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BANKING SUPERVISION AND FINANCIAL SOUNDNESS IN DEVELOPING COUNTRIES: INSIGHTS ON SOUTH SUDAN

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ABSTRACT: *The commercial banking industry in South Sudan has faced a myriad of challenges in playing its' central role of supporting economic development. Several critical medium-term and long-term difficulties have faced the banking sector in South Sudan as it seeks to come up with a productive regulatory environment. Due to the nascent development of regulatory mechanisms post attaining independence the banking industry has mainly focussed on traditional services. This has resulted in most commercial banks facing financial soundness and sustainability challenges due to limited product and service diversification. The aim of this paper was to identify the challenges facing banking supervision in developing economies and provide insights on what can be done to foster financial soundness in the commercial banks. The paper indicated that poor legislation, inadequate technical support, lack of structural reforms, political challenges and poor regulatory framework have limited the development and financial stability within the country. Critical to improving the financial soundness of the banks is introduction of regulatory activities that can foster the monitoring and supervision of commercial banks in the country. Further, incentivizing financial industry players will lead to long-term value creation through strengthening the financial system and improving integration. The study also advocates for strict introduction of enforcement mechanisms that will ensure commercial banks adhere to the stipulated regulations and guidelines in the operations. Finally, advocating for strategic changes in the services offering and improving cross-border trading will be key to enhancing the commercial banks soundness.*

KEYWORDS: banking supervision,financial soundness , developing countries,South Sudan

INTRODUCTION

According to Obafemi, Ayodele, and Ebong (2013), the financial sector is a catalyst for economic growth and development if banks are efficiently managed. Akhtar, Ali, & Sadaqat, (2010), affirmed that the essential function of banks all over the world is the intermediation role through which bank channel financial resources from the surplus units to the deficit units for productive economic ventures available within the economy. From the foregoing, many central banks embarked on different financial reforms, financial liberalization, and restructuring programs to foster banking efficiency and a better allocation of resources (Pancheva, 2012).

The banking sector plays a pivotal role when it comes to financial and non-financial factors of productivity in an economy in every nation's development (Olweny & Shipho, 2011). The central Bank is said to be the bankers of bankers whereby any matter relating to regulating and overseeing the commercial banks is impacted at management and operational level (Central

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Bank of Kenya, 2013). The establishment of regulation can enhance business operations or ultimately do business close down. Thus, a key prudential regulation measure meant to improve the Bank's supervisory approach and to post a good impact on the performances (Kamau & Were, 2013). Ayadi et al. (2016) note that the regulations within commercial banks are a combination of various supervisory and restrictive policies that are aimed at minimizing moral hazard, protecting customers, and limiting risk-taking in the industry.

Casu, Deng, and Ferrari (2017) contend that with globalization and technological advancements, the banking regulations have changed with a refocus from the supervision of commercial banks to the promotion of the internal management within the banks to support financial soundness in the country. Barth, Gerard, and Levine (2008) state that due to the different variables that firms face, there is a need for rules, laws, and regulations to govern their every action. This will aid in promoting a seemingly fair playing field for all firms in a particular economic field (Njeule, 2013). The financial industry and specifically the commercial banks have to be regulated to ensure that they work within a laid down the structure. There is a need to protect both the customers and other stakeholders within the industry (Bouheni, 2014).

According to Eriki and Osifo (2015), European markets became increasingly integrated financially due to the forces of deregulation and technological change that increased competition among banks. In many African countries, central banks appear to have embarked on various regulatory measures aimed at strengthening and broadening the financial system with the sole objective of enhancing banks' operating efficiency (Akhtar, Ali, & Sadaqat, 2010). Berger, Hasan, and Zhou (2009) indicate that commercial banks play a pivotal role in the development of emerging markets. However, the positive growth witnessed in the countries is unlikely to be long-term without meaningful baking reforms that can contribute to an effective banking system.

Gaganis and Pasiouras (2013) reveal that over the last two decades, the baking regulation has become a notable are of examination with a focus on its link to stability, performance, and efficiency. This has led to the International Monetary Fund and World Bank availing cross-country data that can be key to exploring regulations within commercial banks. Hartwell (2015) notes that the banking sector in several developing countries has restrictions on the financial activities that cannot be undertaken, such as real-estate, financial hedging, and insurance, which has dampened the development of the countries.

Barth, Lin, Ma, Seade, and Song (2013) show that supervisory power impacts positively on bank efficiency only in countries with independent supervisory authorities. Anginer, Demirguc-Kunt, and Zhu (2014) show that the effect of prudential capital requirements on bank stability appears to be positive in those banking sectors with relatively weak supervision and monitoring, and underdeveloped institutions. However, questions about the effectiveness of banking regulation have always been important for researchers and policymakers, particularly following the global financial crisis (2007–2009) as some post-crisis studies indicate the weaknesses of regulation to be the critical determinant of crises (Cihak, Demirgüç-Kunt, Peria, & Mohseni-Cheraghlou, 2013).

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In Africa, these banking reforms have, over time, improved bank scale (more private and foreign banks' entry), financial intermediation, and outreach, they have not adequately addressed problems of financial underdevelopment and stability. Evidence shows that the implementation of these reforms has been followed by systematic instabilities, bank failures, and a low degree of financial deepening (Upadhyaya, 2011).

In South Sudan, Ferullo (2018) notes that despite good intentions, the South Sudan banking system has been overrun by Politically Exposed People, which has limited the control and regulations of the Bank. The report notes that there is a need for necessary reforms to be introduced in the industry to ensure that local banks can be the engines of economic growth in the country. This forms the basis of the current study analysis of the banking regulation and financial soundness within commercial banks in developing economies.

Aim of the Paper

The main aim of this paper is to review the role of banking supervision on the financial soundness in developing countries: Insights on South Sudan

Benefits of Banking Supervision

Baron (2013) posits that it is not the number of regulations at play that is important but rather the quality of the regulations vis-à-vis their intended outcome. The authors pointed to the difference in the banking industries of the two countries and highlighted that despite Canada having comparatively fewer regulations, those in effect had a more significant effect in achieving stability than had been the case in the United States.

Furthermore, Baron (2013) emphasized that the financial institutions responsible for the precipitous economic crisis of 2008 were among the most regulated, albeit, with misguided or ill-fitting regulations as assessed according to their intended aim and as a result, competition within the industry was stifled by the handful power-wielding main players in the industryAyadi, Naceur, Casu, and Quinn (2015) suggest that compliance with Basel Core Principles has no relationship with bank stability. Demirgiic-Kunt and Detragiache (2010) assess whether compliance with the Basel Core Principles for adequate banking supervision (BCPs) is associated with bank soundness. They indicate that no evidence of a relationship between proper compliance and bank stability. Other results suggest that stricter compliance with regulatory standards is associated with riskier banks. Their results reflect the inability of assessors to carry out evaluations that are comparable across countries. Both papers were analyzed at a particular point in time. They did not allow for taking into account the evolution of each country's banking system in compliance with international regulatory standards. These results need to be treated with caution, because they may also reflect the inability of assessors to provide a consistent cross-country evaluation of effective banking regulation.

Financial sectors (particularly banking sectors) in African countries lag in terms of their economic importance when compared to peers in other developing non-African countries as well as developed economies (Njeule, 2013). The World Bank (2011) suggests that earlier banking liberalization reforms lacked accompanying institutions such as legal, regulatory, and corporate governance frameworks that had served to promote such reforms in developed countries successfully. Yongo-Bure (2014), in a review of South Sudan post-referendum, reveals that the establishment of monetary policy has been key to improving the flow of money within the economy and promoted production within the country. The researcher noted that for South Sudan to reap the benefits of a robust financial system, there is a need for the country to build financial infrastructure that can support future policy development consistent with state development.

Consequently, Albino-Ajack (2015) reviewed the development in the banking supervision in South Sudan and indicated the system in place is weak as the majority of the staff risk the capacity in risk-bassed supervision and implementation of BASEL framework in assessing the banking performance. The paper advocates for further review and development of the legal framework, which can be integral to financial sector development and economic growth. In the recent past, the South Sudan Central Bank has come up with the credit reporting systems regulation of 2014, exchange regulations of 2015, electronic money regulation of 2017, supervisory and regulatory guidelines of 2017, voluntary liquidation of 2018, and the bank opening requirements of 2019. All these regulations have been formulated to support sustainable economic growth, price stability, and a sound financial system.

Current Bank Regulations in South Sudan

The Central Bank of South Sudan has, in the recent past, revamped the banking regulatory and supervision environment by developing essential requirements and regulations. The laws have been instrumental in enhancing the stability within the industry. However, there are some critical areas for the expansion of the regulatory environment, as indicated in the table below.

Table 1 Banking Regulations

Regulation	**Benefits**	**Area for Improvement**
Credit Reporting Systems Regulation, 2014	This has helped in the mitigation of information asymmetry between borrowers and lenders	*With the growth in the digital lending platforms regionally, the regulations should be reformulated to capture the need for seamless and digitalized credit information sharing.* *This can be critical in supporting growth in the lending environment within the banking industry*
Requirements For Bank Opening 2019	The regulations are pertinent to the growth of the banking industry and increasing openness of the economy	*With the increase in the technology environment, there is a need for the development of regulations to guide Digital Bank opening within South Sudan.* *This will be instrumental in supporting the development of digitalized bank products and accessibility of the institutions to the large unbanked population in the country*

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Supervisory and regulatory guidelines 2017 ladder of compliance	These regulations have been vital in promoting bank supervision and soundness within the industry.	*The Central Bank of South Sudan should be more robust in its involvement in the monitoring and supervision of banks through enhanced risk-based supervision, especially as regards credit portfolio management, non-performing loans, liquidity /assets management of the Bank.* *The regulators need to be proactive and ensure early detection of distress signals in the banking system for quick resolution of such problems.*
Electronic Money Regulation of 2017	This regulation has supported the development of electronic money services transfer within the country	*There is a need for new legislation and review the existing laws on new methods of the payment system in the country, especially the e-banking system and the cybercrimes laws within the industry.* *A colossal amount of money is daily being lost to electronic frauds, some of which the existing laws cannot adequately protect the Bank as intermediaries/agents of these funds.*

Challenges in South Sudan Banking Supervisions
The openness in the global financial system has presented challenges to the development of the banking sectors within emerging markets. Several critical medium-term and long-term difficulties have faced the banking sector in South Sudan as it seeks to come up with a productive regulatory environment (Ferullo, 2018). One of the significant aspects confronting the development of clear regulations in the banking sector is emerging volatility and challenges in debt sustainability. This has been brought about by the drop in cross-border lending within banks in the face of the financial crisis (Said, Hasnan, & Alam, 2013). This has led to most countries turning to the international bond market for borrowing, and this poses a challenge to the local market since the bond market is dominated by foreign currencies, which results in exchange risk, which can contribute to the destabilization of the economy (Mwega, 2016).

The South Sudan commercial bank has focused on traditional banking services. However, the international banking sector has been structurally shifting post the implementation of the Basel III Accord, which has contributed to the development of non-traditional financial services (Akongdit, 2013). The South Sudan financial system has not been at the forefront in embracing the shadow banking concept and the evolution of financial technologies, which are critical to the future of the banking industry. Lack of legislation to this effect has limited financial development and inclusion, which creates vulnerability within the local banking system (Ferullo, 2018).

Fortune of Africa (2016), in a review of the challenges in the financial sector in South Sudan and indicates that offering licensed banks a basic regulatory framework with limited guidance has failed to stimulate the banking sector development. The further review motes that scarcity of labor, limited access to funds, inadequate technical support, limited diversification across the sector, and lack of security and transport facilities have limited the expansion within the sector. Xinhua Report (2017) quoting the Governor of Central Bank of South Sudan indicates that limited structural reforms in the country have contributed to the economic crisis and political challenges that have limited expansion within the financial sector. However, the Bank is conducting a significant restructuring of its systems and regulatory framework geared towards promoting financial stability and efficiency within the country. The Bank also anticipates heightening vigilance activities through the monitoring of licensed banks.

Recommendations

The country needs to strengthen the economy to be receptive to the emerging global markets and integration to the regional economy. The most fundamental long-term challenge for a developing economy is aligning incentives in the global financial system with sustainable development. This will involve shifting the focus away from short-term profit maximization and towards long-term value creation. However, there is no apparent policy solution for this problem. Hence, there is a need for policymakers within the country to reflect on the best route that can be adopted to stimulate the banking system and create sustainable value within the country.

Further, in the laxity in compliance with the banking regulations and guidelines, financial institutions operating in South Sudan should be compelled by the central Bank to adhere to banking regulations through robust enforcement of the laid-down guidelines. Furthermore, development in mobile banking and branchless banking should be encouraged as this will support interconnectivity with other regional banking institutions.

Based on the findings that the central Bank has a significant role in bank soundness, the paper recommends that commercial banks should be guided towards fostering their internal and external factors to improve financial performance. These internal factors include capital adequacy, asset quality, management efficiency, earning ability, and liquidity management. External factors include inflation, gross national product, interest rate, and political unpredictability. The Central Bank should further review the monetary policies that will help the management of commercial banks in developing risk management policies that can help in anticipating the external environments in which businesses operate to avoid shortcomings in the future.

The central Bank should formulate policies that can foster the commercial Bank's involvement in investing in treasury bills and treasury bonds. This will help the banks raise their competitiveness and engage in cross-border trading with other financial institutions. Thus, it is essential to develop policies that can manage changes in fiscal and monetary policies to improve the documented poor financial performance of banking institutions in South Sudan.

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