

Financial Sector Development



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Published by Sida 2004

Department for Infrastructure and Economic Cooperation

Printed by Edita Sverige AB, 2004

Art. no.: SIDA3928en

ISBN 91-586-7550-7

This publication can be downloaded/ordered from www.sida.se/publications

1. Introduction and purpose

As a follow up of the merger in 1995 of five Swedish development cooperation agencies Sida was mandated by the Swedish government to review its policy in relation to the mobilisation of financial resources in developing countries¹. The review would include recommendations regarding support to the mobilisation of domestic resources as well as to the promotion of foreign private capital of these countries.

The purpose of this paper is to present a proposed Sida policy for assistance for financial sector development in developing countries, with a particular emphasis on Eastern and Southern Africa. The aim is that this policy will provide guidelines both for direct financial sector assistance and for the design and implementation of financial sector components forming a part of other assistance activities. The policy guidelines will contribute to improved understanding of financial sector issues within Sida and an improved integration of such aspects in projects where they are relevant.

¹ See main report by a Sida task force – June 1997.

2. Definitions and role of the financial sector

An efficient financial sector is one of the pillars of a well functioning market economy. For the purpose of this paper it is assumed that the *financial sector* forms the structure of arrangements in an economy which facilitates the conduct and growth of economic transactions through the use of money for payments, savings and investments. It consists of financial policies and financial infrastructure which support the *financial system* (institutions, instruments and markets). *Financial policies* relate mainly to the money supply, interest rates, public deficit financing and the provision of financial services. *Financial infrastructure* consists of the support for the financial system found in the legal and the regulatory framework governing financial transactions, the practices surrounding audit, accounting and financial disclosure and the operations of the payment system. As to *financial institutions* they include: government entities such as central banks, national debt offices and financial supervisory authorities; financial intermediaries such as banks, microcredit institutions, rural and informal finance institutions, pension funds, insurance companies, leasing companies, risk capital funds and other specialised institutions; financial facilitators such as brokers, credit information agencies and rating agencies. *Financial markets* comprise money-markets (short term debt instruments) and capital markets (equities and long-term debt instruments). *Financial instruments* represent claims to real resources and they may consist of demand and time deposits, bank loans, bonds, debentures, certificate of deposits and shares.

The main functions of the financial sector are the following:

- to reduce transaction costs by providing a stable and widely acceptable medium of exchange
- to encourage savings in financial assets by supplying financial instruments with attractive yields and different maturities
- to improve efficiency of resource utilisation by screening alternative investment proposals and by monitoring the behaviour of borrowers and issuers of equity
- to make risky investments practicable by pooling, pricing and redistributing risks of financial assets

The main objective of the financial system is to ensure that savings from surplus economic units are efficiently mobilised and shifted to high-yielding investments in deficit economic units with an appropriate balance of risk and returns. Smoothly functioning financial systems lower the cost of transferring resources from savers to borrowers and, thus, raise the rates paid to savers and lower the cost to the borrowers. The adequacy of financial institutions, instruments and markets can affect the volume of financial savings mobilised and the efficiency with which they are allocated to productive uses. Confidence among savers and investors is an important element for the functioning of the system.

It is the task of the government to create this confidence and to enable the environment for the operators in the financial markets. The government should make sure that the actors in the market perform in the interest of consumers, investors and savers. The role of the government is therefore to regulate, monitor and supervise the financial system as well as to promote competition within the system.

In recent years the following trends have enhanced the importance of efficient financial systems in developing countries:

- The implementation of structural reforms and the increased recognition by policy makers of the importance to improve conditions for domestic resource mobilisation;
- The decline in the inflow of official development funds;
- The increase in private capital inflows (both portfolio and direct investments);
- The increased demand for capital from the domestic private sector;
- The enhanced efforts to restructure and privatise state-owned commercial ventures;
- The increased capital requirements for infrastructure projects;
- The increased need to restructure social security systems;
- The increased efforts to reduce outflows of flight capital and to stimulate the return of such capital;
- The increased efforts to broaden the ownership of assets and to allow for less privileged groups to benefit from economic growth;
- The deregulation of financial markets,
- The rapid development of information technology facilitating the integration of these markets.

3. Prerequisites for successful financial sector operations

In addition to basic assistance related to the promotion of peace, democracy and human rights the following elements are essential for the promotion of efficient financial systems.

Good governance. This implies:

- *The rule of law.* A predictable environment, with an objective, reliable and independent judiciary, is fundamental. Apart from constitutional laws which define the role of public and private sectors, laws related to the management and trade in property rights, contracts, bankruptcies, corporate operations, collateral, debt recovery, accounting, auditing, taxation and foreign investments are essential for financial sector development.
- *Good public sector management.* Public administration should be transparent and have a predictable, coherent and consistent framework of law and government behaviour without a minimum of arbitrariness.
- *Fight against corruption.* Corruption, whether in the public or private sector, undermines the credibility of democratic institutions and results in the misuse of scarce resources. Efforts to reinforce the market mechanism is one way of combating corruption.

Macro-economic stability. Price stability and confidence in the consistency of future economic policies are necessary preconditions for establishing an environment conducive to investment. In economic reform the impact on banks soundness is increasingly taken into account in the design and execution of adjustment programmes. A sustainable external debt situation and an efficient debt management system are other characteristics of macro-economic stability.

Financial market safety nets. Because of the central importance of financial markets to the functioning of the overall economy, most developed and developing countries have established some kind of safety net, designed to protect the overall system and promote consumer confidence. The safety net may consist of a lender of last resort facility at the central bank, potentially in combination with a deposit insurance scheme.

Competitive environment. Another prerequisite for the development of deep and broad markets is the establishment of a competitive environment. The liberalisation of the sector, including the removal of barriers

to entry as well the possibility of foreign financial institutions to compete, are some of the measures that are recommended for improved operations. Experiences from financial crises show that a close monitoring and supervision of the financial system by the government and the central bank are essential features of the deregulation efforts.

4. Goals and points of departure

Sida's policy will be to contribute to the fulfilment of the overall development goal adopted by the Swedish Parliament – to improve the quality of life of poor people – and the six subsidiary goals – economic growth, socio-economic equality, economic and political independence, democratic development, sustainable use of natural and gender equality. Financial sector development is particularly related to the promotion of economic growth but may also contribute to meeting other goals.

The goal of Sida's financial sector assistance is to contribute to the provision of efficient, sustainable and competitive financial services to the benefit of governments, enterprises, households and individuals.

The main responsibility for the development of the financial sector rests with the government and the various private actors. The role of Sida is to support the efforts of these parties. Sida, apart from providing finance for such efforts, has an important role as concerned participant in the elaboration of financial sector policies in recipient countries and in the design and implementation of assistance projects. Sida may also act as a catalyst for the mobilisation of additional resources for project purposes and as a networking agent for contacts with other foreign partners for coordination and transfer of know-how.

5. The comparative advantages of Sida

In comparison to “old history”, the merger of the five development agencies has improved Sweden’s possibilities to provide efficient financial sector development assistance. Through the newly constituted Sida, it is possible to have a comprehensive and integrated approach to the development of the sector. While the old agencies often made specific interventions at one level of the financial sector (macro, meso or micro) Sida may combine interventions at different levels at the same time.

Sida has the advantage of cooperating directly with both government and non-government parties in comparison with multilateral organisations such as the World Bank. Furthermore, Sida is in a position to employ a variety of aid instruments. Some of these instruments, for example the provision of risk capital, are presently not used by most other bilateral development assistance agencies.

The build-up of in-house expertise in financial matters will facilitate Sida’s efforts to develop a close relationship with Swedish institutions working in the sector and this will in turn provide new opportunities for transfer of know-how to the recipient countries.

6. Possible areas of assistance within the sector

The following areas in the field of financial sector development have been identified for possible Sida support

Basic legal and regulatory structure

- Legal framework for central banks,
- Legal framework for the banking sector and the capital market
- Rules for prudential regulation and supervision of financial institutions,
- Rules for management of banking crises,
- Regulatory framework for the non-banking sector (including e.g. the insurance sector)
- Rules governing the semi-formal and informal financial sector,
- Rules for foreign ownership of financial institutions,
- Rules related to financial instruments, accounting policies and financial information disclosure.

The objective of support in this area should be to strengthen the financial sector infrastructure.

Financial markets and financial institutions

- Establishment and build-up of money-markets and capital markets;
- Establishment and build-up of banking supervisory authorities, inspection units, national debt offices and other authorities governing the rules of the financial markets;
- Restructuring, corporatisation and privatisation of state-owned banks;
- Establishment of private domestic banks and other financial institutions such as venture capital funds, leasing companies, microfinance institutions;
- Establishment of insurance companies, social security systems and pension funds;
- Establishment of banking associations and other business organisations in the financial sector;
- Establishment of stock exchanges;

- Establishment of shareholders and share promotion associations;
- Promotion of new financial instruments.

The objective of support in this areas should be to strengthen financial institutions and to increase competition in the financial markets.

Capacity to prevent and monitor crises in the financial sector

- Establishment of bank support functions
- Establishment of asset management companies for non-performing bank assets.
- Establishment of deposit insurance schemes

The objective of support in this field should be to improve the capacity for financial crises management in recipient countries. The development of deeper, more complete and transparent financial systems will in itself make countries less vulnerable to financial crises. However, the experience shows that the bank-dominated structure of the financial markets in the majority of Sweden's recipient countries tends to increase the frequency and severity of financial crises. It was acknowledged that the experience of the Swedish resource base is particularly strong in this field as a result of the relatively successful winding up of the recent banking crisis in Sweden. The various institutions which took part in this process have shown interest in cooperating with Sida in this type of projects.

Provision of capital resources

In the restructuring of publicly owned banks or when introducing new non-government financial institutions— be it rural banks, micro finance institutions, refinance agencies, credit insurance units, venture capital funds, or leasing companies— there is often a need to build a capital base in these institutions. In providing finance for equity capital Sida may play a bridging function for market actors to enter as partners in the institutions. When the securities markets for long term finance are not well developed (which is the case in most of Sida's programme countries) there is often a need to provide lines of credits to such institutions or to guarantee or underwrite bond issues.

7. Method of work

Country strategies, economic reforms and sector analysis. Country sector strategies developed by Sweden for its major recipient countries will serve as an entry point for Sida's discussions with government authorities regarding assistance for financial sector development. An engagement of Sida in a financial sector project will normally be based on a study of the sector. In most recipient countries such analyses are conducted by the IMF and the World Bank. There is a growing tendency to include financial sector development targets in the structural adjustment programmes ("second generation" of economic reform). Increasingly basic technical assistance for key transformation programmes, such as restructuring of the central bank, is provided by the IMF and the World Bank. Bilateral donors are often invited to complement the work of the multilateral organisations. Financial sector studies provide an assessment of the financial system, i.e. its level of development, depth, width, efficiency in terms of transaction costs for the intermediaries and the beneficiaries of the financial services, obstacles and linkages to regional and international financial markets and involvement of various donor agencies. In countries where Sweden is expected to be a major actor Sida may be engaged in the work to prepare financial sector studies. One of the functions of Sida's country economists will be to follow and provide information on the development of the financial sector in their respective countries.

Policy dialogue. The efficiency of aid projects in the financial sector depends to a large extent on the commitment of the governments to pursue economic reforms. In connection with discussions and negotiations regarding adjustment support, balance of payment support and emergency assistance programmes Sida will be in a position to recommend policy changes which will facilitate the implementation of various financial sector projects.

Technical assistance. Technical assistance projects will be the normal form of cooperation with recipient country partners – be it government or non-government institutions.

Financial assistance. Financial assistance projects are related to the provision of capital and will take different forms depending on the conditions for the transfer of financial resources. Loans and guarantees can be provided directly by Sida. The availability and feasibility of these instruments will depend on the decisions taken by the Swedish govern-

ment in relation to recommendations by the Concessionary Credit Study (“kreditutredningen”). Provision of risk capital will normally be made through other agencies such as Swedfund which may act as shareholders and execute owner functions in the financial institutions. Sida may provide refinancing of such risk capital on the condition that Sida will not take the full risk.

Combination of assistance and synergies. Restructuring of state-owned financial institutions often include both transfer of know-how and transfer of funds. In the future there will also be increased possibilities to benefit from synergy effects. For example, financial sector development projects could be linked to the implementation of projects related to concessionary credits and soft loans (“U-krediter” and “biståndskrediter”), restructuring of public enterprises and capitalisation of microfinance institutions.

Initiatives for financial sector development assistance may come from government as well as from non-government parties. Financial sector projects funded by country programmes will be initiated by the recipient country while projects funded from other sources (e.g. funds for Enterprise Development, “Näringslivsbistånd”) will be initiated by INEC following consultations with the embassies and the regional departments within Sida.

8. Priorities and selection of projects

In countries with less developed financial sectors. The country strategies will provide basic guidelines as to the types of cooperation projects. In a limited number of countries, e.g. countries in Eastern and Southern Africa, a proactive approach will be applied. Priority will be given to assistance geared at creating an “*enabling environment*”, i.e. support for the regulation, supervision and promotion of financial systems. Support for the creation and strengthening of financial supervisory agencies, capital market authorities, stock exchanges and bank rehabilitation agencies are examples of such support.

Support to private commercial intermediaries in the same country will be avoided or will be made in an indirect, “arms-length” manner, if this will create conflicts of interest with the enabling type of activities. Support to government controlled commercial financial institutions will be restricted to the restructuring of such entities as a step towards corporatisation or privatisation and in areas of market failures (where no private parties have shown an interest to enter).

When support is provided to commercially oriented non-government projects, e.g. leasing companies, venture capital funds and refinancing agencies, efforts will be made not to distort the competition in the sector. Other criteria for selection of projects will be:

- catalytic effects when it comes to attracting capital or know-how from other parties
- innovation and demonstration effects where there are “gaps” in the provision of services to target groups favoured by Sida
- commitment, experience and managerial capacities of the owners of the institutions
- degree of cost sharing
- possibility to promote organisational solutions which are sustainable from managerial and financial points of view and use well established systems of governance (for this reason joint stock companies are often preferable to other forms of for-profit organisations)
- possibilities to involve the Swedish (or Nordic) resource base.

The box on page 20 provides information on Sida’s current programme in the development of the financial sector in Tanzania.

In countries with more developed financial sectors a more reactive approach will be applied. One important criteria for selection will be the extent to which the financial sector project complements the assistance provided by Sida in other sectors. For example, the support to a guarantee fund for microfinance institutions may become a useful complement to a Sida programme targeted at microenterprises and a housing fund may complement a Sida low income housing project.

Sida's financial sector programme can make important contributions to the fulfilment of the goals formulated in the four main Swedish action programmes (poverty reduction, sustainable development, democracy/human rights and gender equality) in development cooperation. (The appraisal, including the use of LFA techniques, of the financial sector projects will facilitate the focusing of the different projects towards these goals.)

For all kinds of financial sector assistance Sida will aim at selecting areas where competent and relevant technical know-how may be acquired primarily in Sweden and other Nordic countries.

9. Microfinance

Assistance in the field of microfinance will be of importance in Sida's future work towards poverty reduction, rural development and micro-enterprise development and should form a substantial part of Sida's poverty-oriented programmes in Eastern and Southern Africa. In order to back up such an approach efforts should be made to mobilise the Swedish NGO sector.

As a short to medium term strategy Sida should support various microfinance projects sponsored by international or local NGOs or other parties, bearing in mind that a principal objective should be to assist only projects which have the possibility to become sustainable. In so doing Sida, should bear in mind the overall financial sector guidelines set out in this paper.

10. Development of the Swedish resource base

Sida will pay further attention to developing the Swedish resource base in areas which are essential for the implementation of this policy:

- Basic institutional structure
- Financial markets and institutions
- Prevention and monitoring of crises in the financial sector
- Capital management

Sida will arrange information gatherings and workshops with scientists and representatives of public and private financial entities in order to increase the understanding in Sweden of financial sector issues relating to developing countries.

11. Research cooperation

The existence of indigenous research capacity across a wide range of subject areas, both theoretical and practical, is an essential component of a country's ability to analyse its financial sector development issues. Through the instrument of research cooperation (mainly SAREC) Sida will assist in the building and strengthening of indigenous research capacity in areas of strategic importance for the development of the financial sector.

12. International networks

This policy conforms to the guidelines on financial sector development forming part of DAC's Orientations on Private Sector Development (1995). In the promotion of financial sector assistance Sida will seek to cooperate with like-minded donors, in particular the Nordic countries. In the European Union, Sida will work for the coordination of member country policies and sector interventions. Moreover, Sida should actively contribute to that the EU assistance conform with DAC's best practices.

Sida will also maintain close contacts with the Bretton Woods Institutions and bilateral agencies (like ODA in England, GTZ in Germany and FMO in Holland) which have shown a particular interest in financial sector issues) especially with regard to the financial diagnostic surveys, the sharing of "lessons learned", the exchange of evaluation reports, the application of techniques for sector assistance and for competence development of Sida staff in these matters.

Financial sector development is one of the most dynamic components and characteristics of the ongoing integration of world economies. Sida will therefore aim at maintaining contacts with institutions in the market (banks, investment management firms, development finance institutions, other financial service companies and financial consultants) which may present new financial instruments and ideas on how to find synergy effects in the use of stagnating official development funds and growing private capital flows to developing countries.

Financial Sector Development – Tanzania

In order to support the development of a well-functioning financial sector in Tanzania, Swedish assistance is based on a holistic approach. Support is provided both to develop an institutional framework and to promote a variety of providers of financial services. The projects below addresses different areas in need of assistance but all with the common characteristic that they are supportive to each other.

1. **The Capital Markets & Securities Authority.** A government agency. Support (MSEK 8.0) enabling the authority to develop its regulatory and supervisory capacity and to establish and develop the Dar Es Salaam Stock Exchange.
2. **First Adili Bancorp Ltd.** A private, indigenous commercial bank. Support (MSEK 5.0) in order to establish the bank. A combination of technical and financial assistance in the form of conditional loan (quasi-equity). The bank is focusing on providing both traditional banking services and investment banking services, which at the time of establishment were not provided for in Tanzania.
3. **Tanzania Development Finance Company Ltd.** A development finance institution owned by local and international financial institutions. The support (MSEK 8.0) in the form of a credit facility will facilitate TDFL's investments in a variety of locally based capital market institutions. Under the facility TDFL has requested the refinancing of a local commercial bank.
4. **Tanzania Venture Capital Fund.** A risk capital institution owned by the Tanzanian National Provident Fund, TDFL and a group of international development finance institutions. The support (MSEK 3.0) is provided in the form of a conditional loan to Swedfund which is the owner of the Swedish shares in the fund. The fund makes investments in local industrial ventures. See also Box 10 on page 60.
5. **udc (Tanzania) Ltd.** A leasing company owned by EDFUND, an international investment fund which has made equity investments in leasing companies in Botswana, Zimbabwe, Mozambique and Tanzania (udc (T) Ltd). These companies provide finance for procurement of vehicles and machinery for small and medium sized enterprises. The support to EDFUND (MSEK 12.0) is channelled through Swedfund which owns 17.5 per cent of EDFUND.
6. **A Microfinance institution.** Support is being considered by Sida to a microfinance institution modelled on Grameen Bank.

In addition to these projects Sida has provided support to "financial components" of development projects aiming at the promotion of small and medium sized companies and micro-enterprises. One of these projects is the Enterprise Development Programme (EDP) for Tanzania, which includes a MSEK 6.0 credit component.

Glossary of financial terms

Below are definitions of a list of financial terms as they are specifically used in this Report:

Capital Market: The market in which long-term financial instruments, such as equities and bonds, are issued and traded.

Chattel: An item of tangible property other than real estate.

Clearing: In the context of the payments system, refers to the transfer and recording of payment instructions made by a payor to a financial institution. Clearing can be done on a gross basis i.e. transaction by transaction or, if channeled through a specialized clearing organization such as a clearinghouse, on a net basis where total receipts of one institution are offset against payments to be made by that institution.

Collateral: Security given by a borrower to a lender as a pledge for payment of a loan. Principal kinds of collateral are real estate, bonds, stocks and chattels. Personal guarantees and joint group liabilities are sometimes defined as “collateral substitutes”.

Commercial Bills: Short-term debt instruments that are used mainly to finance trade. Examples are promissory notes, by which debtors commit themselves to pay to creditors or to their order a stated sum at a specified date, and bills of exchange, which are drawn up by creditors and accepted by debtors.

Common stock: Securities that represent an ownership interest in a corporation. That part of the capital stock of a corporation that represents the last claim upon assets and dividends.

Consessionary lending: Loans made at terms and conditions better or easier than standard commercial rates.

Contractual Savings Institutions: Occupational pension funds, national provident funds, life insurance plans, and similar institutions that collect financial savings on the basis of long-term financial contracts.

Convertibles: Securities (generally bonds or preferred stocks) that are exchangeable at the option of the holder into securities of the issuing firm.

Cooperative bank: A bank that is owned cooperatively and formed to lend funds primarily or entirely to cooperatives.

Credit enhancement: Increasing the creditworthiness of a loan, security issue, or other instrument.

Credit Union: A particular form of cooperative savings and credit society that conforms to a structure common in the international credit union movement, represented by the World Council of Credit Unions (WOCCU).

Curb market: A term used for informal finance, particularly in Asia.

Debenture: A classification for all forms of unsecured, long-term debt whether for corporate or civil obligations, although it is usually applied to a certificate of debt issued by a corporation.

Development banks: Specialized banks, often wholly or partly owned by governments, that are created to meet specific financial needs such as lending to agriculture or industry, not adequately met by existing banking structures.

Direct instruments: In connection with monetary policy, refers to actions affecting monetary conditions which directly force banks into portfolio positions they would not voluntarily accept such as aggregate and individual bank credit ceilings, interest rate controls and directed credit policies.

Discount: A reduction from the face value of a financial contract.

Equity Finance: The provision of finance in a form that entitles its owner to share in the profits and net worth of the enterprise.

Factoring: A financial service that buys accounts receivable from companies and then acts as the principal in collecting them.

Financial Depth: The extent to which savings in an economy is channeled through the financial system. Usually measured as the ratio of broad money (M2) to GDP.

Financial Distress: Usually refers to the sharp deterioration of a group of financial indicators resulting in changes in the behavior of the agent before its restructuring or bankruptcy.; When such distress reaches crisis proportions and is widespread, it usually leads to a rush out of real or financial assets into cash.

Financial infrastructure: The framework of laws, regulations and accounting practices governing financial transactions and the logistics and practices of the payments system.

Financial sector: The structure of arrangements in an economy which facilitates the conduct and growth of real economic transactions through the use of money for payments, savings and investment.
This structure of arrangements include monetary and regulatory policies, infrastructure, institutions, instruments and markets which are intended to enable the transfer of financial resources with minimal possible risk and cost from payers to recipients of funds and from savers to borrowers.

Financial system: The institutions, instruments and markets in the financial sector.

Financial Savings: The portion of total wealth held in the form of financial assets.

Fiscal Deficit: Defined on a cash basis as the difference between total Government cash outlays, including interest outlays but excluding amortization payments on the outstanding stock of public debt, and total cash receipts, including tax and nontax revenue and grants but excluding borrowing proceeds.

Foreign direct investment: FDI is defined as investment that is made to acquire a lasting management interest (usually 10 per cent of voting stock) in an enterprise operating in a country other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short term-capital as shown in the balance of payments.

Formal financial institution: An institution which is governed and controlled by financial legislation and central bank supervisory control.

Hedging: The acquisition of a financial contract designed to protect the purchaser or the seller against a future change in the price of a commodity or security in which the purchaser or the seller has an interest.

Indexation: A mechanism for periodically adjusting the nominal value of contracts in line with movements in a specified price index.

Indirect instruments: In connection with monetary policy, refers to policy actions affecting monetary conditions such as interest rates and price levels through use of market forces and financial markets.

Informal sector: Involves activities outside the formal economy such as trading by street vendors, selling of home made products, subsistence farming, home craft production, backyard carpentry and metal working and other activities not enumerated in national statistics and counted in the gross national product.

Intermediation: The investment process in which savers and investors place funds in financial institutions in the form of savings accounts and the financial institutions in turn use the funds to make loans or other investments.

Leveraged financial institution: An institution, e.g. a bank, that mainly relies on borrowed funds for its operations.

Liquid liabilities: Money plus highly liquid money substitutes, such as savings deposits.

Liquidity Management: In connection with monetary policy, refers to actions taken by a central bank to ensure that the banking system can flexibly provide in the short-run for the cash and payment needs of society.

Micro finance institution: An institution which caters to the needs of individuals, group of individuals and enterprises employing up to ten people.

Monetary policy: Refers to actions taken by central banks to affect monetary and other financial conditions in pursuit of the broader objectives of sustainable growth of real output, high employment and price stability. Distinguished from fiscal policy which affects these broader objectives through Government expenditures and taxes (see direct instruments and indirect instruments).

Money: Currency and other liquid assets: Narrow definitions such as M1 refer to money used as a medium of exchange. Broader definitions such as M2 or M3 add to M1 money used as a store of value.

Money markets: Markets in which financial instruments with a term of one year or less are issued and traded. These instruments usually include enterprise bills, commercial paper, bankers acceptances, Treasury bills, and negotiable certificates of deposits.

Nonperforming Loans: A loan on which contractual obligations (for example, interest or amortization payments) are not being met.

Open market operations: A tool of monetary policy through which a central bank can affect reserve money through purchase or sale of securities.

Payments system: The system of logistics and practices involved in settling economic obligations and transferring resources through financial payments. Clearing and settlement are the two major steps in the payments process. The institutional elements of this process include, for example, the system of checks, clearinghouses, girobanks and automatic deposit and payment orders executed by financial institutions including the postal system.

Portfolio equity flows: These flows are the sum of country funds, depositary receipts (American or global), and direct purchases of shares by foreign investors.

Prudential Regulation: Refers to the set of laws, rules and regulations which are designed to minimize the risks banks assume and to ensure the safety and soundness of both individual institutions and the system as a whole. Examples include lending limits, minimum capital adequacy guidelines, liquidity ratios, etc.

Rating institution: An institution that uses financial information to determine the creditworthiness of potential borrowers or customers.

Risk capital: Equity capital and loans in different forms which are not fully secured.

Rotating savings and credit associations (ROSCAs): An informal group of six to forty participants who regularly make a contribution into a fund that is given in rotation to each group member

Secondary market: The “market” in which primary market instruments (e.g. stocks) are traded after they have been issued by corporations in the primary market

Securities: Financial instruments which can be readily transferred through sale from one owner to another either directly or through the intermediary of specialized institutions and markets. The term generally refers to shares and bonds specifically.

Securitization: The process of conferring the tradeable characteristics of securities to a financial instrument.

Semi-formal financial institution: An institution which is not governed by financial legislation and not controlled by the central bank. At the same time it is not an indigenous and traditional financial institution.

Settlement: In the context of the payments system, refers to the actual transfer of value based on payments instruction through the use of account balances at a financial institution which can be bank balances or on the books of the central bank.

Term Finance: Medium- and long-term debt finance.

Transaction costs: “The costs of doing business” –i.e. costs that are related to finding a buyer, to close a deal and to make sure that the client pays for the purchased good or service. For a lender the transaction costs include the costs for business promotion, information gathering on clients, loan processing, monitoring and loan recovery. For a borrower the costs include out of pocket expenses to obtain documents, assistance to fill in forms, registration fees/stamps, commissions, bribes and travels as well as opportunity costs for time spent in relation to application of loans.

Unleveraged financial institution: An institution, e.g. a pension fund, that does not base its operations on borrowed funds.

Venture capital: Capital to provide funds for start-up situations (“seed capital”) or for existing high-risk small businesses suffering from capital deficiencies but having high profit potential as emerging growth companies

Yield: The rate of return from one’s investment in a specific security or specific piece of property.

Halving poverty by 2015 is one of the greatest challenges of our time, requiring cooperation and sustainability. The partner countries are responsible for their own development. Sida provides resources and develops knowledge and expertise, making the world a richer place.



SWEDISH INTERNATIONAL
DEVELOPMENT COOPERATION AGENCY

SE-105 25 Stockholm Sweden
Phone: +46 (0)8 698 50 00
Fax: +46 (0)8 698 56 15
sida@sida.se, www.sida.se