



UNITED NATIONS
INDUSTRIAL DEVELOPMENT ORGANIZATION

SOMALIA FINANCIAL SECTOR TECHNICAL REPORT

Mogadishu, January 2020

This technical report was conducted by UNIDO Somalia Programme team of experts, within the framework of the “Agro-technology development for Economic Growth in South and Central Somalia” project, implemented by UNIDO and funded by AICS/Italy.



Background of the report:

UNIDO had launched a project “Agro-Technology Development for Economic Growth in South and Central Somalia”, in 2019, which is designed to support the revival of productive sectors in Central and South Somalia regions by establishing a network of three agro-technology and enterprise development units to support Somali businesses in starting, rehabilitating and upgrading agro-industrial operations, accessing new technologies, markets and financing facilities.

Primarily, the project aims at increasing the potential for economic opportunities and job creation in the productive sectors of the Central and Southern regions of the Somalia by focusing on four key actions:

- i) Promotion of agro-technology upgrading and entrepreneurship development;
- ii) Delivery of vocational and technical skill trainings in trades providing support services;
- iii) Facilitate access to technology, markets and finance;
- iv) Provide institutional support in the area of agro-industrial technology transfer, investment promotion, entrepreneurship development.

The project is expected to train 300 existing and perspective entrepreneurs as well as supporting around 600 individuals in starting a micro-enterprise or finding a skilled employment, as a result of vocational and technical skills trainings delivered by the agro-technology and enterprise development Units. Within this framework, an agro-technology credit facility for Somalia MSMEs has been included within this project to ensure that beneficiaries supported through project activities would have access to an appropriate financing scheme.

In order to understand on the terms and product to be part of the credit facility to be launched, a study on the financial sector of Somalia was undertaken. The objective of the study is to understand the existing financial operators, the credit availability scenario, various credit products along-with its terms & conditions, the need of the enterprises etc. The finding of the study is expected to assist UNIDO to design and the develop the credit facility.

Methodology/ Approach:

The methodology used to undertake the study is a quasi mix of secondary data analysis and primary data collection and analysis.

The secondary data availability in case of Somalia is limited and even whatever is available is mainly macro-economic data which is in many cases are old information and difficult to authenticate. Nevertheless, number of publications from World Bank and IMF was referred and quoted in the report. The list of papers has been mentioned in the annexes.

The primary data collection included interactions with the private sector association, commercial banks, experts from Universities etc. through checklist of questions.

In addition, primary data were collected from 15 micro and small enterprises using a detailed questionnaire.

Financial sector of Somalia:

The Somalian financial sector has gradually come out from the informal style of functioning to a more formalised regulatory systems with the Central Bank of Somalia being established in 2009. Although Somalia has had no central monetary authority for upwards of 15 years between the outbreak of the civil war in 1991 and the subsequent re-establishment of the Central Bank of Somalia in 2009, the nation's payment system is actually fairly advanced due primarily to the widespread existence of private money transfer operators (MTO) that have acted as informal banking networks, while in the last couple of years, commercial banks are now playing an important role in the development of the nation's payment system.

The present financial system comprises of Central bank (including in Somaliland), commercial banks, microfinance institutions (MFIs), money transfer businesses (MTBs), and mobile network operators (MNOs) providing mobile money services. A brief snapshot on the financial system is presented below:

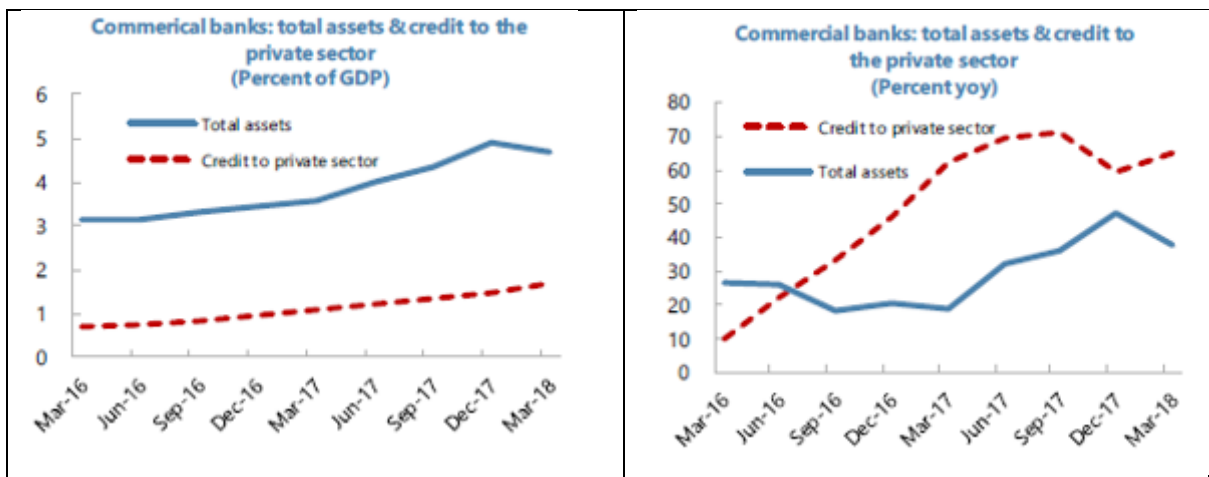
Players	Description
Central Bank of Somalia	<ul style="list-style-type: none">• Main regulator of financial institutions.• Licenses and supervises banks and money transfer businesses under the Financial Institutions Law (FIL) of 2012.
Commercial Bank	<ul style="list-style-type: none">• As of January 2019, eight banks were licensed by the Central Bank of Somalia (CBS), but three banks are not yet operational
Money Transfer Operators (MTOs)	<ul style="list-style-type: none">• As of January 2019, 11 MTOs were licensed by the Central Bank of Somalia (CBS).
Mobile Network Operators (Mobile Money)	<ul style="list-style-type: none">• Mobile money is now the main transaction instrument used by both individuals and businesses in Somalia. About 36 percent of GDP flows through mobile money systems.•
Micro-finance Institutions (MFIs)	<ul style="list-style-type: none">• The Somalia microfinance industry is currently unregulated. The 2012 FIL only recognizes commercial

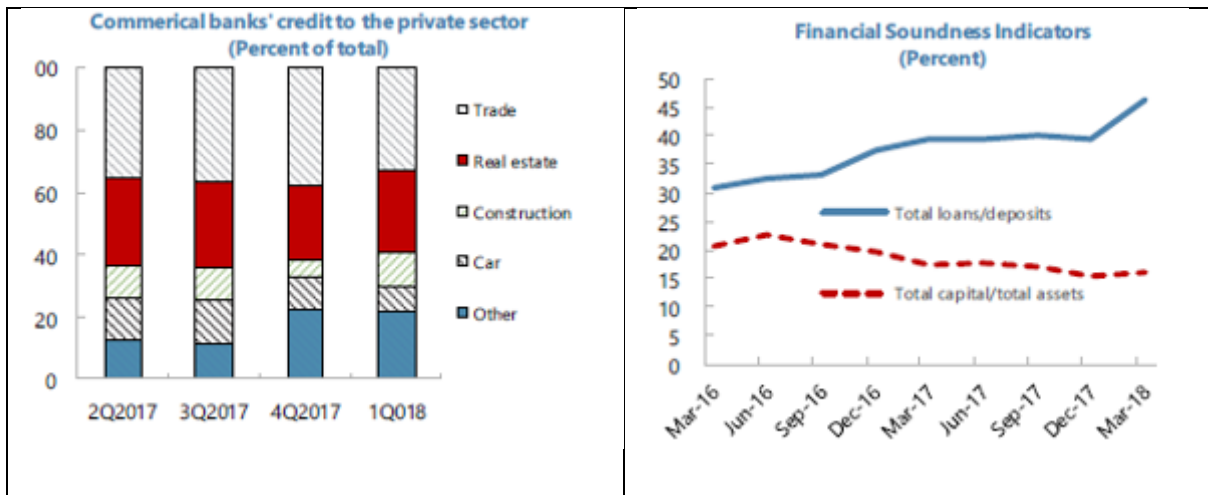
	<p>banks and MTBs as financial institutions which has left microfinance players in a legal vacuum.</p> <ul style="list-style-type: none"> • Six major MFIs operate in Somalia either as affiliated subsidiaries of commercial banks or registered as nongovernmental organizations (NGOs). •
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Banking Sector

The country’s banking sector is in its developing stage with few commercial banks registered. (5 licensed banks operating are- **Premier Bank, Dhabsil Bank, Salaam Bank, International Bank of Somalia and Amal Bank**, while 3 other new banking licenses have been given recently). Two of the newly opened banks in Mogadishu are **Amaana Bank** and **Daryeel Bank**. The other one is headquartered in Puntland region. Furthermore, Somalia will have agricultural bank for the first time since 1990. This agricultural bank is incorporated as **Beeraha Bank**. It is likely to be operational by the beginning of the next year. The **Central Bank of Somalia (CBS)** was revived and came to existence only in 2012 and many regulatory measures are still to be in place.

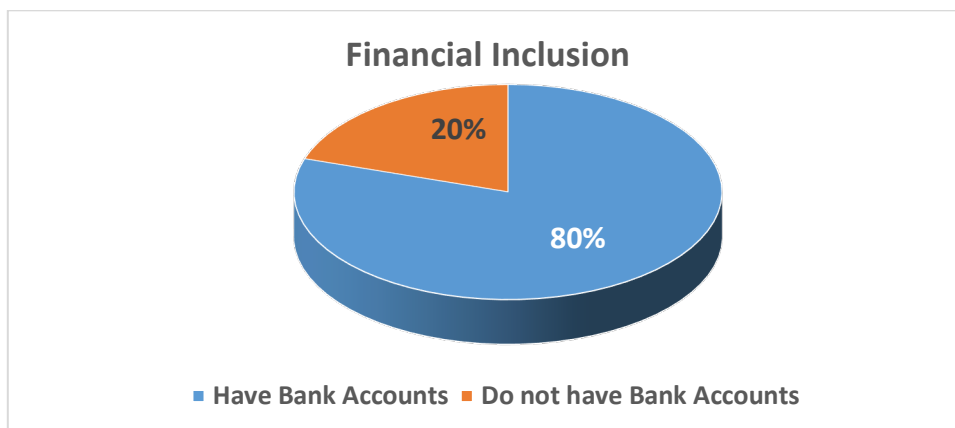
Since, the financial system currently is dominated by Money Transfer Operators (MTO) and Mobile money networks, the penetration of the commercial banking is very limited. only about 15 percent of the population (and just 7 percent of women) has a bank account, and less than 5 percent of people with bank accounts are active users. Though, some informal resources have indicated that there has been significant increase in bank accounts, approximately 28 percent of the population have bank account of the local commercial banks. A brief snapshot of the banking sector statistics is provided below:





The above figures are taken from the *IMF Country Report No. 18/212, Somalia, July 2018*. It can be inferred from above that the participation of the formal banking system in the country's GDP is abysmally small, though credit offtake to the private sector is gradually increasing. The predominant sector where credit off-take happening is trade financing and real estate. Interestingly, the sector is highly liquid and adequately capitalised as shown in the financial soundness indicator.

The primary data analysis as part of the study, where 15 nos. of small and micro business owners from Mogadishu area was interviewed. The response from the owners indicates that the banking outreach has definitely improved particularly in the urban centres with business owners. The chart below provides the level of financial inclusion where 80% of the respondents have current account with one or the other commercial banks.



The CBS has formulated the **Financial Institution Law No. 130/2012**, which provides the general guidelines of financial institutions operations, both Islamic and conventional. Though, all the operational five commercial banks adhere to Islamic banking, the law no 130/2012 leaves the financial industry to accommodate and to be open for conventional financial institutions; i.e. Riba-based (Interest taking) banks and insurance companies. In-fact, the Puntland regional government approved the opening of CAC international bank branch in Bosaso following the conventional banking rules.

The operating banks are into most of the types commercial transactions through business accounts, including providing bank guarantees (*performance bond, shipping guarantee, payment guarantee*), opening letter of credit (LOC), taking deposits, operating savings and current accounts, etc. As for financial products offered, almost all the banks are into *Auto finance, Real Estate financing, trade financing, equipment financing, project financing*. The financial products of all the five banks are operating on Islamic finance principles. Primarily, the following Islamic finance solutions are used:

- **Murabaha:** Is a particular kind of sale where the seller expressly mentions the cost of the commodity purchased, and sells it to another person by adding some profit thereon. Thus, Murabaha is not a loan given on interest; it is a sale of a commodity for cash/deferred price.
- **Musharakah:** Under Islamic jurisprudence, Musharakah means a joint enterprise formed for conducting some business in which all partners share the profit according to a specific ratio while the loss is shared according to the ratio of the contribution. It is an ideal alternative for the interest based financing with far reaching effects on both production and distribution.
- **Mudarabah:** This is a kind of partnership where one partner gives money to another for investing in a commercial enterprise. The investment comes from the first partner who is called "Rab-ul-Maal" while the management and work is an exclusive responsibility of the other, who is called "Mudarib" and the profits generated are shared in a predetermined ratio.
- **Istisna :** Is a sale transaction where a commodity is transacted before it comes into existence. It is an order to a manufacturer to manufacture a specific commodity for the purchaser. The manufacturer uses his own material to manufacture the required goods.
- **Ijarah (Leasing):** It is an arrangement under which a bank leases equipment, building or other facility to a client against an agreed rental.

Microfinance Industry in Somalia

The Somalian microfinance industry is still un-regulated with the FIL law of 2012 doesn't give mandate to Central bank of Somalia to draft monitoring and regulatory framework to include micro-finance operations under its ambit. Though informal and un-regulated, the micro-finance institutions are playing a crucial role in financing needs of the under privileged. At present, six major MFIs are operating in the country with many of them affiliated with commercial banks, while many local and international NGOs provide heavily subsidized microfinance products too. Asset sizes of MFI players in Somalia range from US\$0.3 million to US\$3 million.

Microfinance regional coverages differs by institution. Microfinance operators affiliated with commercial banks generally operate in the same regions as their parent institutions while NGO-based MFIs are usually concentrated in major urban centres such as Mogadishu, Garowe, and Kismayo.

The average loan size is around USD 1000 with women being the most represented client group. The loans are for both business and consumption. It is also note-worthy to mention here that similar to commercial banking sector, MFIs too provide services using Islamic financing instruments. The two most utilized financial instruments within the industry are **Qardu Hassan (charity-based and often subsidized with donor money) and Murabaha (cost-plus)**. The Qardu Hassan is not easily available for all individuals looking for short- term loan but only to those individuals who have strong recommendation from well established businesses in Somalia.

Gradually, in last few years, the informal sector credit needs are tried to be addressed through micro-credit. Many of the existing commercial banks and few large NGOs have started their own verticals for lending small ticket loans for individuals and micro businesses. Interestingly, the operations of micro-credit institutions are still not under any regulation and needs interventions to formalise and expand.

Money Transfer Operator (MTO)

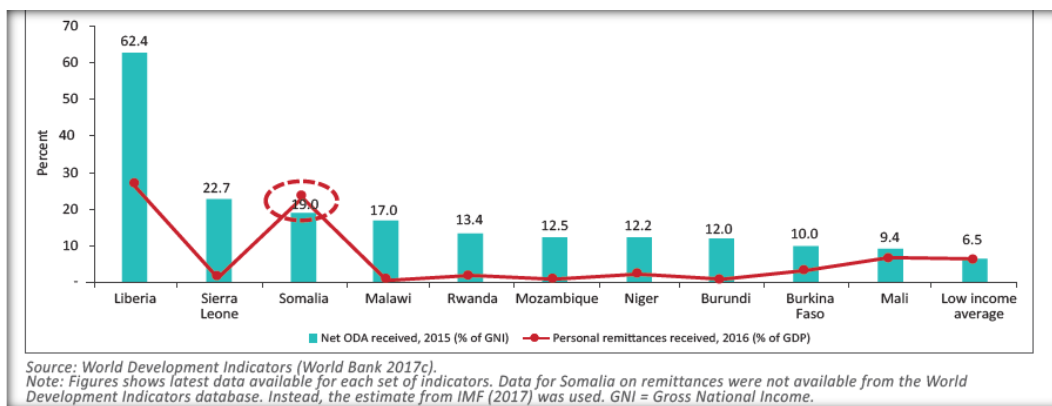
Money Transfer Operators(MTO), since the period of Instability have constituted the backbone of Somalia's informal financial system, with Dahabshiil Financial Services Inc., Amal Express, Dalsan Trading and Towfiiq among the largest Somali companies. These MTOs are critical to financial transfers to Somalia, whether in the form of remittances from the diaspora to their communities in Somalia or in the form of transfers to local humanitarian organisations. The extent of its role in the economy of the country can be measured by the importance of remittances play, remittances account for between 25% and 45% of Somalia's economy till 2015, exceeding the amount the country receives in humanitarian aid and foreign direct investment combined. However, experts acknowledged that the role of MTO in the economy has been declining since 2012 due to the return of many Somali Diasporas, and the increase in the production of the domestic economy as result of new investments from both foreign investors and Somalis. Consequently, many MTO have turned their business into banking and that contributed much to the growth of the banking sector in the last five years.

Known as Hawala , MTOs are often the only remittance option for many poor migrants and their families who have no other point of access to the formal financial sector. MTOs themselves typically rely on banks to provide financial services such as check collection, deposit services, payroll services and most critically, wire transfers as well as for their typically more robust anti-money laundering/combating the financing of terrorism (AML/CFT) information technology infrastructure. in every town.

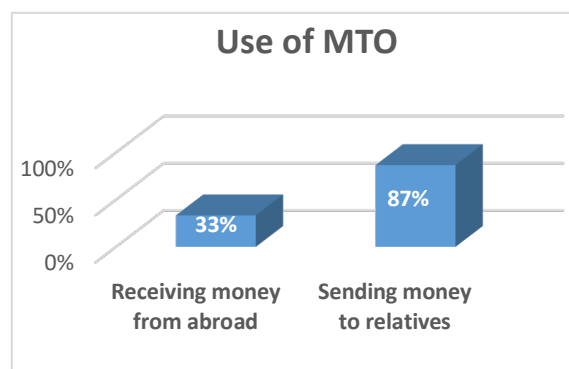
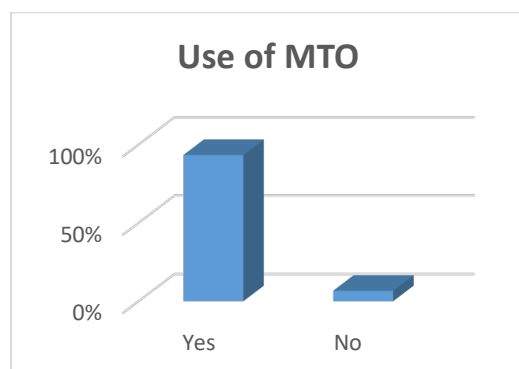
The operational MTOs in the country can be categorised between MTOs that operate locally and those that operate internationally. For MTOs operating internationally, 'they are compliant with regulations in the countries where they operate and have bank accounts. Most of the Somali money transfer operators (MTOs) are credentialed members of either the Somali Money Transfer Association (SOMTA), an umbrella organisation that regulates the community's money transfer sector, or its predecessor, the Somali Financial Services Association (SFSA).

Though MTOs to a large extent is the only source of fund transfer from abroad , its popularity also comes from the fact that these Somali funds transfer companies charge lower commission fees than their Western counterparts; typically around 5% for sums of up to \$1,000, for amounts greater than \$1,000, Somali MTOs charge commissions of 3% to 4%, significantly lower than Western Union's 7.1% fee and MoneyGram's 7.2% fee for sending similar amounts to Ethiopia.

Official remittances from the diaspora are estimated at about \$1.4 billion a year, equivalent to about 23 percent of Somalia’s GDP (IMF 2017). About 3.4 million people—roughly 40 percent of the population—depend on remittances for their daily needs, and about 80 percent of all new business ventures are funded by remittances². Remittances account for about 6 percent of the value of all mobile money transfers.



The primary data analysed on the usage of MTOs clearly indicated the strong outreach of the services. The findings are illustrated below:

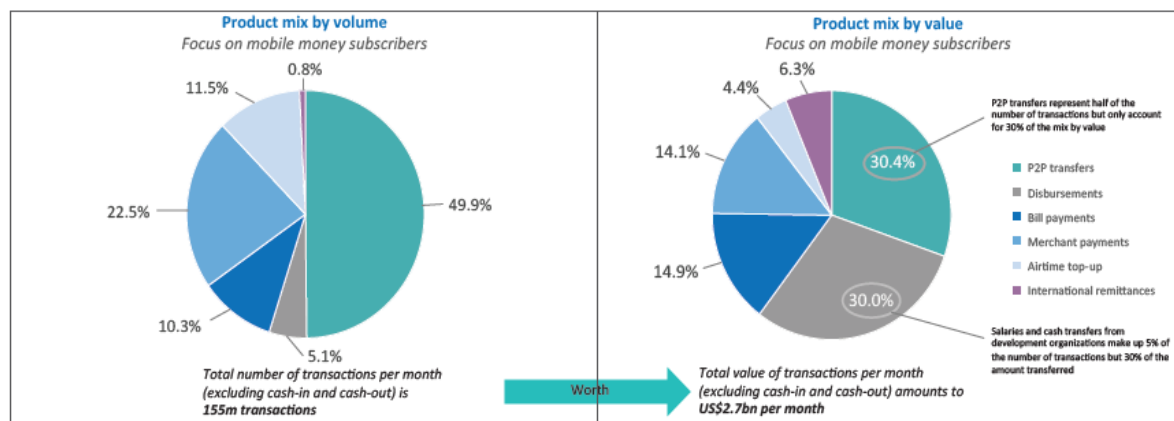


Mobile Money

Somalia being no exception to other East African countries with mobile money being the most popular tool for financial transactions within the country. In Somalia: three-quarters of the population use mobile money transfers, compared to 15% who possess bank accounts for their financial transactions (Firestone et al., 2017). The services used through mobile money includes deposits of eMoney to mobile money accounts, cash withdrawals, merchant payment transactions, salary receipts etc. The Mobile service providers such as Hormud's EVC+ or Telesom's Zaad are the monopolistic players providing mobile money facilities. Interestingly, there is no agreed protocol between these service providers hence mobile money transfers within different service providers are not possible. This monopolistic behaviour is owing to the fact that mobile money is largely unregulated and lacks adequate oversight, though a new telecom law has been passed in 2017 to bring the mobile money under regulation

The outreach of mobile money in the country is phenomenal with almost three-quarters of the population above 16 years use mobile money. The Penetration rates are highest in urban areas (83 percent) and camps for internally displaced people (72 percent), while rural areas are marginally low with 55% penetration. Mobile money is now the main transaction instrument used by both individuals and businesses in Somalia. About 36 percent of GDP flows through mobile money systems. The value of mobile money transactions in Somalia is estimated at \$2.7 billion a month.

The figures below present a snapshot on the usage pattern of mobile money:



The widespread use of mobile money is validated through the findings of our primary data which consisted of small & micro business owners interviewed as part of the study. The response from 15 data points from Mogadishu, overwhelmingly confirms the usage of mobile money and is used extensively both for business like buying goods and receiving payment from buyers and also for individual day to day use.

The major challenge the country is still facing is the financial integration with the outside banking system. This is due to major restrictions faced due to FATF regulations, following the

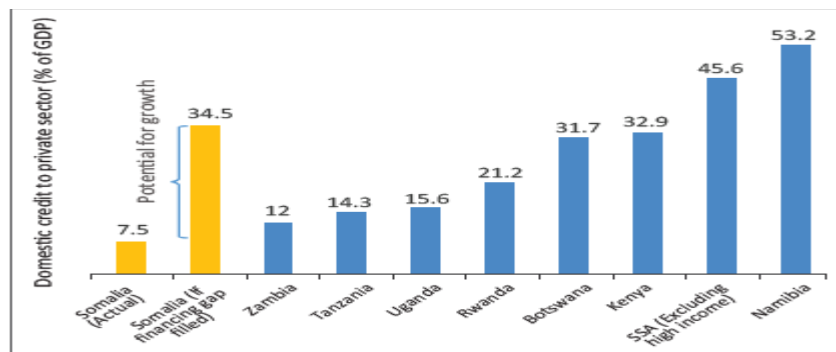
9/11 event in US. A stricter monitoring system was adopted for anti-money laundering and financing of terror by most of the countries with financial transactions effecting Somalia very strongly. In 2013, for instance, British bank Barclays closed the accounts of over 200 clients operating money service businesses in Somalia

Somali banks have encountered a number of challenges, and have witnessed the problems NGOs face as a result. The US Banks in this regard, are stricter with transactions related to Somalian banks/ MTOs due to prevailing law & order issues. To circumvent the problem, many banks advise to open bank accounts denominated in Dirham or other currencies, but subsequently clients’ SWIFT codes were denied, affecting 1,000 businesses. And in addition, the beneficiaries lose out due to losses in currency exchange.

However, although the CBS has been re-established, staffed and funded, it ‘has no control over either the exchange rate or the supply of the Somali shilling’. Moreover, ‘[it] has not issued any banknotes since 1991, resulting in a largely dollarized economy’ (IMF, 2017: 8). The financial sector is effectively stuck between the dominant money transfer companies and a small and relatively weak banking sector.

Credit scenario in the country:

The credit availability scenario for business and individuals in Somalia is typically true for any war ravaged economy where in-availability of financial infra-structure prohibits development of effective credit financing tools. A study by E & Y in 2018, indicated that the gap between the demand for credit from both businesses and individuals and supply is about 2 billion USD. In-fact, if this gap is lowered, the credit to private sector in Somalia will surpass that of Kenya.



Source: Estimated 2017 nominal GDP of \$7.4 billion is from IMF (2018). Supply of and demand for finance are from Ernst & Young (2018). Comparative country data are from World Development Indicators (World Bank 2017c).

The major means of raising of finance for both individuals and businesses is still the informal sources such as family, friends and business acquaintances. According to Ernst & Young (2018), about two-thirds of businesses depend on friends or family to cover financial needs. The two main reason for this use of informal source is the un-favourable terms and conditions of financial institutions as well as inability to provide large collaterals.

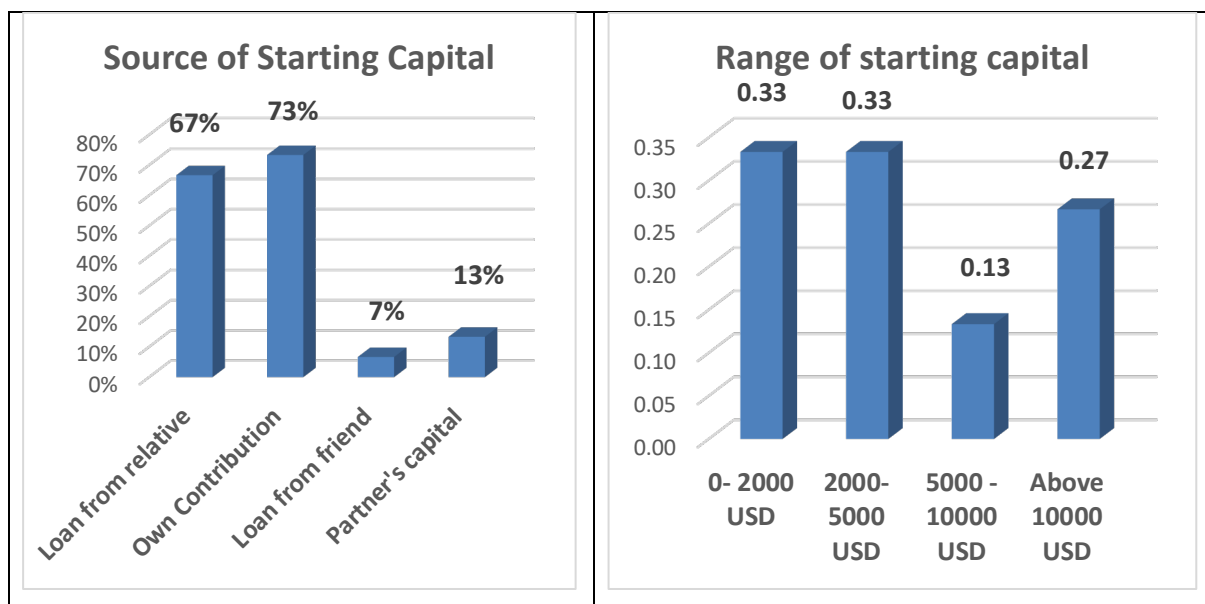
This behaviour of banking fraternity is example of operating in a conflict zone where risk of lending is tried to be offset by high cost of financing. in Somalia, banks started operations with very high cost of financing, which was as high as 30%. Practically, banks strive to satisfy their shareholders, who look for high profit margins. Somali banks’ high cost of financing has pushed a lot of household consumers back and this discouraged a lot of poor and low-income households to apply for financing. High cost of financing coupled with limited contract duration created an environment where private sector’s access to credit gets undermined.

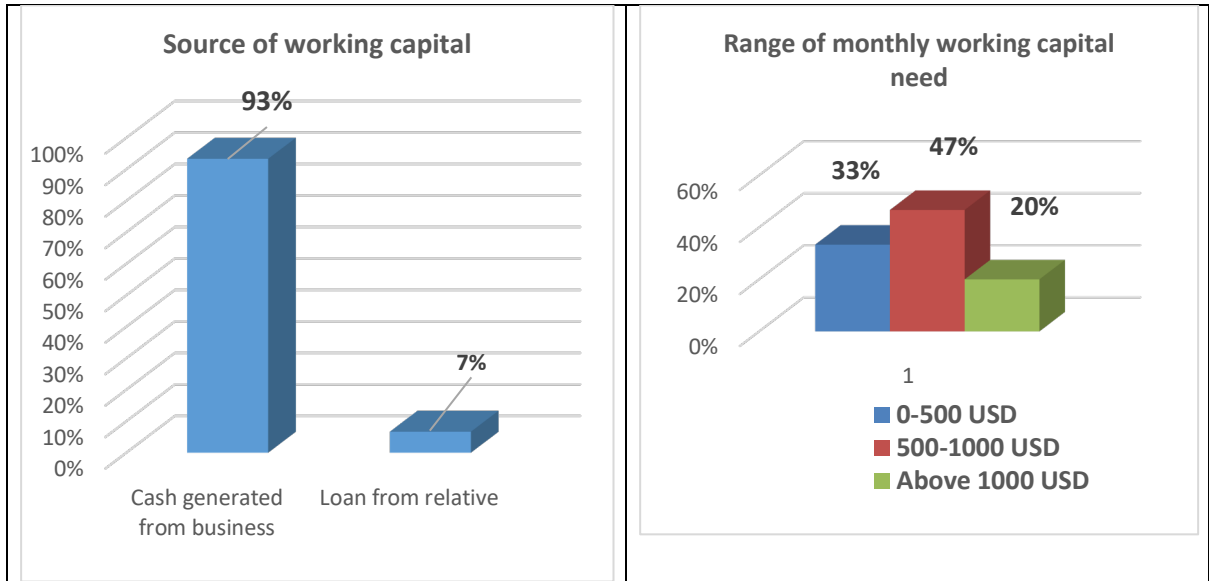
Lending is heavily concentrated on short-term trade finance, which makes up approximately 85 percent of the total portfolio of financial institutions leaving a large unmet market demand in the real economy.

In addition, the banks have a weak pipeline of bankable micro, small, and medium enterprises (MSMEs) operating in productive sectors of the economy and limited understanding of project financing resulting in little to no provision of credit to businesses and/or poor credit terms.

The primary data analysis of the samples of micro and small businesses interviewed through the study provides an insight to the credit situation in the country.

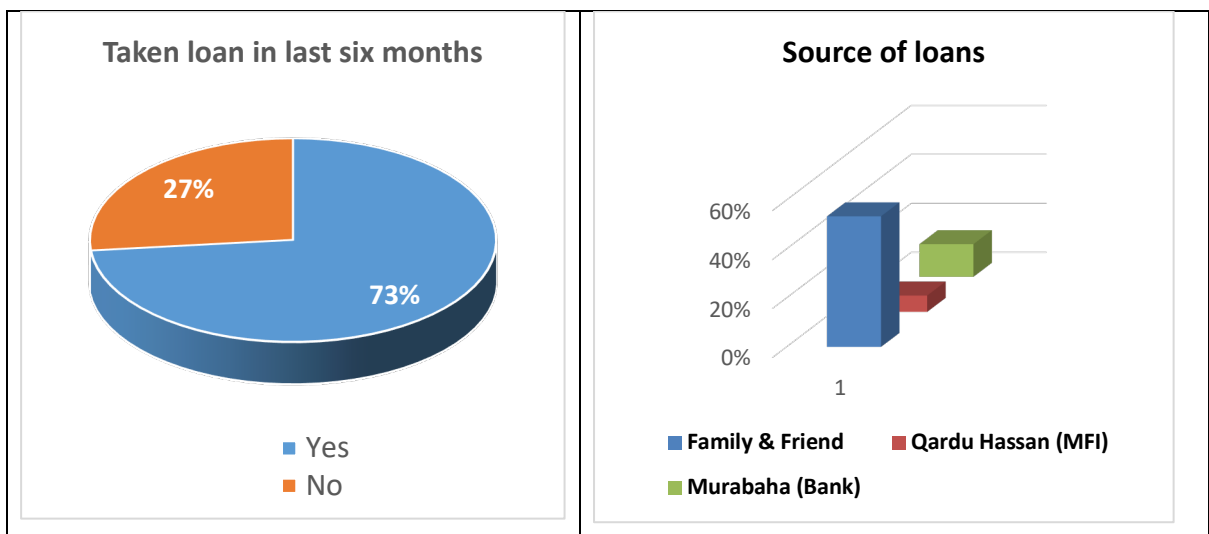
The figures below present the funds requirement for these small and micro-businesses.





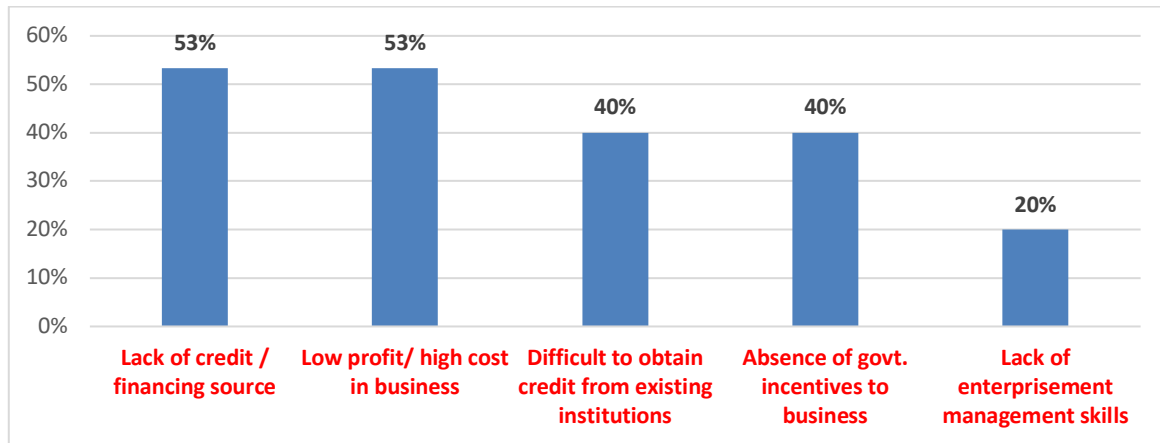
The figures above clearly indicate that the credit availability in the country for small and micro businesses are through informal sources, particularly for the start-up capital. This could be due to the fact that the existing credit product of the financial institutions are geared towards trade financing and which only encourages existing trading concerns. An interesting fact which is reflected in the working capital source is that the businesses are viable and sustainable since it generating its own working capital. This is a positive fact for the formal credit institutions to invest in starting capital as well as support in expansion through infusion of working capital to the business. Though the above trend could be reflective of the fact that most of these enterprises interviewed are from the period of 2016-17, when the banking sector was gradually evolving.

The subsequent question on the credit availability and sourcing in last six months, do provide a picture where financing sources are getting for formalised. The findings are presented below:



The above figures do present a changing scenario with formal Islamic banking institutions including banks and MFIs have gradually tapping into the un-met credit demand.

In order to understand whether the credit availability is a felt need or not, the enterprise owners were queried on the difficulties faced in the finance of the business. The response overwhelmingly indicates towards the absence or shortcomings in the credit availability.



As a part of the study, extensive interactions were done with representatives of all the five active commercial banks in the country. The interactions provided insights on the existing credit products both macro and micro. The table below provides the snapshot:

Parameters	Micro-credit	Macro-credit
Popular products	Islamic banking products- Murabaha, Qardu-Hassan	Islamic banking products- Murabaha
Product duration	The Murabaha products duration ranges from 1 to 2 years.	The product duration varies from 1 to 5 years, but preferably is 1 to 2 years .
Payment pattern	Instalments are mostly weekly or monthly .	Instalments are mostly monthly or quarterly . Some FIs can be negotiated for longer period.
Mark-up in the product	The mark-up on the murabaha product depends on the Institutions and the loan duration. The present rate varies from 10-14.4% for 1-year period and 18-21% for 2-year period. Some of the other products can be from zero to 5% .	The mark-up for murabaha products ranges from 12 to 14% for 1-year product while for 2-year product it is mostly 20% .
Grace period	The grace period depends on the duration of the product and level of negotiation. Normal range is from 1 month to 2 month .	The grace period depends on the duration of the product and level of negotiation. Normal grace period is 2 months , which in some cases can be extended to 6 months.

<i>Collaterals required</i>	The major collateral in the micro-credit products is personal guarantee of an established person of the community.	In addition to personal guarantee, collateral in terms of immovable assets of value 130 to 140% of the credit amount.
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Conclusion:

The study conducted on the financial sector in Somalia provided number of insights that will be useful in designing the credit facility planned under the “Agro-tech” project. It is very apparent that the country is gradually maturing into fully functional financial sector with the Central Bank of Somalia reinstating it’s the authority for all fiscal transactions and its monitoring in the country.

The Institutions available in the financial spectrum of Somalia can be broadly classified into four distinct groups- ***Commercial banks, Micro-finance institutions (MFIs- operated through the commercial banks or NGOs), Mobile Network Operators (Mobile Money) and Money Transfer Operators (MTOs).***

The financial system currently is dominated by Money Transfer Operators (MTO) and Mobile money networks, the penetration of the commercial banking is limited. only about 15 percent of the population as per 2017 data has a bank account, and less than 5 percent of people with bank accounts are active users. Though, some informal resources have indicated that there has been significant increase in bank accounts, approximately 28 percent of the population have bank account of the local commercial banks as of date. The primary data analysis as part of the study, where 15 nos. of small and micro business owners from Mogadishu area was interviewed. The response from the owners indicates that the banking outreach has definitely improved particularly in the urban centres with business owners. The chart below provides the level of financial inclusion **where 80% of the respondents have current account with one or the other commercial banks.**

A study by E & Y in 2018, indicated that the gap between the demand for credit from both businesses and individuals and supply is about 2 billion USD. Lending is heavily concentrated on short-term trade finance, which makes up approximately 85 percent of the total portfolio of financial institutions leaving a large unmet market demand in the real economy.

The major means of raising of finance for both individuals and businesses is still the informal sources such as family, friends and business acquaintances. The primary data analysis of the samples of micro and small businesses interviewed through the study provides an insight to the credit situation in the country. The responses clearly indicated that the present source of finance to start a business is own contribution or contributed by friend or relatives. This doesn’t mean that the MSMEs are not interested to take finance from commercial banks. The lack of outreach, high collaterals or guarantees and high mark-up prevents the businesses from accessing finance from commercial banks.

This indicates that the credit facility to be introduced through the project has to be friendlier than the existing sources while not distorting the market. The commercial banks could be the medium through which the credit facility can run using traditional Islamic banking principles of Murabaha (with reasonable mark-up and collaterals).