

FINANCIAL SERVICES AND BUSINESS LENDING:  
PRODUCTS AND SERVICES CURRENTLY AVAILABLE TO  
BUSINESS

STATEMENT BY  
DR. J. D. ROGERS  
GOVERNOR, BANK OF SIERRA LEONE

AT THE SIERRA LEONE INVESTMENT FORUM

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**Mr. Chairman**

**Distinguished Participants**

**Fellow Students**

I want to express my profound thanks to the Executive and members of FINSSA, IPAM for the honour conferred on me to serve as Guest Lecturer at the First Public Lectures and Launching Ceremony of your Association. The choice no doubt fell on me, I dare say appropriately, being Chief Banker and Chief Regulator of Financial Institutions in Sierra Leone.

## **I. Background Statement**

The wide diversity in development and the distribution of its benefits in Less Developed Countries (LDCs) has led to reassessment of development theories and strategies. In a 1995 Seminal Paper on the concept of Sustainable Human Development which seemed to have emerged as the most fashionable fad in development theory. Professor Paul Streeten (1995) noted that “Sometimes the change in the fashion of thinking about development appears like a comedy of errors, a lurching from one fad to another – economic growth, employment creation, jobs and justice, redistribution with growth, basic needs, bottom-up, participatory development, sustainable development, market friendly development; among others. The Financial Sector has not escaped this shift in thinking on what the sector is or is supposed to be and the nature and role of its institutions.

## II. Definition and Categorization

In fathoming a definition and categorize of the Financial system, one is likely to be confronted with immeasurable difficulties, and Scholars and Analysts have simply taken solace in the escapism that there is hardly any universally accepted definition.

A financial institution is therefore often defined by the nature of its balance sheet and sometimes in terms of the service(s) it provides. Simply put, it is an institution that undertakes financial transactions. The financial institutions in an economy could be categorized into three main groups:

- ❖ The Money Market institutions consisting mainly of the Central Bank, Commercial Banks and Mutual Funds;
- ❖ Non-Securities Capital market institutions typically dealing in debt-related instruments such as term loans and mortgages. These include Savings banks, Mortgage banks, Leasing Companies, Insurance Companies and Development Banks.
- ❖ The third category refers to Securities Capital market institutions, primarily trading in stocks, bonds and equity-related securities. The dominant institutions here are the Stock Exchange and Investment banks.

All these institutions are by no means expected to be present in all economies. However, they are known to form the bedrock of developed financial systems.

### **III. Approaches to Developing Financial Institutions**

Economic theory distinguishes between two approaches to the development of financial institutions and markets:

- ❖ the Evolutionary approach and
- ❖ the Planned approach.

The Evolutionary approach refers to the situation where money and capital markets evolve over time, with policy measures concerning their development adopted in a rather piecemeal and inconsistent manner, and at the expense of long-term objectives. Empirical evidence indicates that this approach has been the predominant experience in financial market development in most economies.

The Planned approach, on the other hand, involves the use of laws, regulations and policy instruments to stimulate development of financial markets and institutions in a specific direction. This approach has proven to be desirable and beneficial, and shown to possess a number of advantages leading to the strengthening and deepening of financial systems. Some of these advantages includes:

Firstly, a planned approach fosters the broadening of the range of market instruments and participants, and allows the capital flowing through it to be priced rationally and, therefore to finance the most productive opportunities.

Secondly, it stimulates financial resource mobilization by offering savers, investors, and borrowers more varied risk/return choices and a more efficient means to adjust their portfolios to meet changing circumstances.

Thirdly, it limits the emergence of unofficial markets usually characterized by wide spreads, high risks, and tax evasion; and finally, it introduces over time the right technology, adapted to local conditions.

#### **IV. Functions of Financial Institutions**

The functions performed by financial institutions could be broadly divided into general and specific functions:

##### **a) General Functions**

Notwithstanding the number and complexity of financial institutions it is possible to distinguish three major functions which they perform.

The first major function of financial institutions is that of **intermediation**. Acting as intermediaries between individuals who accumulate money or have excess idle savings and corporations and others who require money to invest in productive activities. They are, in essence, part of the machinery for bringing together borrowers and lenders and responding to their particular needs and preferences. They facilitate the rational allocation of resources and may tend to specialize in large or small scale operations, by type of credit, or in a variety of other ways.

A second recognizable function is that of the **reduction and sharing** of risk. Risk may be reduced, in part, through maintaining fuller and more accurate information, thereby reducing the element of uncertainty, which arises from lack of knowledge. In part, risk

reduction may be accomplished by the acquisition of operational skills in the safeguarding of funds, the extension of credit, and the administration of credit. Lenders devote great effort and time to designing the terms of a loan so as to anticipate and hedge against future contingencies, and thereby minimize risk.

Finally, financial institutions may provide **liquidity**. This is accomplished in different ways and in varying degrees. First, a well established financial institution is likely to be widely known and to have a saleable reputation. This alone, ordinarily makes even the promises, which it makes more liquid than the promises, which it receives from its clientele.

Secondly, the larger the scale on which it operates enables it to provide for normal outflows of cash by utilizing the inflow of funds which can be counted on to take place at the same time. This feature is closely related to the intermediary role referred to earlier.

Thirdly, it is able, in case of special need to tap supplementary sources of funds through, borrowing or liquidation of assets, that would not be so readily available to individuals or other businesses.

These three general functions of financial institutions are, of course, closely inter-related. Moreover, the intermediary relationship, risk amelioration, and liquidity all strengthen and reinforce one another.

## **b) Specific Services performed by financial institutions**

The functions described above are generic. However, the specialized nature of most financial institutions warrants the provision of specific services. A synopsis of these services is outlined below:

- ✓ ***Provision of circulating medium*** – An important service provided by financial institutions is that of providing circulating medium. This function is principally performed by the central bank and commercial banks, with the central bank issuing currency in circulation and the commercial banks creating circulating medium in the form of demand deposits.
- ✓ ***Providing Expert Management and Administration*** - Certain financial institutions have as their primary purpose the provision of financial management services. This is essentially true in the case of Trust companies, although most banks now operate trust departments. The essence of trust relationship is that something of value is “entrusted” to be managed in particular ways and for particular purposes.
- ✓ ***Provision of Information and Advice*** – The provision of investment information and advice often with some degree of investment supervision, are offered by an increasing number of banks under a variety of descriptions.
- ✓ ***Provision of Savings Facilities*** – A large number of financial institutions are engaged in providing facilities for the safe handling of personal savings.
- ✓ ***Acting as Intermediaries in Security Distribution*** – One of the most typical and important service performed by financial institutions is that of facilitating the marketing of securities, including a large variety of financial instruments ranging from short-term commercial paper to stocks and long-term bonds.

- ✓ ***Provision of Lending Facilities*** – The most basic service of financial institutions to which most of the other services are either peripheral or supplementary, is that of supplying credit to borrowers of different kinds and type. Commercial banks are traditionally the principal suppliers of short-term business credit, with which they are almost solely identified.
  
- ✓ ***Provision of Diversification*** – The most important financial institutions for which diversification of assets is the primary service provided are Investment companies which make it possible for the holder of shares in such a company to secure (at a cost) the full benefit of the investment skills of its officers, regardless of the relative size of its own investment. In recent years, banks having trust departments have developed a technique of providing diversification which somewhat resembles that of investment companies.

## V. **Financial System in Sierra Leone:**

### **A Case Study**

As with almost every economy the world over, Sierra Leone's financial system has evolved over time. Prior to political independence, the financial system was part of the colonial monetary arrangement with the West African Currency Board (WACB) as the issuing authority. There were only two commercial banks in operation: The Bank of British West Africa Ltd which is now Standard Chartered Bank Sierra Leone Ltd., and Barclays Bank (D.C.O) later became Barclays bank Sierra Leone Ltd and now transformed to Rokel Commercial Bank.

These banks were branches of large British commercial banks with headquarters in Britain and were primarily established to provide banking facilities for British trading firms and the colonial administration in Sierra Leone.

Following independence in 1961 and the shift in focus to rapid rate of economic development, monetary and financial institutions were designed to assume the responsibility of mobilizing domestic resources as capital for development. The WACB was found inappropriate in this changed environment and was thus replaced by the Bank of Sierra Leone in August, 1964.

This remarkable development was followed by rapid growth of indigenous financial institutions, starting with the incorporation of the National Development Bank (NDB) as a public limited company in 1968, the National Insurance Company (NIC) and the National Cooperative Development Bank (NCDB) in 1971, and in 1973 the establishment of the first indigenous commercial bank, the Sierra Leone Commercial Bank (SLCB). A series of domestic institutions then followed.

The current financial system comprises the formal sector and a vast informal financial sector which together cater for the needs of the populace. Since by definition the informal financial sector is officially unknown. I will rather focus on the formal financial system.

At the apex of this system is the Central Bank, the Bank of Sierra Leone. There are six commercial banks, namely: Sierra Leone Commercial Bank Ltd, Rokel Commercial Bank Ltd, Union Trust Bank Ltd, First International Bank Ltd, Guarantee Trust Bank Ltd,

and the recently established International Commercial Bank Sierra Leone Ltd. The other financial institutions in operation include the National Development Bank, National Co-operative Development Bank, Post Office Savings Bank, Sierra Leone Housing Corporation, Finance and Trust Corporation, First Discount House Limited, Home Finance Company, the National Social Security and Insurance Trust.

The Bank of Sierra Leone is also facilitating the establishment of Community Banks. Four of which have been established (Mile 91, Masimera, Mattru and Segbwema) and two are in the pipeline (Zimmi and Kabala). There are 44 Foreign Exchange Bureaux the first of which was established in 1992, and eight Insurance Companies.

Sierra Leone's financial system has all the features of a developing financial system. It is essentially incomplete, without the full complement of markets and institutions to cater for the financial needs of the economy. Specialized institutions for providing finance for small and medium scale enterprises, and long-term finance for industrial and infrastructural projects are non-existent. The system remains dominated by the commercial banking sector, which is itself oligopolistic. The range of financial instruments is also rather limited.

## **VI. The Regulatory Role of the Central Bank**

Unlike the other financial institutions which merely act as a conduit through which the economy is regulated, the central bank is by statute charged with the primary responsibility of regulating the economy. Since the Bank of Sierra Leone Act became law in March 1963 and the Bank commenced operations in August 1964, its statutory

responsibility has been the promotion of monetary stability through the formulation and implementation of monetary policy and the development of a sound financial structure. It is thus expected to supervise and regulate the activities of commercial banks and other financial institutions to ensure a healthy financial system. It is also responsible for promoting credit and exchange conditions conducive to the balanced growth of the economy.

The Bank has over the years been largely successful in executing these responsibilities and attaining its primary objective of price stability. Given the adverse macroeconomic imbalances which characterized the economy in the mid 1980s, the rate of inflation skyrocketed to an all-time high of about 187 percent.

In a bid to address these economic challenges, the Bank shifted away from direct monetary controls found to be financially repressive to a more efficient system of indirect monetary management. Consistent with this framework was the liberalization of trading in government securities through an auction system, with the interest rate being market determined. With this policy shift, the Bank succeeded in drastically reducing the rate of inflation to below 5 percent in 2002. Today, the inflation rate as reflected by the consumer price index has been relatively stable at just above 10 percent, on a year on year basis. Notwithstanding this achievement, the Bank has continued to strengthen its operations. Open market operations, the main instrument of monetary management employed by the Bank, has been deepened with the introduction of Secondary Market Operations and is currently in an advanced stage of introducing Securities Repurchase Agreements with the banks and other financial institutions.

In further striving to enhance the efficacy of monetary policy, the Bank is in the process of modernization of the national payments system by developing an efficient payments system framework. With technical assistance from the International Monetary Fund (IMF), the Bank is also developing a Liquidity Forecasting framework geared towards an efficient domestic liquidity management. Such a framework helps determine the appropriate quantum of liquidity to inject or withdraw from the system consistent with the country's overall macroeconomic objectives.

The Bank has also vigorously pursued its mandate of maintaining financial stability through the development of an efficient banking supervisory framework. The Bank conducts both on-site and off-site monitoring and supervision of all the commercial banks in line with international best practices such as the Basle Core principles. Stringent guidelines are also set out for their registration including a minimum capital requirement and ensuring that the managerial cadre is comprised of 'fit and tested persons'.

The Bank has had periods of significant challenges, especially in the early 1990s, in executing its supervisory role. The case of the International Bank for Trade and Industry (IBTI) and the Bank of Credit and Commerce International (BCCI) are instructive. The Bank has since not only strengthened its supervisory capabilities, it has expanded its operational base. This is evident by the enactment of the Other Financial Services Act 2001 which paved the way for a more robust supervision of the financial services sector. Within the framework of this Act, the Bank currently supervises and regulates the

operations of the foreign exchange bureaux and the First Discount House SL Ltd. Modalities are being put in place to extend supervision to the other financial institutions including National Development Bank, SALHOC Savings and Loans Bank, Finance and Trust Corporation and Home Finance Company SL Ltd, among others.

Over the years, the Bank has worked assiduously towards stabilising the exchange value of the Leone in relation to other currencies. The exchange rate was removed from administrative controls in 1992 and is now market-determined. The liberalization of the Current Account of International transactions in December 1995 and the subsequent review of exchange controls in November 2002 and May 2003 have enhanced the conduct of foreign exchange transactions.

The introduction of a weekly foreign exchange auction in February 2000 has led to the gradual convergence and narrowing of the spread in the foreign exchange rates. Despite severe external shocks caused by a volatile oil market, the Bank has strived to maintain the value of the Leone within acceptable limits.

The Bank also in the past introduced a number of developmental schemes including the Premium Savings Bonds Scheme, Export Credit Guarantee Scheme, Domestic Credit Guarantee Scheme, and the Rural Banking Scheme, though to varying degrees of success.

The Bank continues to maintain a cordial working relationship with international financial institutions, notably the IMF and the World Bank, in formulating and monitoring programmes aimed at restoring macroeconomic stability. Effective economic policy management requires a high degree of synergy between monetary and fiscal policy.

The Bank therefore works very closely with the Ministry of Finance in ensuring consistency of policies. By continuing to serve as a lender of last resort to government through the provision of ways and means advances, within statutory limits, the Bank ensures that the economy is well regulated.

## **VII. The Evolving Role of financial institutions**

As highlighted above, financial institutions play a pivotal role in the economy both in terms of the provision of intermediary services and its actual regulation. However, with the country emerging from over a decade of civil conflict coupled with the many global economic challenges, the focus of financial institutions has been redirected towards the fostering of economic growth and development in addition to performing their traditional roles.

More than ever before a huge proportion of the credit portfolio of the commercial banks has been allocated in support of post-war reconstruction activities and the revitalization of the real sector. With this support, the manufacturing sector is gradually picking up.

The Bank of Sierra Leone plays a lead role in efforts aimed at mobilizing domestic resources for economic development. In addition to encouraging the strengthening of the operations of small and medium-scale enterprises, (SMEs) the Bank has taken action to improve financial intermediation, especially in rural areas, through the establishment of community banks. The Bank is also fostering micro-finance activities, evident among other things by its immense contribution to the development of a National Micro Finance Policy.

In a bid to facilitate medium and long term lending and borrowing transactions in money and money denominated instruments and subsequently enhance development of both the private and public sectors, the Bank is spearheading the establishment of a Stock Exchange. The Sierra Leone Stock Exchange has already been incorporated and registered as a company limited by guarantee and the Bank has put in place institutional measures aimed at the formation of a Regulatory Unit that will provide administrative support to the capital market development programme. The Bank continues to encourage the private sector to establish a wider range of financial intermediaries through its Private Sector Development Unit.

Finally, the Bank has also not been left out in the global fight against the growing menace of money laundering and terrorism. An Anti-Money Laundering Bill has been drafted and already approved by Cabinet and submitted to Parliament for enactment.

### **VIII. Challenges For the Future**

Tremendous strides have been made by the Central Bank, Commercial Banks and other financial institutions to meet the growing needs of a dynamic economy in which they operate. Commercial Banks have modernised their operations and are adopting wide ranging reforms aimed at providing high quality service to their rapidly expanding clientele.

There are however enormous challenges for the future. Key among these are:

- ❖ Reform of the Central Banking System to respond more efficiently to its environment. In her Seminal Work “The Rationale of Central Banking” Vera Smith invites us to reassess our monetary

institutions and give reform policies due consideration. The Central Bank must align itself with the community in which it exists and not be an ivory tower

❖ **Diversification and enhanced competitiveness**

The emphasis should be on products diversification to break into wider and more productive sectors of the economy. Geographic diversification is not enough.

❖ **Managing Expectations.**

The simplest view about expectations is that people expect the future to be like the past and adapt their plans accordingly. This is referred to in Economic literature as the “Adaptive Expectations Hypothesis”. The main challenge to this hypothesis has come from a group of economists who argue that past experience is only one of a number of variables that effect future outcomes. Financial institutions must take on board other dynamics of the economy in planning for the future.

❖ Taking advantage of enhanced investment climate and staying firmly on the ICT high way and be competitive.

❖ Maintaining a sound and stable macroeconomic environment. The Central Bank must ensure exchange rate stability and low inflation, key parameters in macroeconomic stability.

❖ Maintaining a sound legal and Regulatory Framework. This will include the enacting of sound commercial, bankruptcy, land and money laundering laws, as well as strengthening of the judicial system to enforce such laws.

These and many other challenges would have to be met if Financial Institutions are to be the leading stimulus of economic growth and development.

Once again, let me thank FINSSA for inviting me to deliver this lecture.

**I thank you all for your kind attention.**