Lessons Learned Series

How to Make Financial Sector Development Strategies Work: Successes and Failures

Five Key Lessons Learned

Introduction

A country’s financial sector plays a critical role in economic development. Research confirms that countries with more developed financial sectors tend to enjoy a sustained period of growth. Financial sector development is not simply a result of economic growth; it is also the driver for growth (Levine, Loayza, and Beck 2000). Additionally, a more developed financial sector reduces poverty and inequality by enabling and broadening access for the poor and other vulnerable groups, by facilitating risk management and reducing the groups’ vulnerability to shocks, and by raising investment and productivity, which generates higher income (Demirgüç-Kunt and Levine 2009).

Over the past 10 years, the Financial Sector Reform and Strengthening (FIRST) Initiative has assisted a number of countries in creating financial sector development strategies to help translate their vision for the sector into a clear strategy and a road map for accelerating financial sector development and catalyzing other reforms. Each strategy, of course, has been tailored to the specific country context.

A well-designed strategy, when implemented, can have a multiplier effect. It crowds in not only domestic resources but also external resources and support. With a clear strategy and road map laid out, the private sector and donors know where they are likely see government commitments and where they can step in. This knowledge translates into better public and private sector collaboration.

Ownership is a key factor. The government should demonstrate ownership of the strategy, which should be supported by high-level officials in all key arms of government and key stakeholders in the private sector and civil society. Achieving such ownership requires broad consultation throughout the design process.

FIRST Initiative’s support

On average, 10 to 15 percent of FIRST funding has been committed annually for strategies development—mostly in Africa—resulting in 34 projects over the past 10 years (figure 1). Traditionally, financial sector development strategies followed Financial Sector Assessment Program (FSAP) as a means of prioritizing FSAP recommendations. However, because the FSAP now prioritizes countries with systemically important financial systems, the number of low-income countries undergoing FSAP assessment has declined. Consequently, recent financial sector strategies are not necessarily linked to FSAP assessments. Furthermore, theme-specific strategies (such as a financial inclusion strategy) are also seeing increasing demand.

Results have been mixed. In some countries, the strategies were quite successful in catalyzing reforms, securing follow-up technical assistance and additional funding for implementation, and ultimately achieving the objectives. In other countries, the strategies were not as successful because of a lack of political will and buy-in from all stakeholders.

FIGURE 1. The FIRST Initiative’s Financial Sector Strategy Engagements, by World Bank Region

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Five key lessons on making financial sector development strategies work

How does one make financial sector development strategies work? The FIRST Initiative has surveyed several of the countries in which it has worked in an effort to answer this question. Over the past 10 years, experience on FIRST-funded projects has indicated five key lessons for ensuring the effective design and implementation of financial sector development strategies (figure 2). Each of the five lessons described in this section includes specific factors that proved critical to making the strategy a success.

Lesson 1: Meet the prerequisites: A reform-minded government and strong champion

Have a reform-minded government

Political commitment is highly important, but it is not sufficient. The government needs to be reform minded. Ministries and the central bank should proactively initiate reforms. The legislative body should enact laws in a speedy manner, because legal reforms are important in accelerating reforms of the system. If enacting a new law will take time, interim measures should be planned, including issuing regulations under the existing legal framework or using temporary decrees to empower regulators to take actions. Chances of successfully implementing a strategy are higher if the government is willing to reform.

Have a strong champion and clear ownership

Having a strong champion both in terms of individual and institutional leadership is important for ensuring ownership. This champion will lead the entire reform effort. A strong champion should be in a position of responsibility and decision making so that he or she can lead the process both during the strategy formulation and later, when the strategy is being implemented. A champion agency should be empowered to coordinate and lead the effort. This agency should receive support from the president or prime minister’s office. Survey results show that reform-minded champions and strong leadership constitute the most critical factor for reform implementation (score of 4.9 out of a 5.0 scale; see figure 3).

Lesson 2: Institutionalize the process: Set up a Governance Structure

Establish the hierarchy of political and technical committees

Formulating a strategy requires time and effort and a dedicated team. This process can be formalized by setting up ad hoc committees at two levels: a high-level committee and a technical advisory committee, both supported by a technical secretariat (figure 4). The high-level committee provides overall guidance and makes decisions, whereas the technical advisory committee provides expert inputs and technical guidance. The technical secretariat manages the strategy drafting process and monitors implementation of the strategy on a day-to-day basis. The strategy should be developed hand-in-hand with the authorities. Having committees set up before strategy formulation should assist in this regard.

The high-level committee should be chaired by the minister of finance or the governor of the central bank to ensure that it has adequate traction. The committee should also include relevant ministries, financial sector regulators and supervisors, and private sector representatives. Including the private sector will allow the strategy to be based on a broad and inclusive view of the financial sector development.

The technical advisory committee should include senior experts from respective regulatory bodies and agencies and the private sector. If a country’s financial sector is relatively large, the technical advisory committee may set up subcommittees or working groups to address important themes: for example, micro, small, and medium enterprise financing; housing financing; payment systems; banking; insurance; pensions; and capital markets. Technical advisory committee members should be qualified senior professionals.

The technical secretariat should be given resources and a clear mandate. The secretariat should have competent staff members, who lead the drafting of the strategy and convene all stakeholders. Survey outcomes indicate that most countries set up needed institutional mechanisms either at the beginning of the strategy exercise or when the
strategy is ready to be implemented. Creating these committees at the beginning enables better ownership and buy-in among stakeholders. It feeds inputs to the strategy formulation, resulting in a realistic locally suitable strategy.

“The countries [that] are about to develop and implement financial sector development strategy should have full commitment from the Authority and the high-level steering committee. They should put in place a technical committee and a dedicated technical secretariat to oversee and coordinate the implementation of the plan/strategy …”

–Christophe Edmond, First Deputy Governor, Central Bank of Seychelles

Lesson 3: Formulate a good, solid strategy
Translate the vision for the financial sector into a strategy

Many governments have a vision for financial sector development. The vision, which is often linked to a national economic development plan, indicates where the financial sector should head in the coming years. The vision then needs to be translated into a strategy to lay out what efforts are needed to get there and by whom. Having a clear link to a national strategy and clearly articulating the role of the financial sector for economic development is critical.

Rwanda, for example, set the following vision, which was linked to the country’s Vision 2020: “to develop a stable and sound financial sector that is sufficiently deep and broad, capable of efficiently mobilizing and allocating resources to address the development needs of the economy and reduce poverty.” Mozambique set the vision “towards a strong, healthy, inclusive, competitive, transparent and resilient financial system that promotes economic development.”

Build on sound diagnostics

Given the importance of evidence-based policy making, the strategy should be built on sound diagnostics. In an environment where FSAP assessments are either dated or completely absent, developing a financial sector strategy will require undertaking some key diagnostics before moving to the strategy formulation stage. An analysis of reforms undertaken in the financial sector and a stock taking of external technical assistance provided by donors are necessary first steps. However, even when the strategy follows an FSAP assessment, some additional analysis may be needed in specific areas that are strategically important to the country’s financial sector.

Focus on suitability and reality on the ground

Effective strategies require a reality check of the local context. Client surveys indicate that although a high-caliber international team of experts was deployed, their advice did not always reflect local context. Suitability to local context was rated lower than other factors (3.9 out of 5.0; see figure 5). In addition to ensuring adequate stakeholder consultation, ensuring that local experts are included in the strategy formulation is useful.

Form a high-quality team

Having a high-quality team in place is important for every effort, but to make a financial sector development strategy work, the technical quality of the team is critical. The expertise of the team members should reflect the scope of the strategy, and selection of team members should take into account not only the quality of individuals but also their complementarity within the team. Client surveys show that quality of teams was quite satisfactory in the FIRST Initiative (rating of 4.4 out of 5.0 scale; see figure 5).

 “[T]he success in the preparation and implementation of financial sector development strategy depend upon the commitment and ownership of the main stakeholders, alignment of the strategy objectives with the national development programs, support from donors, strong coordination among the relevant public and private sectors, and donors.”

–Gabriel Mambo, Adviser to the Minister of Economy and Finance, Mozambique
Develop a prioritized road map with a clear timeline and accountability

The strategy should include a road map or an action plan that is prioritized and includes a clear timeline and accountability. Prioritization should be based on short-, medium-, and long-term goals within and across sectors. In addition, the strategy should ensure the right balance between seemingly different objectives, such as stability and inclusion.

The most common timeframe for a strategy is around 5 years, although a few countries have selected a longer timeframe (7 to 10 years). Given today’s rapidly changing financial sector landscape, 5 years may be more realistic; however, if the country sets high-level objectives that require more time to achieve, 7 to 10 years is reasonable. Regardless of the timeframe chosen, the most important aspect is that the strategy remains a living document that will be reviewed periodically to take into consideration the changing global and domestic economic and financial sector environment.

The road map should include an action matrix that indicates (a) action items, (b) priority levels, (c) responsible agency, (d) timeline, and (e) need for technical assistance. The latter is an important feature because it allows teams to indicate which actions require external technical assistance and, to the extent possible, estimate the required level of effort. This information will be extremely helpful when the strategy moves to the implementation stage.

Set measurable targets and performance indicators

Performance indicators are important to ensure accountability for results. The targets should be set at the program level as well as at the activity or reform level. At the program level, the targets should measure how the financial sector contributes to economic development (its ultimate impact). The targets should be outcomes such as improved financial stability, financial inclusion, and financial market deepening. Numeric targets are a powerful tool to mobilize financial and human resources. Such targets are fairly easy to set in the areas of financial inclusion or market development or deepening, but financial stability is more difficult to measure numerically. Stability measures could include compliance with international standards, establishment of the necessary laws and regulations, and establishment of an institutional mechanism (for example, a financial stability board). For a longer time horizon (7 years or more), intermediate targets will be necessary that are steppingstones toward achieving the ultimate goals. Performance indicators should be set for each activity or reform so that outputs and the expected outcome are clear. These indicators will be a powerful tool for monitoring and evaluation.

Lesson 4: Ensure ownership by stakeholders

Consult extensively with stakeholders

Ownership by all key stakeholders in the country is important. The relevant policy and regulatory bodies need to be fully on board because reforms are often initiated by the public sector through legal and regulatory changes. However, the private sector is also critical because the market is not likely to take off unless the right mix of incentives is present. Once the strategy is owned by both public and private sector stakeholders, they will become the driving force for reforms. Securing buy-in from development partners is also useful when technical assistance is needed. Ensuring ownership and securing buy-in requires an adequate consultation process during the strategy formulation stage. Such consultations can be lengthy and time consuming, especially in weak-capacity environments, but they are critical for the success, ownership, and buy-in of the strategy development as well as implementation thereafter. They can also take longer when stakeholders (for example, public and private stakeholders) have different views. Although in these cases a consensus is not always easy to reach, an open consultation process can help to combine different views so that some basic level of agreement can be reached.

Ensure high-level adoption of the strategy

Once the strategy is formulated, endorsement and adoption by a high-level government body is critical. Adoption of the strategy transforms it into a national development tool and sends a signal to key stakeholders, including development partners, that the government is committed. In almost all countries where financial sector development strategies have been supported by the FIRST Initiative, the cabinet has adopted the strategy.

“Countries about to develop [a] financial sector development strategy need to establish a focused coordinating team to oversee the implementation process.”

—John Rwangombwa, Governor, National Bank of Rwanda

Lesson 5: Disseminate and monitor for better implementation

Disseminate and secure domestic resources and external funding

Dissemination is important for several reasons. First, it raises public awareness of the strategy and sends a positive signal. Second, it can be used as a means to secure domestic and external resources for implementation of reforms. According to the survey, dissemination was not as strong (3.6 out of 5.0; see figure 5), and efforts to disseminate strategy varied in their effectiveness across countries. Some countries had highly effective dissemination; others did not. Evidence suggests that in countries with adequate dissemination, implementation—including the securing of assistance from development partners—proceeded at a better pace.

Ensure rigorous monitoring during implementation of the strategy

Monitoring is extremely important to keep track of the progress of implementation efforts. It also helps the team involved in implementing the strategy understand the reasons for any delays faced and allows it to address the causes of the delay. Client surveys highlight the reasons behind slow implementation. Major reasons include the lack of financial resources, lack of institutional capacity, and domestic politics. The legal enactment process is also cited as very important for accelerating reforms because the lack of legal framework often slowdown subsequent reforms.

Monitoring should be done by the committees and the technical secretariat. The technical secretariat should be responsible for the day-to-day monitoring of the implementation, including the...
identification of technical assistance needs, resource mobilization, and coordination. The secretariat should be adequately funded for the duration of the implementation process, and this funding should be provided by the government. The secretariat should be given the necessary powers to get the implementing agencies to act. These powers include the authority to allocate resources for implementation and to conduct annual reviews to track progress and report the findings. The secretariat should ensure that the strategy remains a living document. The high-level committee should be ultimately responsible for implementing the strategy, and the technical advisory committee should provide inputs and advice to the technical secretariat.

Conclusion

A financial sector strategy is a critical tool to guide and accelerate development of a country’s financial sector. If properly designed and implemented, such a strategy can catalyze many reforms supported by public and private sector stakeholders and development partners. The lessons learned that are presented in this note outline important conditions that make financial sector strategies effective. They are based on the experience of the FIRST Initiative as it worked in this field over the past 10 years.4

Although the experience of the FIRST Initiative varied from country to country, a number of factors were prevalent in the countries that implemented strategies successfully: a reform minded-government and a strong champion; well-functioning high-level and technical committees, supported by a technical secretariat; a clear vision to guide the strategy; a strategy that was based on sound diagnostics, accompanied by a clear road map with a timetable, measurable targets, and performance indicators; strong ownership and high-level adoption of the strategy; and rigorous monitoring and evaluation of the implementation of the strategy.

Notes

Acknowledgements: The authors wish to thank FIRST’s Senior Program Manager, Consulate K. Rusagara for the overall guidance and supervision; Mazen Bouri and Gunhild Berg, for providing peer review comments; Irina Astrakhan and Yira J. Mascaro, for their support, and Hanh Thi Bich Le and Subita Gurbani for data analysis and publication support.

1. These projects were in Angola, Bhutan, Botswana, Burkina Faso, Burundi, Cabo Verde, Comoros, Côte d’Ivoire, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mauritania, Mauritius, Mozambique, Niger, Nigeria, Papua New Guinea, Paraguay, Rwanda, São Tomé and Príncipe, the Seychelles, Sierra Leone, Swaziland, Tajikistan, Tanzania, Togo, and Zambia. Some of these countries received assistance on more than one project.

2. The FSAP is a joint World Bank–International Monetary Fund program launched in 1999 following the Asian financial crisis. More than 200 assessments have been conducted since its inception. FSAP assessments play a pivotal role in financial sector work as a key diagnostic tool that informs and provides the analytical foundation for countries to strengthen their financial sectors.

3. The survey was sent to 15 countries, 9 of which responded: Botswana, Côte d’Ivoire, Lesotho, Liberia, Maldives, Mozambique, Rwanda, the Seychelles, and Sierra Leone.

4. FIRST annual reports feature some of the FIRST Initiative’s financial sector strategies projects. For example, the 2014 annual report featured the Mozambique financial sector strategy; the 2012 annual report described the Burundi, Nigeria, and Rwanda financial sector strategies; the 2011 annual report covered the Malawi, Rwanda, and Tajikistan financial sector strategies; and the 2009 annual report discussed the Liberia financial sector strategy (FIRST Initiative 2009, 2011, 2012, 2014b).

References


