An Overview of Factors Which Characterize the Financial Systems of Emerging and Developing Countries

Akwasi Adjei-Kuffour

***Abstract:** The paper attempts to discuss the factors which characterize the banking systems of many developing and emerging countries such as Africa, Caribbean, South America, Asia except Japan. The research will identified problems of savings, loans and poor asset management, interest rates and inflation, credit issues and borrowing in default. The paper will also focused on equity issues, market imperfection such as underdeveloped capital markets, problem of competition, severe asymmetric information, poor property rights, highly volatile economic environment. Finally compulsory reserve requirements, lending regulation, currency denominated liabilities, conglomerates, financial supervision. Issues of public finance, cost of financial intermediation will be discussed. Other areas to be hammered are financial layering, bank credit, lack of efficient resources, systemic stability risk. The paper will assessed the underlying problems and remedies such as the Basel Accord need to be emphasized. Finally a summary in the form of a conclusion will be briefly demonstrated.*

***Keywords:** Africa, Caribbean, South America, Asia except Japan, requirements, lending regulation, currency denominated liabilities, conglomerates*

I. INTRODUCTION

A nation's financial system entails its banks, security market, pension and mutual funds, insurers, market infrastructures, Central Bank and regulatory and supervisory authorities. Prominent researchers perceived that the financial systems plays a significant role in alleviating market frictions and therefore affecting saving rate, investment decisions, technological innovation and hence long-run growth rates (Schumpeter 1912, Gurley and Shaw,1955, Goldsmith, 1969, McKinnon, 1973, Miller 1978). The IMF has spotted packages of core and eventual Financial Soundness Indicators (FSIs) that are relevant in analyzing strengths as well as vulnerabilities in financials. The IMF backs country efforts to compile and disseminate FSIs.

II. FINANCE AND ECONOMIC DEVELOPMENT

Currently, there is a growing body of evidence which suggests countries with better developed financial systems experience faster economic growth, however also enhances the distribution of income. In respect of financial development on economic growth in the financial system, McKinnon(1973), put forward that liberalization of financial permits entry of financial services among the rural society is paramount.

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Dr. Akwasi Adjei-Kuffour, Department of Accountancy, P.O BOX 981 Koforidua –Ghana.

As pointed out by World Economic Forums' Financial Report (2011), higher level of financial progress and broader the accessibility of financial services permit for diversification of risk. These raise the long-term growth channel of a state and virtually improve the interest and influence of producers and consumers with access to financial services.

A collective of measures constitute elements of financial development. These include depth, thus, the size and liquidity of financial services. Access, thus, the capacity if individuals to access financial services and efficiency, the ability of institutions to offer financial services at less cost and with huge revenue and the level of operation of capital markets.

III. OBJECTIVE

The paper attempts to offer the following as objectives to the research:

- To assess the causes that characterizing the financial system in both emerging and under-developing countries.
- To investigate the problems affecting the financial systems of under-developing economies.
- To assess the solutions for a sound financial operations.
- To provide the necessary recommendation for a better financial services.

IV. LITERATURE REVIEW

According to Rose and Hudgins (2006:4), '' a bank can be defined in terms of the economic functions it serves, the services it offers its customers or the legal basis of its existence".

The Oxford Dictionary of Business (2003:46),'' banks are concerned mainly with making and receiving payments on behalf of their customers, accepting deposits, and managing short term loans to private individuals, companies and other organizations''.

In my personal viewpoint, the main definition of a bank is primarily borrowing and lending to provide monetary investment for economic development of the people.

In contrast to the financial systems pertaining to the developed economies such as US, UK, Canada, Japan, the Scandinavian countries, Continental Europe are able to mobilized private savings and allocate these savings to the most productive sectors. A growing proportion of developing countries financial system such as Djibouti, Uganda, Kenya, Ethiopia, Liberia, Rwanda, Afghanistan and

Chile are unorganized and fragmented. There is lack of transparency and dependence on international sources of finance.

These factors create complexity for the government to be able to regulate the monetary supply or curb external exchange reserves. This results in monetary system by which the affluent have the opportunity to capital while the bulk of the population within the society is compelled to depend on the unorganized, unregulated monetary system that constraints people access to capital, accelerates the cost (interest rates) of capital. Relying on international sources of capital for the reason being that internal savings seemed not to offer the relevant capital for economic development. Under-developed economies are in the position to borrow from developed countries and international financial institutions such as World Bank, IMF, International Finance Corporation for reconstruction for development . As a consequence, have massive external debts. Aftermath to the 1970s, the debt were really small and goes with concessional (less) interest rates and to the governments or International institutions, had wide repayments periods. Prior to the shock in 1973, Commercial banks flush with 'petrodollars' for the reason being that they were fundamental sources of loans to under-developing countries . In sharp contrast to International levels, Commercial Banks charged expensive interest rates and had shorter repayment time. This situation was burdensome as developing countries had to borrow huge money to settle the rising costs of oil imports, a crisis which developed countries had to cut down their imports, leading to a fall in commodity prices.

As a result between 1990 to 1997, the external debt of Less-developed states grew from $68.4b exceeding to $2 Trillion, a jump exceeding 250% debt service payments push up a related percentage to $250billion in 1999.

The World Bank categorized fort-eight countries as seriously in debt, implies the most vulnerable to default. Most are West African states such as Ghana, Togo, Benin, Dakar, Guinea Bissau, Guinea, and others countries such as Uganda, Tanzania, and many Asia countries and that of Argentina and the Caribbean.

In these countries, there is a financial market imperfection such as underdeveloped capital markets, resulting in limited corporate bonds, and commercial paper, and limited competition within banks that lead to monopolistic or oligopolistic market structure and pricing practices, and segmentation, serious asymmetric information, poor financial safety makes financial systems in developing countries unattractive business.

In many parts of the developing states, commercial banks tend to occupy the financial system, equity issues are constrained or non-existence, as firms are frequently family-owned .But, despite privatization and cross-border acquisitions have improved in current years ,the level of banking sophistication in many countries financial system in less-developed economies is still stagnant in terms of development in developed markets namely the swift development of non-bank intermediaries, the movement toward the 'originate and distribute' model in respect of banking and the development of opaque, off-balance sheet instruments.

There are poor property rights and inefficient legal systems that in effects lead to contract enforcement very cumbersome and stimulate collaterized lending. Bankruptcy law characteristically offers small creditor at a disadvantage position. This invariably leads to poor intermediation, rising costs of capital, rise in collaterization rates, and less recovery rates for creditors. McKenzie (2010, p.199), provides detail explanation that developing countries may magnify distortion in that there is'' highly volatile economic environment, due to the high incidence of domestic and external shock, which include large foreign capital inflows, followed by abrupt withdrawals or sudden stops, may fuel unsuitable lending booms, as for instance East Asia in the early 1990s or indifferent stage of economic development, or in Eastern Europe and Central Asia in the 2000s''.

Despite developing countries suffer and depend greatly on exports to financed governmental income and settle loans, a fall in exports minimizes government which either has to reduce expenditure, or manage a budget deficit.

In developing countries it is quite cumbersome for the state to accumulate capital through taxation. This is because income levels are relatively small and hence the tax systems framework within the population is small as compared to the developed states, the tax regime is vigorously enforced. Thus, most of the developing countries such as Mali, Burkina Faso, Sri Lanka, Rwanda and a host of others face the problems of levying taxes. This is perhaps attributed to absence of information concerning markets for traded goods and lack of illiteracy level accounting for 30%. There is also absence of commercial organization, operations and lack of efficient resources for civil service that is incapable of levying taxes in the economy.

It should be argued that under-developing countries banking seemed to be less competitive, are heavily taxed, and suffer increasingly rate loss than OCED states. Hence bank spreads seems to be heavily broader, for example in Uruguay, the size or scale between average deposits and loan rates is still surpass 15% grade until 1981 despite cut needed in reserve ratios of oligopolistic structure in terms of banking systems. Fragile asset management comprises poor loan book because of massive exposure in some sectors, regulators use exposure constraints. In the light of this, breaching the regulation may be damaging entirely. Deficiency in the management of failed financial institution such as banks, mortgage lenders, brokers and fund managers is demonstrating negative impacts of developing countries financial systems in countries such as Sudan, Somalia, Zimbabwe, Haiti, Yemen etc.

The financial crisis that hit the banking industry as a result of cut in bank credit and a struggle in terms of liquidity. Few institutions had to shift to trade credit. The side-effect of these problems linkages reduced the efficiency of the credit allocation mechanism, increasing the effective cost of credit to would-be borrowers in the poor economies.

Historically, the Mexican banking systems is seen to be characterized by two qualities that seemed to prove dramatically resilient over period of a rising level of concentration and denominator across the private sector. Partnership relationship between bankers and the government started to reveal as the state's capacity to regulate the financial system started to escalate in the 1970s,

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private bank learned to shift capital across similar conglomerate. Government determination to control credit allocation seemed to be on the high pedestal and fluctuated by bankers' speculative operations, regulation, evasion, and facilitation of Capital flight. At a period between 1980 and 1990, Central bank had lost the capacity to regulate the transfer of credit in the financial systems.

Brazilian Policy makers were skeptical that external bank penetration would be an antidote of the two endemic problems within the banking system. Firstly, lack of insufficient long-term credit offering and rising interest rates.

Also, like Salina's technocrats in Mexico's the economic team is under pressure in that banking opening may damage the government informal control regarding the financial system .

In Indonesia, the banks and particularly their corporate clients had huge uncertainty or unleashed external currency-denominated liabilities, exposing them to quick transfer in the exchange rate. Additionally, a growing proportion of Indonesia's biggest private banks came under industrial conglomerate; the banks lent widely to comparative groups, often, in breach of legal lending constraints and lacking adequate risk regulation and hence widen financial system to massive credit risk. Also, bank in Indonesia's ability to supervise and regulate the banking institution-that had undergone explosive growth in the aftermath was seemed to be poor and prone to political intervention.

In South Korea, conglomerates accumulated huge amounts of external currency-denominated liabilities at the late 1990s in loan derived from banks and non banks systems. Unlike Indonesia conglomerates, Korea's corporate giants permitted to manage its banks, however, the 'Chaebol' acquired a handful of non-bank financial institutions, by which ownership limitations was not applicable.

In Malaysia, there was lack of effective monitory in respect of Merchant banks' potential borrowers. This demise of financial surveillance and regulation implies there were mere vulnerabilities.

V. VARIOUS SCHOOLS OF THOUGHT THE CLASSICAL SCHOOL

Beginning with the classical view, Thornton (1802) and Bagehot (1873) explains at length at the Mothers Bank of country such as Bank of England or Bank of Ghana should follow normal banking principles but should lend freely at times of crisis. While commercial banks may constrain their lending during such periods . Bagehot urges the Bank, as manager of the banking system reserve, to lend freely, bodily to stop panic' (p.64). Two rules are applied by Bagehot; first, loans should only be made at a penalty rate, to prevent the greater number of applicants who do not require it. And secondly, that at this rate these advances could be made on all good banking securities' (p.187-8) .Bagehot complains that the bank's Discount Office restricted itself to discounting good bills during the crisis.
"Lending policies required the banks to confine to short – term, self-liquidating paper growing out of actual commercial, industrial and agricultural operations' (Timberlake, 1993, p.255). Strict adherence to these eligibility criteria prevented the central banks from providing sufficient accommodation to solvent member banks on several occasions.

A. *The Monetarist School*

Turning to the monetarist perception, Godfried and King (1988) claim that open market operations are adequate to absorb the overall liquidity level. There is no need for discount window loans in individual banks. Connecting the monetarist view to the classical doctrine. Humphrey (1989b) forecasts that Bagehot would have backed the application of OMO for lender of last resort motives.

The monetarist school attributes banking crisis to reductions in the monetary base. If only the central bank would avoid a fall in the monetary base, a banking panic would be resolved or resurrected. Friedman (1968), for instance, pointed out that the Great Depression of the USA in 1929-33 to the deflationary policies of the Federal Reserve system 'which forced or permitted a sharp reduction in the monetary base' (p.3). Kadlor (1983) critics Friedman on the grounds that the Federal Reserve increase the monetary base during the Great Depression, as demonstrated by the statistical table in Friedman and Schwartz (1963). The argument is that structural linkage between monetary aggregates and the economy tend to break down during periods of panic. While the monetarists focus on exogenous behaviour in terms of the money supply, most components of the money supply as its roots from endogenous factors, such as bank credit.

One remedy to the problem of determining the right magnitude of increasingly- powered money during a crisis is to shift from the fundamental control to interest rate control. The monetary authorities supply an elastic currency to absorb precautionary demands to covert deposits into currency. In the absence of ascertaining what a sufficient level of money supply is during a banking failure, the central bank stands ready to carry out OMO at the rate of their choice. The aggregate demand for reserves will then be relieved at high rate. This approach is spearheaded by Godfriend and King (1988). In conformity to the classical doctrine, the proposed that the last resort lending rate should be safeguarded and fixed above normal market rates to reduce any government subsidies. But, the monetarist school does not specify that interest rate should be stabilized through central bank. In period of banking crisis there is a rush to quality and the spread between rates on high quality paper, such as Treasury bill, and paper of lesser quality, such as bills of exchange or commercial bank, tends to broaden because of rise in credit risk. It raises a question as to whether the central bank also needs to stabilize the interest rate on the latter type of period so as to stem a crisis. This point out the question of how sound the interbank market for reserves operates in periods of crisis. In a world of perfect information, solvent banks are cut-off from interbank market. Furthermore, the classical doctrine holds that the central bank ought to lend freely to liquid but solvent banks . However the classical writers fail to interpret how to differentiate between solvent and insolvent institutions.

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B. The Modern-Pragmatic School

Goodhart (1988) claims, however, that the development of non-competitive central banks provides them an advantage over the market players. While a bank in turmoil's may be unwilling to show information to its competitors, it can inform the central bank on a confidential basis. Furthermore, the proportions of the modern-pragmatic view (Solow, 1982; Goodhart, 1987; Summers, 1991) argue that the social cost of a bank failure may surpass the private cost in some respects. This in turn may justify discount window loans by the central bank-acting for the public good instead of stimulate by profit objectives-individual banks. The modern-pragmatic school explicitly recognizes the information problem in such LOLR lending. The bases of the problem lies in the doubt concerning the true value of a bank's loan book as the creditworthiness of a bank's borrowers is private information (Leland and Pyle, 1977; Diamond.1984). As a result, growing proportions of banks loans in Ghana are illiquid and cannot be marked to market. Saddled with adverse news, or just rumours, concerning their bank, depositors can withdrawn their claims at demand causing a bank failure.

However, if a bank needs to liquidate its loans after having utilized its liquid assess, it will confront a 'lemons' issues and can only sell its loans at a considerable discount (Akerlof, 1970). However, a run on a bank may precipitate runs on other banks with a similar asset structure. The role of the LOLR is then to stop such a chain reaction in its earliest levels. Given the inherent difficulty of valuing the assets of a bank, it is obviously uncertain to differentiate illiquidity from insolvency at the time the LOLR must act. As a result, the LOLR has no choice but to lend even when it knows the bank's solvency is in doubt.

VI. PROBLEMS FACING FINANCIAL SYSTEMS IN TRANSITIONAL & DEVELOPING COUNTRIES

The main problems facing the financial systems in developing countries are as follows:

The cost of financial intermediation means the relationship across cost of borrowing and net returns on lending. The World Bank (1974;40), '' finds that just the administrative cost of an efficient agricultural credit institution lending to small farmers equal 7-10 % of its aggregate portfolio''.

Hanson and Rezende (1986) are able to demonstrate increasingly bank operating costs in poor economies with rising inflation rate and lack of competition.

Operating cost across financial institutions such insurance, brokers, stock and equity markets and the accompanying spread across deposit and loan rate is seen to be inordinately up in the whole of Central African countries.

Delinquent rates may move up in under-developed states for a variety of reason. Cultural dimension undoubtedly play a negative impact. The idea surrounding repayment is unfamiliar in a host of countries such as Sri Lanka, Rwanda. In circumstance of government involvement in credit programmes, recipients often are not able to distinguish loans from grants.

As echoed by Choi (1991: 67-68),'' Korea provides a surprising example of high levels of non-performing assets in the banking system. The restructuring of episodes, that happened in the 1969-1970, 1972, 1979-1981 are eloquent testimony to the existence of a vicious cycle of financial repression generated by the strategic independent between the government and the business''. Financial layering is backed with preferential rediscount system for instance in Indonesia, A three-tier financial structure comes into play in Korea, and also in India, with county co-operatives borrowing from National Agriculture Co-operatives borrowing from the state Agriculture Co-operative Federation, and vice-versa. Brazil seemed to have a Two-Tier financial structure involving three federal institutions finding capital to second-stage financial organization like the commercial bank, investment bank and development banks. Comparatively, an instance of financial layering is seen in countries such as Colombia, Thailand, Morocco, and parts of Central African countries.

The key to financial layering is to direct credit to priority activities and to reimburse the final lender incompletely for the backing. Unfortunately, these supply-lending approach are limited with extra increasingly cost.

Examining North Africa, 'throughout the region, financial systems are still dominated by bank intermediation (Settino, 2004),(European Commission 2004) Bond markets are still undersized particularly in their private components, but a small current issues by Morocco, Tunisia, and Egypt companies for better path or channel.

In Tunisia, nearly one-third of the banking institution is recently controlled by foreign intermediaries. In Morocco, more than 25% of the system's aggregate assets are from foreign controlled .In Egypt, privatization have translated in between 2004 to 2006 , the control exceeding one-fourth of the state's banking institution from the government to the private sector.

There have been a growing proportion of constraints to capital market in Turkey. There has been a weak accounting and auditing, interlocking ownership and control of banks and business corporations, inadequate bank financial intermediaries to build up capital support services, insufficient secondary markets and finally insufficient supervisory approach. ,Prasad (2009). These issues are more relevant to middle-income or emerging market economies. Among low-income economies, the emphasis may need to be more on getting the basic elements of the institutional framework right, including the legal and regulatory frameworks, corporate governance, accounting and auditing standards. Strengthening and Improving Banking Systems. In major Asian emerging markets, the financial systems remain largely bank dominated.

Crisis surrounding a government-permeated banking institution.

Financial turmoil that is mainly offset by government interference within the banking system is seen as gradual affairs. The underlying characteristics are set down below:

- Macroeconomic shocks which raises the variability of inflation, exchange and interest rates, or capital flows.
- Weak credit decision and inept management of credit risk that are frequently related to government influence on credit allocation.
- Government ownership as regard to huge section of the banking institution is constantly a symbol of

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constraints to emerge, but as demonstrated, despite the lending of private banks can be under government control .

- It is frequently certain to get data on the proportion of lending which is at the free discretion of banks, which does not come strict scrutiny of compulsory deposits. The compulsory component investment as regard to government securities or lending to particular borrowers, alternatively to fund whose disposition comes under the judgment of the bank.
- The borrowing culture emerged from the central bank frequently involves some level of formal control over the bank bank's utilization concerning credit. For example, a borrowing of 25% deposits is a warning sign.
- The side within the budget deficit is likely to assist timing in that damage may offset rising dependence within the banking institution.
- The magnitude of clear financial intermediation tax system is seen as an indicator of government dependence within the banking institution. That is, a rising degree of government subsidy within the banking system is likely to demonstrate that the institution had sunk into a level of reliance, certainly as result of former government pressures.
- Deficiencies in supervisory policies in areas such as capital standards or restrictions on insider activities.

VII. DATA COLLECTION INDICATING EARLY WARNING

• Ruling across a specific syndrome: Every bank underlying constraints can frequently be indicated through skillful design of standard techniques for instance peer group assessment.

• Structural indicators: Demonstrations for macroeconomic shocks. The endogamous nature of this kind of turmoil has evenly transparent features. Normally asset price movements, quick growth regarding lending particularly property transactions and for stock market financing positions, capital transmission within: The underlying factors does shows the underlying symbols in terms of banking failures financed asset price boom that seemed to be immaterialized.

- Total balance –sheet as well as operating account data highlighting unsound banking. A case in point is the growth as regarding aggregate lending, the loan-to-deposit ratio, and dependence in terms of foreign borrowing. Increasing values of each envisage a financial environment which is likely to be targeting its resources in growing manners than only financial. Furthermore, from operating accounts, the gross interest margin, demonstrating profit and the non-interest income in terms of aggregate income .
- Particular indicators for macro-cycles: Swift growth in terms of aggregate banking lending for instance estate developers should be utilized as a gap between current direction values of the price of real estate property as well as equities. Huge aggregate portfolio of inflows in capital would be a caution.
- Additionally, an extra source of information, not constantly seen to be available, however stating to a trend in which gathering of data could show some headways.
- Indicators of weak management and other microeconomic deficiencies: In assessing the system for poor management, it should be pointed out that banks are financially efficient, and whether they are being managed in better way through honest individuals.
- Indicators of a government-permeated banking institution; Structural characteristic that point out the potential for crisis of this nature.

- The lending proportion with the judgment of banks comes under compulsory deposits and within the framework of major banking activities. The government ownership of a huge section regarding the banking system constantly a symbol of constraints to emerge, despite symbols of the private lending of banks can be regulated by government.
- Borrowing from the Central Bank frequently involves some level of formal control over the banks application of credits, it should be pointed out that, there is the need for prudential symbols.
- The magnitude of clear financial intermediation taxing system is an indicator of government dependence on the banking institution. Also a greater magnitude of government subsidy within the banking institution comes under state reliance, certainly due to previous government intervention. To be able to measure theses needs some work of methodologies that can be developed and utilized in growing examples.

VIII. DESIGNING FINANCIAL POLICY TO MINIMISE VULNERABILITY OR REMEDIES IN THE FINANCIAL SYSTEMS

-Legal and Information Infrastructure: Financial systems require developed legal and information infrastructure to function very well. Empirical evidence demonstrates firms are in the position to access external finance in nations where legal enforcement of stronger (La Porta et al, 1997, Demirgue-Kunt and Maksinnvic,1998, Beck, Demirgue-Kunt and Mackisinovic,2005) and that better creditor protection raises credit to the private sector (Djankov, McLeish and Shleiter(2007). More effective legal system permit more flexible and adaptable conflict resolution, increasing firms access to finance, in states, where legal systems are more effective, financial systems lesser interest rate spreads and arte more efficient.

Time availability of good quality information is equally useful, for the reason being that this support to minimize information asymmetries between borrower and lenders . The collection mechanism and use of borrowing history and other information necessary to household as well as small business lending-credit registers-have been swiftly increase in both the public practice sectors Miller (2003).Computer technology has also to some extend facilitated the amount of information which can play a useful role in this process, and while setting up of public credit register is likely to discourage private penetration.

Regulation and Supervision: With the interventionists' approach, where government intervention is viewed as the remedy to market failure Stigler (1977). With this view, vigorous supervisors are expected to ensure stability of the

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financial system and guide banks in their business decisions through regulation as well as supervisor. To the scale which offering by and large have limited capital and the expertise in making business decisions and comes under political and regulatory captures, this mechanism is likely not to be carry out successfully (Beck er and Stigler,1984, Haber et al,2003). Between the two polar lies the private empowerment view of financial regulation. This assertion simultaneously recognizes the potential usefulness of market failures that suggest that supervisory agencies do not relevantly have incentives to soften market failures, where there is a significant function for governments in enhancing the capacity and incentives of private agents to solve information and transaction costs, so that private investors can facilitate effective governance over banks. As a result, private empowerment views emphasis to offer supervisors with the responsibility and authority to stimulate banks to disclose perfect information to the public so that private agent can more effectively monito r (Barth, Legrive and Levine, 2006). Empirical evidence clearly backs the private sector empowerment view. While, there is little evidence which empowering regulations enhance bank stability, there is little evidence which regulations and supervisory practices which compel perfect information disclosure and raise private sector monitory stimulate the general level of banking sector and stock market development. Policy makers around the globe often express concern about whether their nation's banks competition policies are suitable structured to generate better-performing and stable banks. Globalization and the accompanying consolidation in banking continuously aggravate interest in the underlying issues, bringing about strong public policy debate. Competition policies in banking is likely entail varying trade-offs. While bigger competition is likely to enhance the efficiency of banks with positive implications for economic growth, huge competition may further destabilized banks with impact on cost on the economy.

Current study has demonstrated that contrary to conventional logic, the trade-offs are projected in respect of banks competition. Bigger competition-as captured by lesser penetration limitations, fewer regulatory barriers on bank operations, greater banking freedom and smooth general institutional development is a springboard for efficiency, good for stability, better for firms access to finance . Indeed, regulation which mingle with competition pave the way for banks less efficient, more vulnerable, and minimize firms' access to finance . Hence, it seems to be a good haven for governments to stimulate competition in banking by cutting the irrelevant blocks to penetration and operation barriers. In another development, improving the institutional terrain and permitting huge freedoms in banking and economy in overall would result to desirable outcomes.

Financial liberalization, financial development and the sequencing of outcomes of reforms: A growing proportion of have liberalized their financial systems in the 1980s and 1990s with mixed positive outcomes. Liberalization, involving deregulation of interest rates and more flexible penetration policies, frequently result to important financial development, specifically in states where there was relevant repression, however the sprit with which financial liberalization was sticked into in some implementation of institutional further left a larger proportion of financial system weak to systemic failures (Demirgue-Kunt and Detragiacheli,1999).Weak sequencing of financial capital is weakly structured contract and supervisory landscape impacted to bank insolvencies as bank safeguarded by clear and hidden government guarantees vigorously to capital advantage of flesh application to increase risk, in the absence of arriving at lending skills . Banking failures in Argentina, Chile, Mexico and Turkey in the 80s and 90s have been the result of the underlying factors (Demirgue-Kunt and Detragiache, 2005).

In another direction, a growing proportion of Sub-Saharan African states which have also liberalized their interest rates and credit allocation and practiced their institutions by permitting penetration of reputable foreign banks were not victimized of instability, however from lesser intermediation and some respect lesser access to financial services . Some of this was attributed to contractual as well as informational for fresh capital (Honohans &Beck, 2007).This has also brought about in claims of collapsed liberalization in these states, and demands for immense government interventions within the financial system.

In the first place, government can continue access by making and encouraging infrastructure improvements. But, prioritizing different reforms is paramount and current study also propose that in under-developing countries improving financial infrastructural seems to generate positive outcomes than legal reforms. (Djanko et al, 2007). However legal reforms are also integral part and within those and there is evidence that while property rights match the state is highly relevant for financial development overall, other aspects in terms of contract enforcement for instance instability to collaterial is likely to be more relevant for access (Haselman, Pistor & Vig,2006).

Institutional reform is a long term process and particular – policy actions can assist stimulate access quickly. There are a broader range of such measures, ranging from particular legislation to strengthened nonbank intermediation encompassing leasing and factoring, technologies based on the interest and mobile phones, development of credit register, safeguarding against money laundering as well as terrorist finance in the absence of jeopardizing household access and others.

Government regulation can further support. Removal of interest ceilings, or usury laws would cushioned up institutions to modify the rates which they require to sustainable and improve access. Increase capital adequacy requirements, strict accounting requirements is likely to minimize the capacity of institutions to cater for the poor vulnerable in society. As a growing proportion of households are interested in savings series however, not in credit services is likely to assist (Classens,2005) For instance, in South Africa, expansion of bank regulation and supervision to micro finance institutions cut their ability to give their services profitably.

Governments can improve access by raising competition in the financial sector. As financial institutions find their traditional business come under serious rivals, they venture into diversification strategy into fresh business lines of opportunities available so as to bring about returns in the long-run and including lending to the SME and the

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very poor in the society. Given the appropriate incentives, private sector can develop and utilize fresh technologies such as credit scoring to arrive at the very segments of population who are considered vulnerable.

- Macro Stability Policy: A growing proportion of commentators argue on the good-side for Lassiez-faire in banking, on the premise that regulation might bring in greater misrepresentation than it remains, a transparency huge perception favours close microeconomic supervision regarding banking practice and enforcement of capital adequacies. However, regulatory control may be saddled with political pressures, flesh institutional structures is likely to be treated to buttress the underlying regulations.
- Macroeconomic and stability system stability safeguarding the solvency in terms of banks and other financial sector engagements is seen as not the fundamental motive for securing macroeconomic stability. Hence, to depend advocacy concerning macroeconomic stabilization policy is clearly a penetration of the particular policy problems which give rise in conformity to macroeconomic sorts of financial sector collapse.

Financial systems in developing countries need to deregulate their operations to ensure efficiency, effectiveness, and expansion and growth. Some of the points raised are prudential regulation, stable political regime the political will, liberalization, greater innovative ,financial instrument, interest rate cuts, sound secondary markets, legislation, government intervention, greater regulation of financial assets among others.

The Basel II Capital Accord has been formulated to initiate a more risk –sensitive approach to setting capital requirements and to minimize regulatory arbitrage.

Basel II Accord applies a three pillar framework such as minimum requirements, supervisory review and market discipline all geared towards the curb of financial market developments in Third-World countries. Thus, Basel ll regulations which are meant to assist banks reduce costly bank failures.

Some of the remedies or solution such as regulation and supervision and were hammered. Lack of Space and word count did not give me much room for the applicant to deliberate on some points in details. Prasad (2009). These issues are more relevant to middle-income emerging market economies. Among low-income economies, the emphasis may need to be more on getting the basic elements of the institutional framework right, including the legal and regulatory frameworks, corporate governance, and accounting and auditing standards. Moreover, public sector banks (PSBs) still play a dominant role in several key Asian emerging markets including China and, to a lesser extent, India. Improving the efficiency and governance of both public and private banks is a key priority. Unfortunately, in both of those countries, PSBs are often seen as instruments of social policy, including directing credit toward favored industries. A number of other Asian countries are in a similar position.

Interestingly, the financial crisis has cast public banks in a different light. During periods of extreme financial stress when the rest of the financial system is frozen up, public banks can serve a useful function by continuing to provide credit as they have direct government backing. But reforms are still necessary to ensure that these banks turn in an adequate performance in normal times as well. There are large but often hidden efficiency and welfare costs to maintaining an inefficient public banking system. While these banks offer a useful layer of protection during a crisis, this can be a very expensive form of insurance for the economy.

There is no reason of course why government ownership per se should make a bank inefficient, although this is often the reality as political and social considerations often trump commercial ones. Corporatizing PSBs, which does not necessarily entail a full-scale one-shot privatization, would be one step toward improving their performance. Indeed, some PSBs have increased their efficiency and, despite their social obligations, are able to compete with private sector banks. The State Bank of India is a good example of a publicly owned bank that has become highly profitable and competes effectively with private banks, both domestic and foreign.

The priorities for strengthening banking systems in emerging markets are quite different from those in advanced economies. While banks in many emerging markets, including China and India, meet or exceed even the higher capital requirements proposed under the Basel III Accord, the major priority for these banks is actually to improve risk management rather than to strengthen their capital bases. Given the high domestic saving rates in these economies and the likelihood that banks will remain dominant.

Krishnan (2009) provides an interesting overview of the factors that have governed the development of India's financial markets and discusses why Indian equity markets have done well in terms of depth and resilience while corporate bond markets and the commercial paper market have barely gotten off the ground.

Financial systems for some time to come, more efficient banking systems that can do a better job at intermediating domestic savings into productive investment can enhance growth and economic welfare.

A. *Corporate Bond Markets*

Development of corporate bond markets is necessary to broaden the scope of financial markets in order to raise financing for large-scale enterprises. In bank-dominated financial systems they create a more competitive environment, inducing entrenched banks to increase their efficiency and direct more lending to small-scale enterprises. Bond markets also provide a way of disciplining firms and increasing their transparency. In countries like India where the needs for financing of large corporate and major infrastructure projects are close to exceeding the capacity of domestic banks, corporate bond markets can serve as an important conduit for channeling both domestic and foreign capital toward these needs.

However, the development of well-functioning corporate bond markets is closely tied to the development of government bond markets since the yield curve on low-risk government bonds serves as a benchmark for pricing corporate risk. In China and India, these markets are small

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and underdeveloped partly because of regulatory constraints as well.11 The Asian Bond Fund initiative was meant to catalyze the development of regional fixed-income securities markets, particularly bond markets, but has gained only limited traction in this dimension.

B. Development of Basic Derivatives Markets

Improving Technical Infrastructure for Trading Financial Instruments In the big transitional markets, significant progress has been made in improving the technical infrastructure for trading various financial instruments, including equities, bonds, and derivatives. Moving more securities transactions onto open exchanges and creating a viable alternative for OTC transactions would increase transparency and efficiency in these markets. Extensive oversight of the payment, clearing, and settlement mechanisms will be necessary to maintain confidence in these markets, particularly to prevent any single financial firm from playing a dominant role, especially relatively thin markets.

Given these financial development priorities, the question is what the right approach should be to building regulatory capacity relative to fostering financial innovation and development. While it is tempting to put financial stability first and to focus on minimizing risks and potential losses, there could be costs in terms of reduced growth and welfare that result from underdeveloped financial markets. Although derivatives products have acquired a negative connotation, there is a range of plain vanilla derivatives and securitized products that have proven to be useful innovations that reduce rather than raise systemic risk when properly regulated. These include commodity derivatives, which can play a key role in many low-income countries where a significant fraction of the workforce is still connected to agriculture as well as the extraction and processing of primary commodities. Asian countries have become increasingly open to trade, making it valuable for importers and exporters in these countries to have access to exchange rate derivatives for hedging foreign currency risk.

Indeed, even during the woes of the crisis, the Asian region made progress in setting up some of these markets. In particular, currency derivatives markets have only recently been set up in both China and India; the size of these markets has expanded substantially over the past year, indicating the strong demand for these derivative products. Indian authorities have recently permitted the introduction of credit default swaps, albeit in a limited and carefully controlled manner. Nevertheless, this development shows that there is a demand for a broader range of securitization products in the large emerging markets and those regulators are willing to accommodate this demand as long as they are reasonably certain that they can maintain adequate regulatory control over such products so that they do not elevate the level of systemic risk.

Financial inclusion is a critical part of the financial development agenda for emerging markets. Indeed, the G-20 has highlighted the importance of the need for greater “financial access” in both advanced and emerging market economies. In the latter group of economies, a significant fraction of the population lacks access to the formal financial system. This affects economic growth and welfare by restricting access to credit (for households and entrepreneurs), making it harder to share risks and limiting diversification of financial savings Regulators sometimes see broadening financial inclusion as increasing risks to the financial system, but, in fact, it could be a key component of increasing rather than diminishing financial and macroeconomic stability. Indeed, lack of adequate access to credit for small and medium-size enterprises as well as small-scale entrepreneurs in the This points to a difficult tension that emerging markets face between tight regulation that limits the development of new financial markets and products, and adequate regulation that provides some space for financial innovation. Financial crises can have particularly painful effects on populations living at or near subsistence levels, so relatively poor and even middle-income countries might choose prudence over innovation and the risks that the latter entails. At the same time, holding back financial innovation and development has hidden but large costs if it stunts growth or makes growth less inclusive.

The solution might lie in broadening the perimeter of regulation and adapting the evolving international principles of regulation to suit the needs of newly emerging financial markets and institutions. Indeed, since nonbank financial intermediaries in Asian emerging markets are typically smaller than those in advanced economies while also accounting for a relatively smaller share of the financial system, it should be easier for countries in the region to upgrade their regulatory frameworks to encompass all such institutions in a more comprehensive manner.

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Financial inclusion often has been seen as a social priority

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that should be subsidized by the government. For instance, the Indian government requires banks to dedicate certain amount of it financial capital.

IX. RESULTS AND DISCUSSIONS

TABLE 1. The relationship between Financial Development and Economic Growth in Emerging Markets.

Country Economy	Score 1-7	Change In Score
Brazil	3.61	+0.09
Russia	3.18	- 0.04
India	3.29	+ 0.05
China	4.12	+0.08

Development Report. BRIC Country's Source: World Economic Forum (2011).

From the data above depict' Brazil's performance lies on its stable currency system, its biggest stimulant is in the non-banking services that have remained specifically strong. Despite Brazil's has a relatively low level of financial sector liberalization, financial access remains one of the biggest strength of this economy. Study from the data indicated that China's robust economic performance could be attributed to the financial stability and the vibrant within the non-banking financial sector. But its fragile business landscape, China remains steadfast vibrant in its financial intermediation, (Locyza and Rainciere, 2004).

The study demonstrated India's economic performance attributed to the strength of its non-banking financial services. Despite India's has a fragile financial access, its energetic financial intermediation stimulated stronger results in its foreign exchange.

The Russia financial performance could be rested on its currency stability. Russia persistently demonstrates solid results in financial intermediation and the non-banking financial sector. Russia under performance could be under-utilized by considerable instability in its banking systems; however this could be based on better performance in other financial services that impact positively to its outstanding performance (Lee 2009). To ensure as to whether financial development and economic growth have any correlation or linkage, this study have a world perspective at the economic index of the BRIC states ie, Brazil, Russia, India and China over the first quarter of 2012. This analysis will prove a transparent perception of this issue (Lee, 2009).

TABLE 2: Depth of Financial Development in Africa

	Domestic Credit to Private Sector	Liquid Liabilities as % of GDP	Bank Depositors of GDP
Africa	36.3	54.4	45.5
Sub-S/Africa	24.4	35.3	29.7
N/Africa	48.1	73.4	61.4
E/Africa	21.0	30.4	26.11
W/Africa	20.3	35.5	27.2
W/A without Nig.	20.5	35.7	27.0
S/Africa	43.1	45.1	44.4
SO/A without S/A	31.8	45.7	42.6
L/A& Caribbean	45.5	54.0	48.9
H.Income OECD	134.3	114.4	100.4

Source: Global Financial Development (2014)

Applying this measure,, Sub-Saharan Africa seemed to have the lowest financial depth within the various parts of the region as reflected in table 2.The study indicated that at 24% internal credit to the private sector is approximately half the average ratio for North Africa as well as Latin America and Caribbean and less than a one-forth in respect of OCED countries. The research underscores that West and East Africa recorded the lowest ratios of 20% and 21% respectively. In the case of South Africa, it records a relatively a jump of ratio 43%. This shows growth in financial development in this region. The ratio of liquid liabilities to GDP, a measure of monetary resources serves as a detailed symbol in terms of the level of financial intermediation by major financial actors as well as bank deposits as a percentage reflected a lesser ratio of low financial depth in the case of West Africa and East Africa as depicted in column 3 and 4 of the above table. Deepening within the financial sector in the long-run can be explained partly by financial institutions capacity to have an enquiry into repayment history among financial intermediaries.

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Difficulties in setting up borrowers' capacity and desire to resettlement and absence of schemes that impact negatively to poor financial development. In poor and institutional landscape, financial institutions come under serious risk in terms of lending to agents with dismal prospects of repayments.

X. CONCLUSION

In conclusion, this essay had really discussed the underlying characteristics pertaining to developing countries financial system. These are the problem of saving, loans, taxation, interest rates, credit and compulsory reserves was elaborated. Also, the market imperfections were discussed such as equity issues, underdeveloped capital markets, asymmetric information, poor property rights and highly volatile economic environment was assessed. The problems of conglomerates,, financial layering, issues of public finance, cost of financial intermediation, banking operation cost and non-performing assets were seriously analyzed comprehensively.

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There are six key characteristics that suggest weaknesses in developing countries' financial systems: (i) weak public institutions; (ii) lack of experience in the operation of financial markets and excessive emphasis on public ownership of financial institutions; (iii) inadequate accounting and risk assessment standards; (iv) high concentration of ownership in financial institutions; (v) expensive or inefficient financial intermediation; and (vi) lack of an internationally diversified banking portfolio. These characteristics give rise to a series of problems that can affect market stability and weaken the quality of supervision in developing economies. They can also contribute to increased credit risk, a lack of market support in institutional monitoring, and inadequate standards for the entrance and exit of financial institutions.

Although idiosyncratic events within financial markets generate specific obstacles to supervision in developing and emerging economies. The challenges of financial reforms are by and large determined by the level of complexity and development in the financial market, and the capacity and expertise of the supervisors. Regulatory agencies have the expertise necessary to create new methods of supervision to cover new and changing risk situations. It is illogical to think that developing countries that have not created fundamental regulatory mechanisms, such as basic systems of investment classification or loan controls, will be capable of implementing these types of reform, which require expert personnel to implement and oversee them.

First and second-generation financial reforms should not necessarily be implemented in a mechanical or strictly sequential fashion, in which finishing the first round is a prerequisite to beginning the second. It is perfectly possible that second-generation reforms may be implemented alongside first-generation changes, depending on the characteristics of each specific market.

The position of developing and emerging countries in international forums should be based on a solid understanding of the specific problems of supervision and the principal required courses of policy action in those countries. The recommendations in the Basle documents constitute general principles, useful as reference to what makes an ideal framework for banking supervision, within a context of well-established markets and independent public institutions with the required authority and expertise.

However, the reality of the majority of developing and emerging countries is far removed from such a context. Its supervisory weaknesses lie more in the implementation of· agreed principles than in the definition of legal frameworks. The main issues on which the developing countries should concentrate as they develop their own positions in international forums are: capital adequacy, financial conglomerates, consolidated supervision, internationalization, management evaluation, credits to related parties, entry requirements, exit mechanisms, supervision of assets and market risk.

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