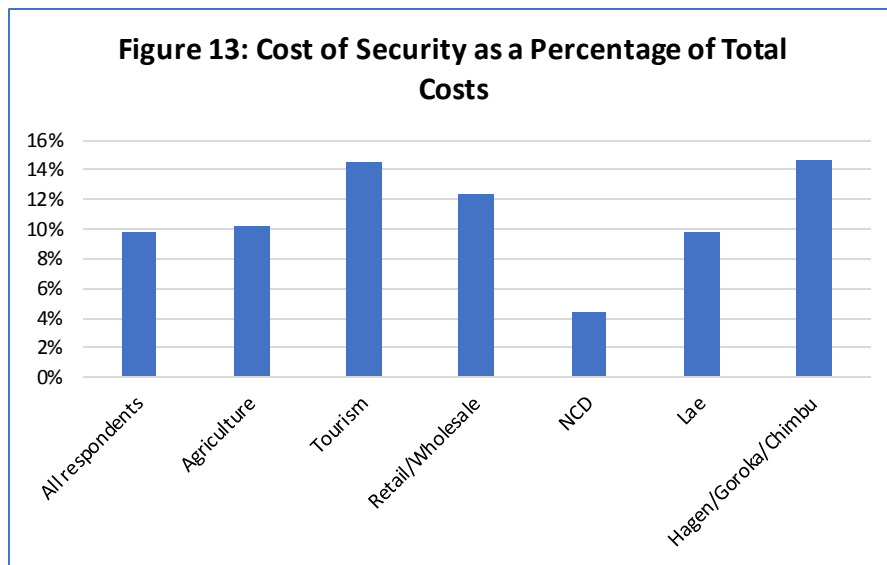


Law and Order

18. Numerous publications, reports and newspaper articles have highlighted the effect of crime on personal safety and business security. There are copious reports in PNG newspapers

on theft of crops, inventory and cash. Trucks on highways are hijacked and looted, with these thefts often being violent. Shift work maximizes the usage of capital and increases the productivity of assets, yet in PNG is rarely possible because of the threat of crime against business workers. While many in PNG indicate that the threat to tourists is exaggerated, the external perception in the tourist industry is that PNG is a dangerous place to visit, which greatly reduces the advantages of the country's great natural beauty.

19. Furthermore, crime directed at businesses constitute a tax on doing business, with the

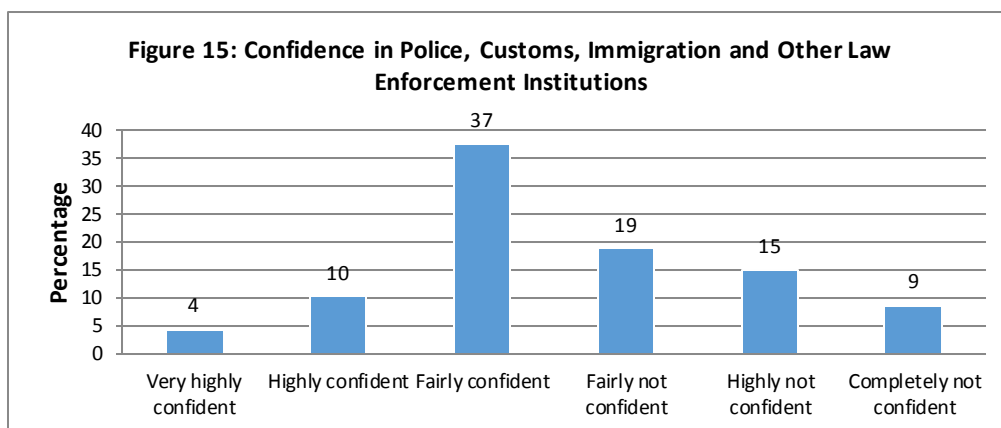


more serious the crime problem, the higher the tax. In many cases, the amount spent on security can be as high as the average profit margin that firms earn. Respondents in the survey were asked to estimate the cost of security on their businesses as a percentage of all their costs (figure 13). On average, businesses reported that the cost of security, consisting of the cost of protecting their businesses plus losses from crime amounted to 10% of their total costs. The industry

reporting the highest cost was tourism, while businesses located in the Hagen/Goroka/Chimbu area reported the highest costs from crime.

20. If there is one constant from the 4 business surveys over the past 15 years, it is the adverse impact of security and crime on the business environment. Each of the past surveys identified this issue as businesses' most pressing concern, and the 2017 results are no different. Law and order is one of the key public goods that governments should provide. In this regard, the state in PNG has failed and continues to fail.

21. In the 2017 survey, 64% of respondents indicated that the law and order situation had negatively influenced their investment decisions. While this represents some improvement over previous surveys, security issues are clearly still taking a significant toll on decisions to investment and expand. Figure 14 shows the evolution of concern for the impact of the law and order situation on investment decisions over the 4 surveys.



22. There is also a low degree of confidence in law enforcement bodies. Figure 15 shows that over 40% of the businesses in the survey sample expressed a lack of confidence law enforcement. However, the evolution of responses indicates some improvement over time. In the 2012 survey, over 50% of those survey expressed lack of confidence in law enforcement bodies in answer to this question.

23. Confidence in the judiciary is mixed. The number of businesses expressing very high or high confidence was only 20%, which contrasts markedly with the 2002 survey when the equivalent statistic was 44%. Nevertheless, the 2017 responses represent some improvement compared with those in 2012, when the equivalent number was 14%. Table 1 shows the evolution of businesses confidence in the judiciary over the 4 surveys.

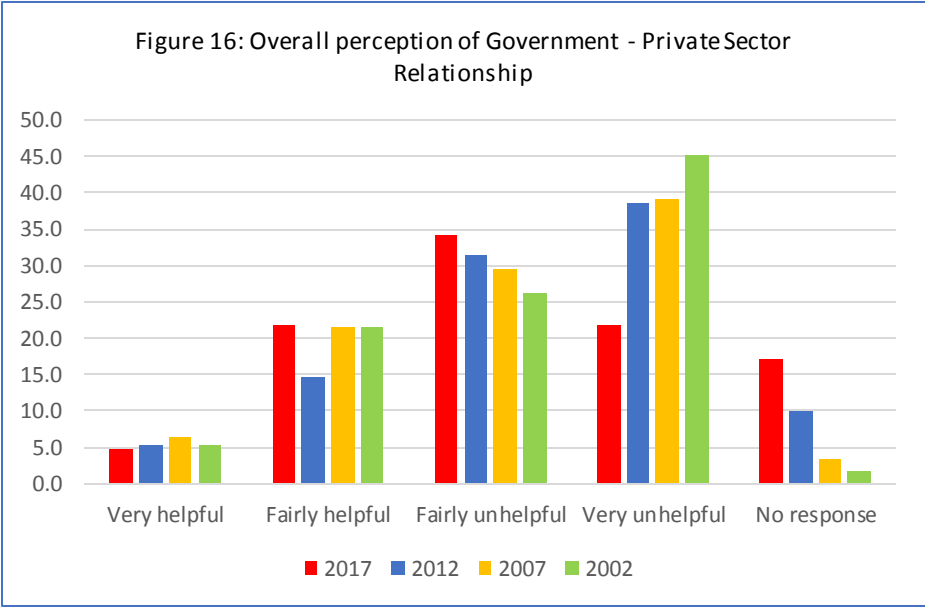
Table 1: Business Confidence in the Judiciary: 2002 - 2017				
Confidence in %	2002	2007	2012	2017
Very highly confident	21	5	5	3
Highly confident	23	12	9	17
Fairly confident	34	43	44	40
Fairly not confident	14	19	18	16
Highly not confident	5	12	12	8
Completely not confident	2	7	10	6
No response	2	0	2	10

24. The judicial system is one of the most important institutions in any country, because it is responsible for ensuring criminal justice and it has a crucial role in the enforcement of contracts, the fundamental building block of business transactions. If businesses do not have faith in the sanctity and enforcement of contracts, their business and investment decisions will be riskier, and demand higher rates of return. As a result, growth and productivity will be lower than it otherwise would be.

Government Business Relations

25. A vibrant private sector requires a strong, collaborative relationship with government. Ongoing dialogue with government ministries and institutions ensures that potential policy initiatives reflect the feedback from businesses regarding how their operations will be affected by new policy initiatives that impact the private sector. If business feels that it has a voice, it will be more willing to cooperate with the public sector and follow laws and regulations. At the same time, government should resist entreaties from businesses for special treatment that reduces competition or provides special treatment to sectors or individual businesses. Independent bodies, particularly non-profit institutions that are neutral, have a strong role to play in flagging poorly designed government policies as well as rent seeking behavior on the part of the private sector.

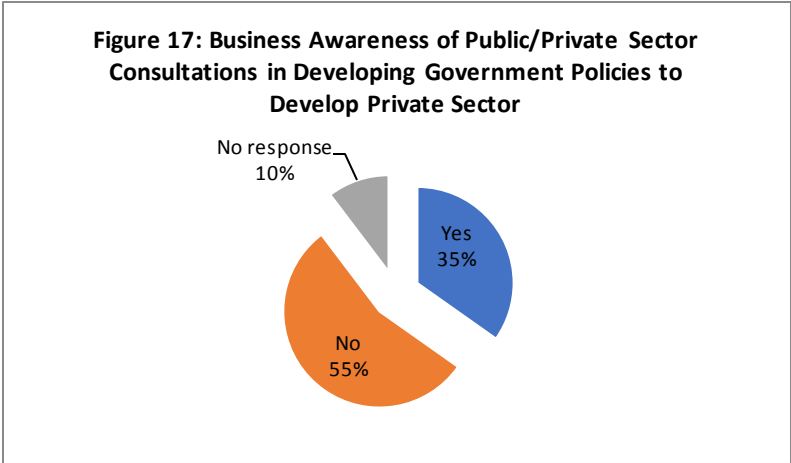
26. Businesses were surveyed on their perception of the relationship between the public and private sectors. Figure 16 shows the evolution of how helpful businesses view government in the relationship with the private sector. It shows that there has been some improvement in this regard, with nearly 30% of respondents indicating that they perceive government to either very helpful (5%) or fairly helpful (22%). This represents an improvement of several percentage points since the 2012 survey. Furthermore, there was a large decline in the number of respondents who viewed government as being very unhelpful – from 38% in 2012, to 22% in 2017. Nevertheless,



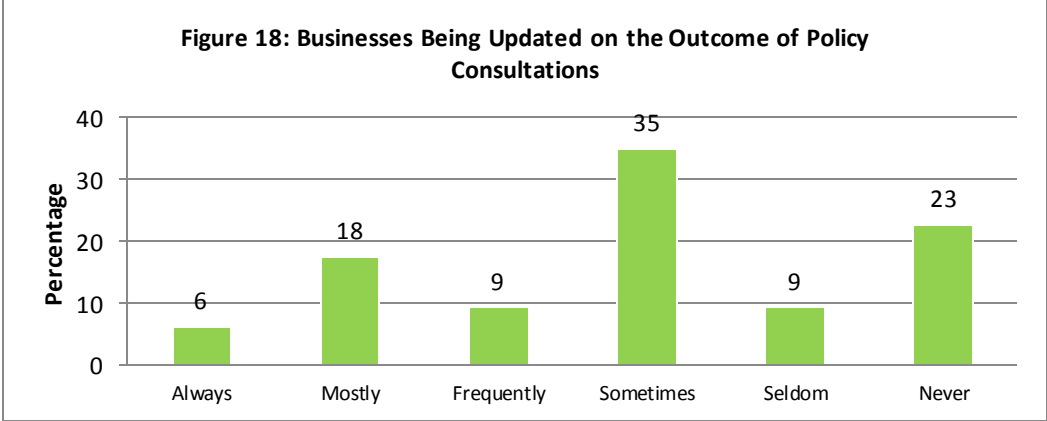
when interpreting the improvement, the fact that over 50% of all businesses survey still view government as being either fairly unhelpful or very unhelpful.

27. A feature of a strong business environment is consultations between government and the private sector over proposed policies. However, 55% of the survey respondents indicated that they were not aware of public-private sector consultations when government was developing

policies and law reforms that would affect their businesses (figure 17). This indicates no improvement in awareness of the interaction between the public and private sectors. If the public and private sectors do not engage in dialogue, misunderstandings arise – the private sector will claim that it is ignored by government, while policymakers and government officials will maintain that they are doing all that is necessary to help businesses, but that their efforts are being ignored.



28. Furthermore, even among those businesses that were aware of public sector/private sector consultations, 67% of respondents indicated that they were not updated frequently on the outcome of consultations (figure 18). This indicates that not only are consultations between businesses and government an issue, but also that consultations within the private sector leave much to be desired.



29. Businesses were also asked to rank government policies and regulations as hindrances to their businesses. The rankings are shown in Figure 19. Foreign currency regulations are regarded as the largest single issue, by a significant margin. This is the result of foreign exchange rationing by the Bank of Papua New Guinea. Importers are required to apply for foreign exchange to pay for their purchases of goods and services from other countries. Delays in obtaining foreign currencies can run into months, rather than weeks. This is a sure sign of a severely overvalued

exchange rate. Furthermore, like efforts to defend overvalued exchange rates in other countries,

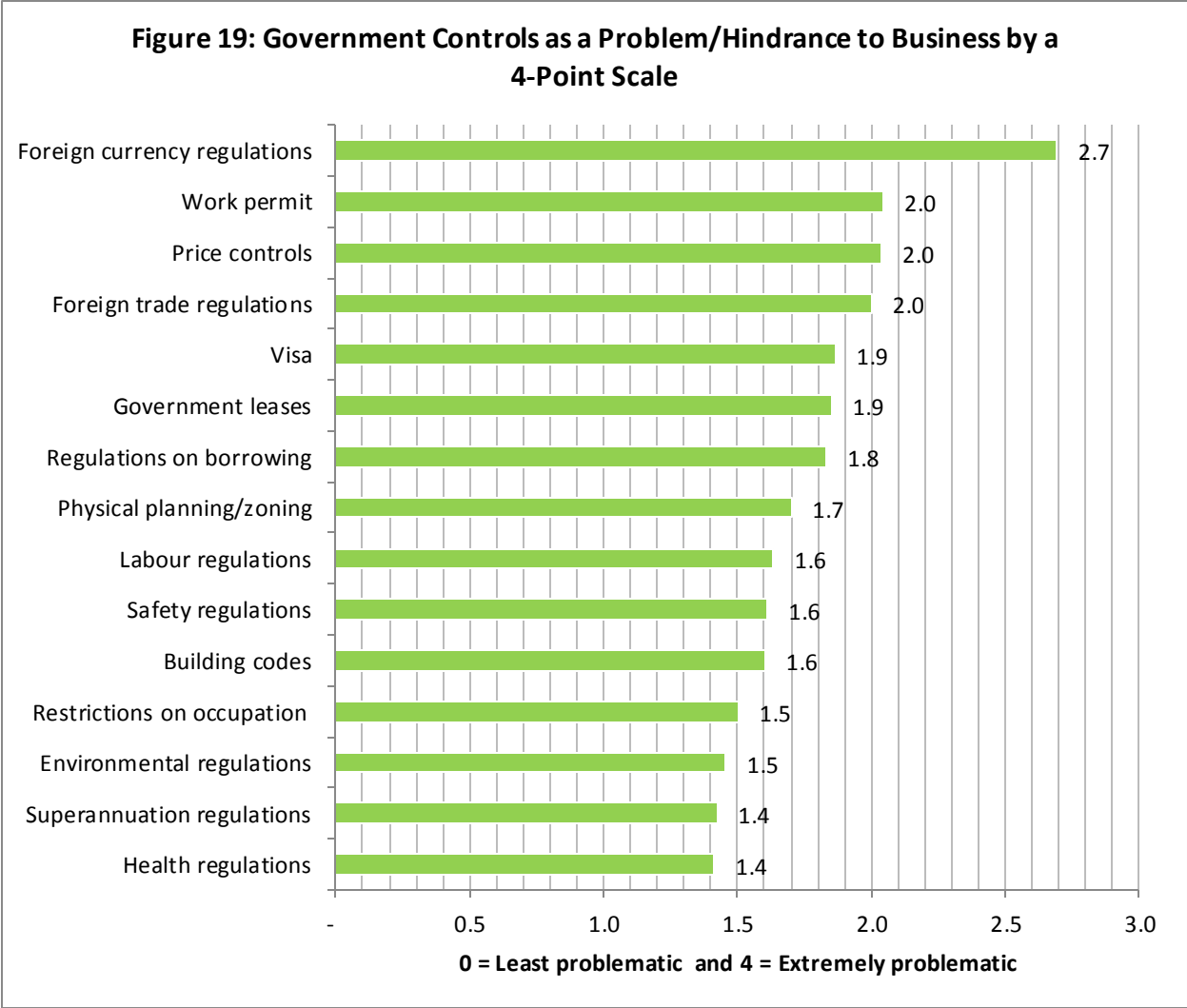
Text Box 1: International Monetary Fund Observations on the Kina Exchange Rate Policy.

The analysis and recommendations of the most recent 2 IMF Article IV Reports confirm the findings of the survey regarding the difficulties caused to PNG businesses by foreign exchange shortages. The IMF points out the consequences of attempting to defend an overvalued exchange rate through rationing of foreign exchange. “FX rationing has increased the risks of balance of payments problems, and hampered private sector investment by compressing imports, discouraging non-resource exports, and impeding dividend transfers abroad.”^a Furthermore, the IMF found evidence that allocations of foreign exchange went to favored importers, rather than being distributed neutrally. The IMF observed that “the current FX allocation mechanism poses risks for sustainability of the external position and could result in disorderly exchange rate adjustment.” It recommended “greater exchange rate flexibility and improved market efficiency and transparency [that] would reduce the cost of adjustment to lower commodity prices and curtail risks.”

The 2017 Article IV report observes: “The main impediment to private sector development is macroeconomic policies. The main obstacle to business activity and investment are difficulties in obtaining foreign exchange. This is adversely affecting both current activity and the willingness of parent companies to continue investing in PNG.”

- a. International Monetary Fund, January 2017, Article IV Consultation Report for 2016
- b. International Monetary Fund, December 2017, Article IV Consultation Report for 2017

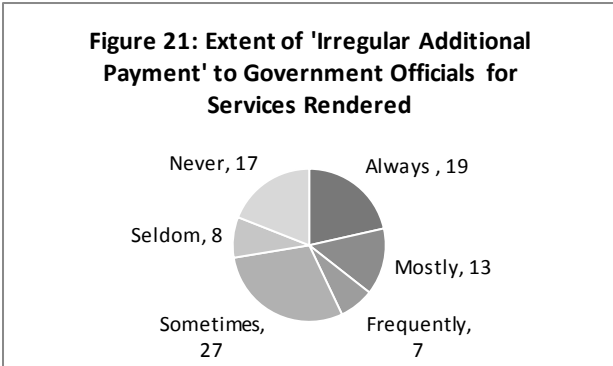
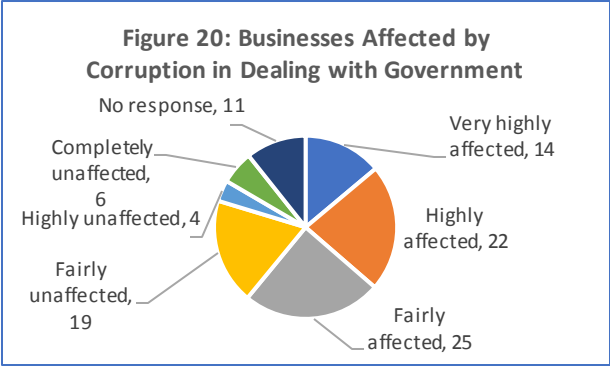
PNG’s attempts to limit currency depreciation has resulted in an ongoing drain on foreign exchange reserves – US\$830 million in 2015 alone – without addressing the fundamental imbalances resulting from the overvalued kina exchange rate.



30. The most significant other impediments to businesses reported by respondents were price controls, foreign trade regulations, and work permits (figure 19).

31. A further issue with respect to government business relations that the survey revealed was the problem of corruption. Over 60% of the respondents indicated that they were either very highly affected, highly affected or fairly affected by corruption in dealing with government (figure 20). At the same time, 66% of respondents indicated that they made “irregular additional payments” to government officials (figure 21). About 40% of respondents indicated that such payments led to positive outcomes on a regular basis. However, less than 20% of respondents indicated that they regularly sought recourse when approached for irregular payments.

32. The extent of corruption reported by businesses appears to be widespread. While the greatest number of respondents indicated that the problems lay in either Lands or Customs/Finance/Tax institutions, these amounted to less than 30%. Most respondents indicated that there were multiple institutions where irregular payments were necessary.

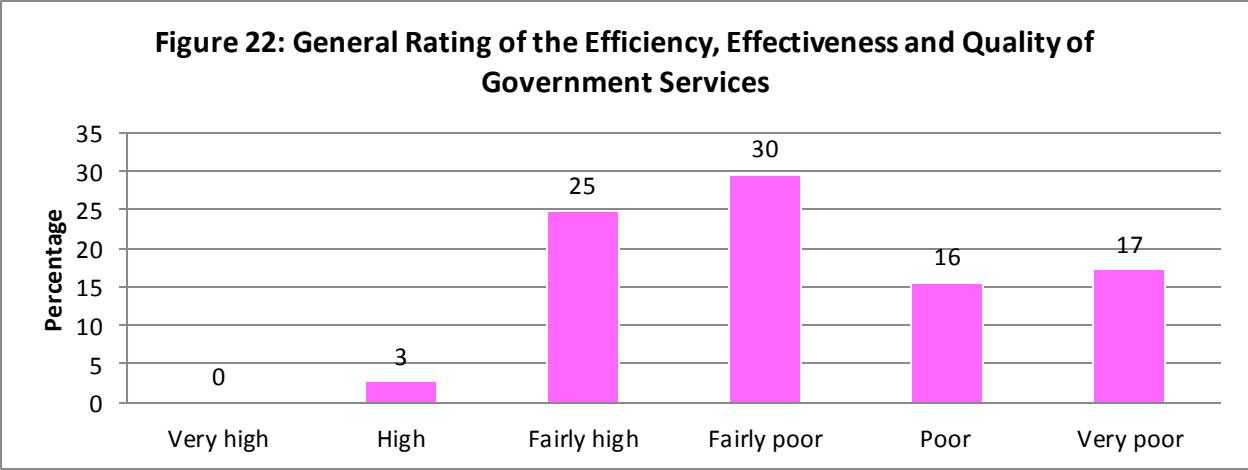


33. Corruption thrives when regulation is widespread and government officials have latitude in their interpretation.⁴ As with crime, the need to make corrupt payments amounts to a tax on business, but also can distort resource allocation, with negative effects on productivity and investment.

The Efficiency, Effectiveness and Quality of Government Services

34. A business environment that encourages investment and entrepreneurship requires good quality infrastructure. In many high income countries, governments supply some infrastructure, such as roads, while the private sector supplies types of services for which it can charge, such as electricity, ports and airports. However, in the Pacific, government ownership of most infrastructure services is the norm.

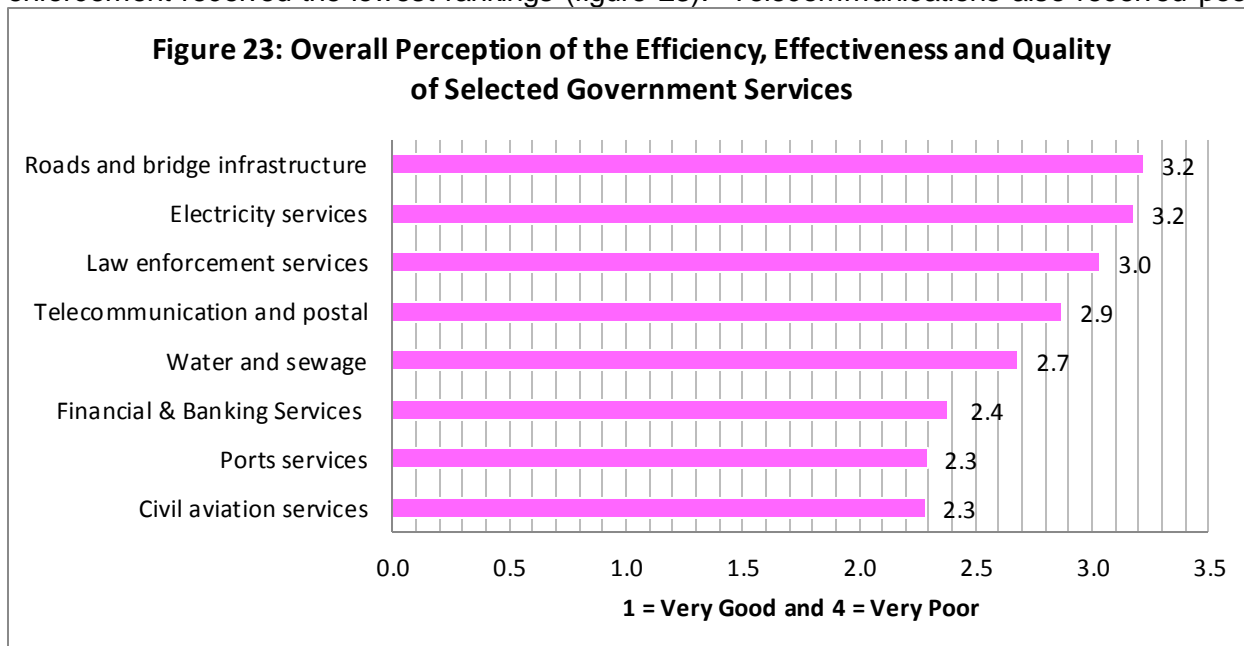
35. Businesses were asked about their perceptions of government services. No respondents ranked the efficiency, effectiveness and quality of government services as being “very high”. By contrast, 63% of respondents viewed government supplied services as being fairly poor, poor or very poor (figure 22).



36. A further question asked businesses to rate the quality of services in specific sectors on a 4 point scale, with 1 being the highest quality and 4 the lowest. If 2 is taken as a neutral view, all the scores were above this, indicating that the private sector view government services of being below even average quality. Highways, roads and bridges and, electricity services and law

⁴ See Paul Holden and Jennifer Sobotka, 1998, Corruption: An Economic Perspective, International Society of Social Defense; Conference Volume on Corruption, Milan Press

enforcement received the lowest rankings (figure 23). Telecommunications also received poor



ratings, despite the explosive growth of mobile phones. This may well be because it is costly to access the Internet as well as the poor performance of state owned telecommunication providers, and the government monopoly on access to the Internet undersea cable.

37. In general, the productivity of state owned enterprises in PNG is very low (text box 2). Often, observers focus on the financial performance of SOEs. While SOE deficits can be a major drain on the public sector budget, good financial performance does not account for the contribution of SOEs to growth. This is determined by their productivity, which is the prime factor behind all growth accounting – in the long run, prosperity is derived from increases in productivity, which is why the low productivity of PNG’s SOEs is of concern.

Text Box 2: The Productivity of State Owned Enterprises in PNG.

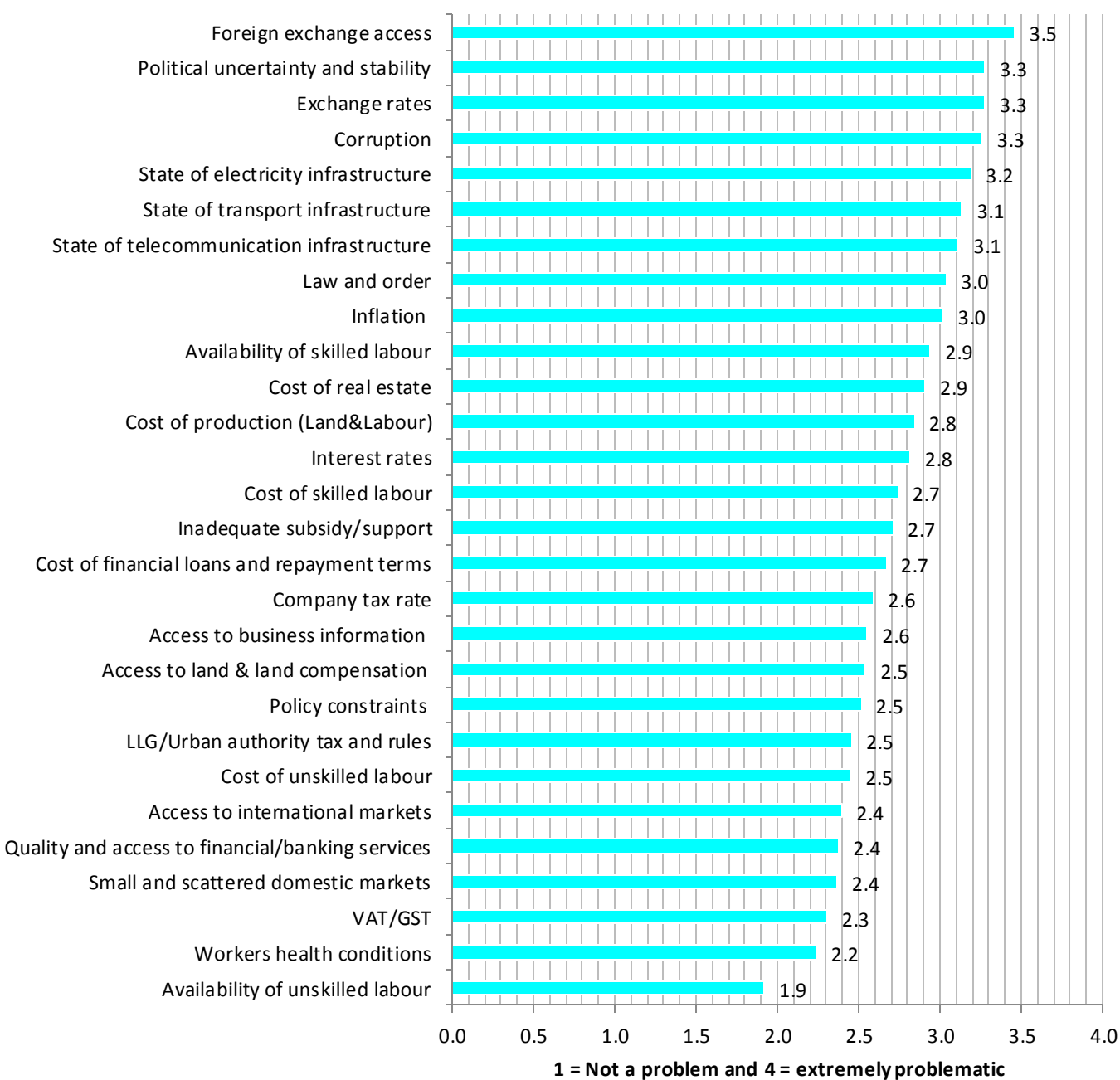
A recent study on productivity of state owned enterprises in the Pacific region ^a found that PNG’s SOEs are among the least productive. Using New Zealand as a benchmark, because it is a relatively small island economy, the results of the study indicated that PNG’s SOEs were only 6% as productive as those in New Zealand. This cannot be explained by differences in capital investment. On average, capital/labor ratios in the region were about 50% of those of New Zealand companies analyzed – if everything else was equal, this would imply that SOEs in the Pacific should be much closer in terms of productivity differences to those of New Zealand. Analysis of the productivity of PNG Power was hampered by the fact that publicly available information could only be obtained up to 2009, an indication that lack of transparency and accountability is a major problem. However, the productivity of PNG water was the lowest of all the water SOEs in the region.

^a Paul Holden and Luis Guasch, *The Productivity of State Owned Enterprises in Pacific Island Economies*, 2017

Chapter 5: Summing Up the Survey Findings

The overall ratings of constraints to business are shown in Figure 24. The responses support the findings of the earlier sections. The most significant constraint is perceived to be issues related to the exchange rate and foreign exchange access. The concern with which business views the foreign exchange situation is illustrated by the fact that for the first time since surveys commenced in 2002, law and order, political uncertainty and corruption are not the constraints that are the most significant, although they remain of substantial concern. Infrastructure is a major impediment, particularly electricity, transport and telecommunications.

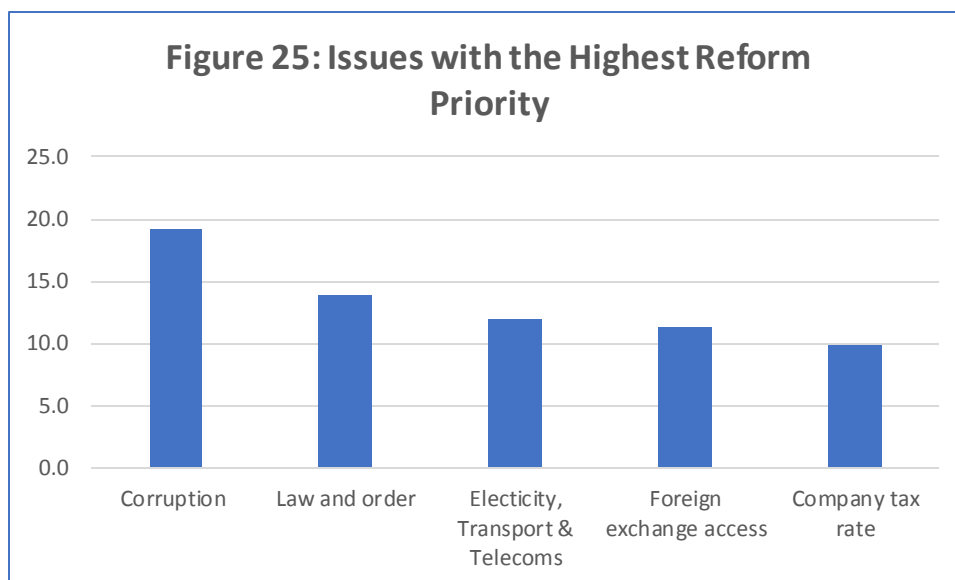
Figure 24: Ranking of Hindrances to Business and Investments



Key Priorities for Reform

38. One of the key questions in the survey was how businesses viewed the most important priorities for reform. Figure 25 shows the responses that identified the top 5 reforms that businesses would like to occur. In order of priority, they were: corruption, law and order, infrastructure, foreign exchange access and the company tax rate.

39. With one exception, the issues and the rankings are identical to those identified in the 2012 survey. The exception is access to foreign exchange. Businesses report having great difficulty obtaining foreign currency to pay for imports. An issue that was the 5th reform priority in



the 2012 survey, access to land, was not identified as being of significant consequence in the 2017 survey.

40. It is surprising that the reform priorities do not follow exactly the issues viewed as constraints to doing business. A possible explanation is that survey respondents only listed as reform priorities factors regarding which they believed were amenable to reform, but the law and order and corruption priorities are systemic and could take many years to improve. The company tax rate was the 5th most important priority. PNG's company taxes are high by international standards, with the rate for locally owned companies being 30% and that for foreign companies, 48%, which is a substantial disincentive for foreign investors, keeping out of PNG valuable knowledge and investor know how.