



Financial Products Diversification in Somaliland: Challenges and Opportunities

Contents

1

Introduction

2

Objectives

3

Methodology

4

**Results
&
Discussion**

5

Conclusion

6

Recommendations



Background

- The financial sector plays a crucial role in facilitating economic activities and promoting growth in any country or region (Kammer et.al, 2015).
- Financial products refer to the range of instruments and services offered by financial institutions to meet the diverse needs of society (Salman, 2014).
- In the context of the financial sector, diversification refers to creating a portfolio of different financial products to spread risk and enhance potential returns. It involves investing in a mix of assets with varying characteristics.
- Somaliland's financial sector historically operated on an informal basis, with limited involvement of traditional banking systems
- The first commercial banking license was granted in 2013, and subsequent licenses have been issued to additional banks.
- In addition, the insurance sector is relatively new, featuring several firms offering a diverse array of insurance products, predominantly focusing on health and car insurance.



Problem statement

- The financial sector in Somaliland is in a state of transition, moving towards a more formalized structure to better serve the economic needs of the populace.
- However, this transition is accompanied by challenges.
- These challenges may include regulatory constraints, limited market infrastructure, information asymmetry, and lack of investor awareness or understanding.
- Particularly concerning the limited range of financial products available to the public.
- Thus, this study aims to comprehensively analyze these challenges and shed light on potential opportunities.



Objectives

The objectives of this study are:

1. To conduct a comprehensive analysis of the current status of the financial sector in Somaliland
2. To identify key challenges hindering product diversification in Somaliland's financial sector
3. To investigate the policy and legal gaps in creating more risk-sharing products
4. To explore financial product diversification opportunities to effectively meet the diverse needs of society in particular the lower income segments



Methodology

- The study adopts a mixed-method approach, utilizing both primary and secondary data sources to comprehensively investigate the financial sector in Somaliland.
- The primary data was gathered through 68 questionnaires distributed among businesses and individuals.
- Additionally, in-depth interviews and discussions were conducted with key stakeholders in the financial sector, encompassing representatives from the Central Bank of Somaliland, the Somaliland Insurance Authority, the Somaliland Banking Association, the 5 operational banks in Somaliland, insurance companies, and microfinance institutions.



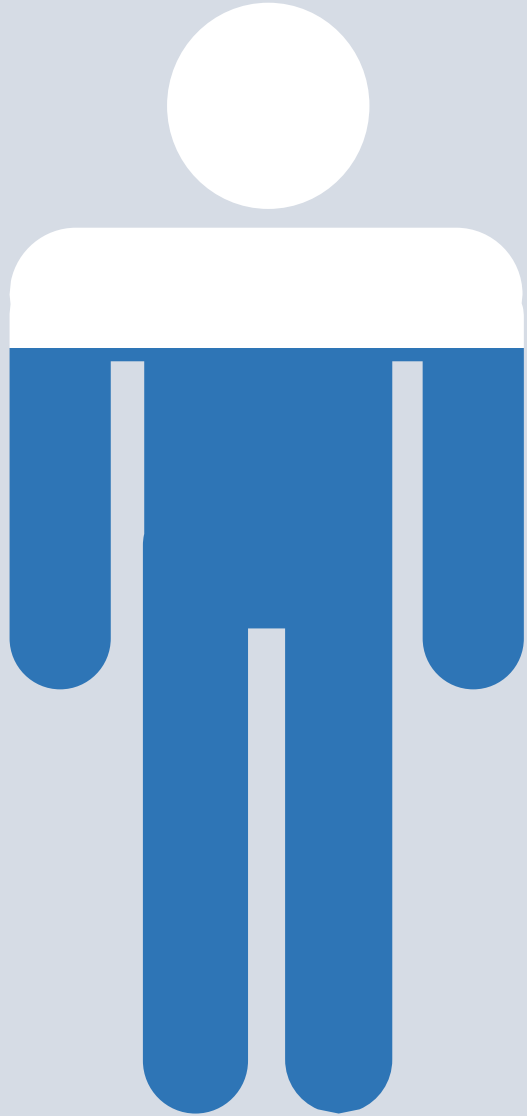
Results and Discussions

❑ *Demographic profile*

In this section, the study presents the demographic profile of the 68 respondents who participated in the study, as outlined in the subsequent table. The data provided here offers insights into the diverse demographic characteristics of the individuals and businesses that contributed to the research.

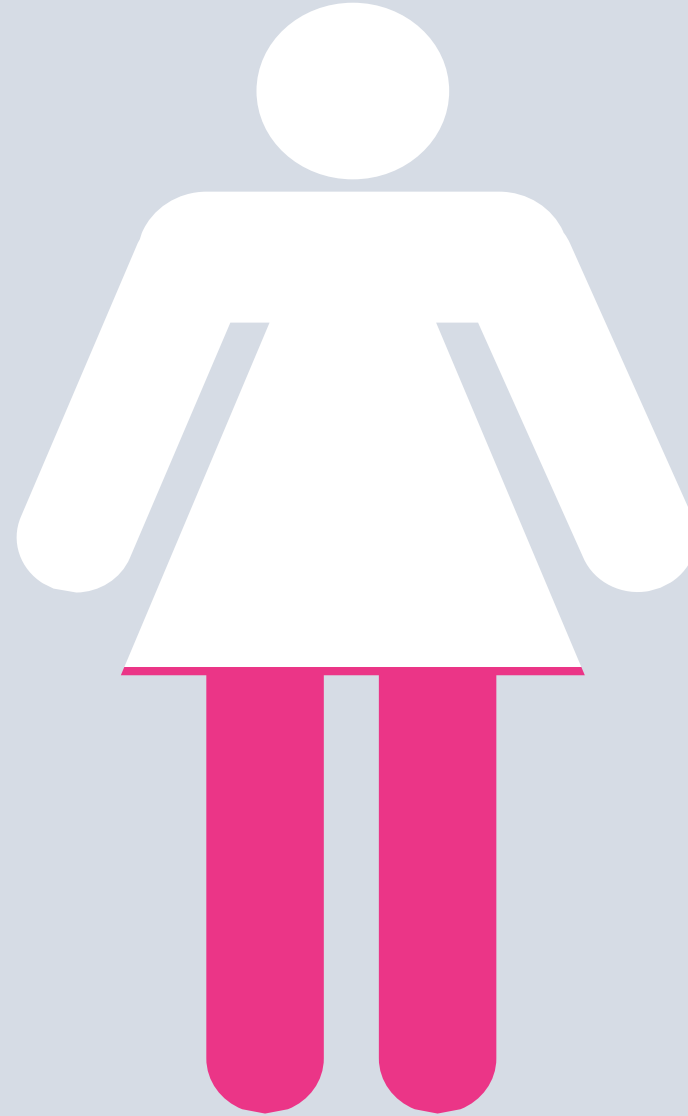


GENDER



91%
MALE

The majority of
respondents were
male (91%)



9%
FEMALE

Only 9% were female

CURRENT STATUS OF THE FINANCIAL SECTOR IN SOMALILAND

The financial sector of Somaliland contains the following
banking and non-banking institutions



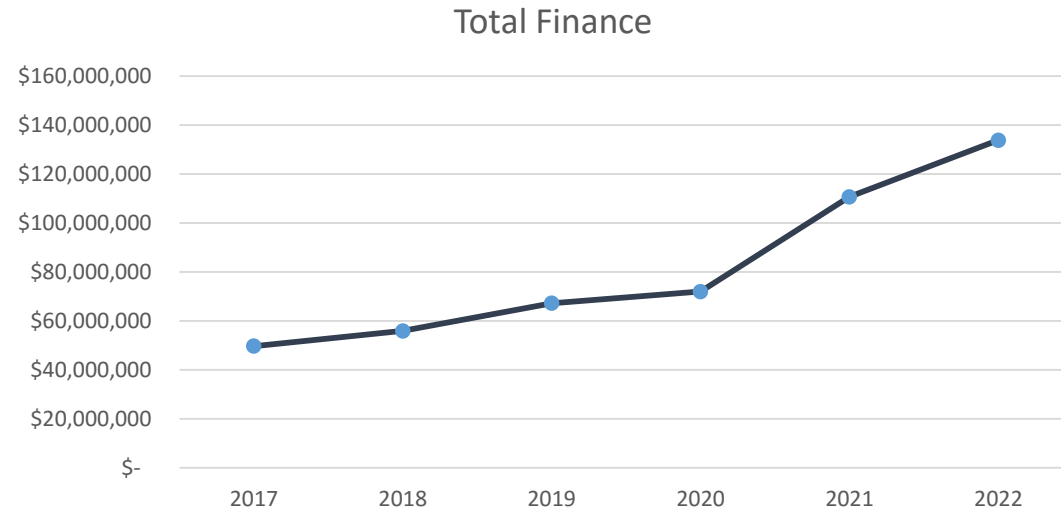
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BANKS

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**INSURANCE
FIRMS**

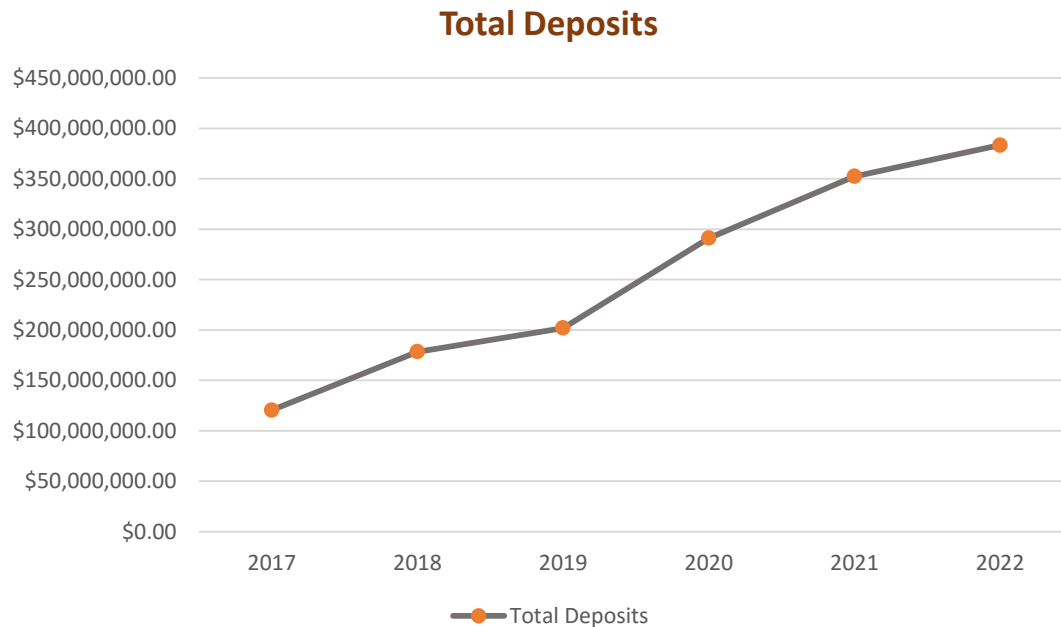
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**MICROFINANCE
INSTITUTIONS**

3
**MOBILE MONEY
SERVICE
PROVIDERS**

CURRENT STATUS OF THE FINANCIAL SECTOR IN SOMALILAND



From 2017 to 2022 the total bank loans in Somaliland changed from 49.7 million dollars to 133.8 million dollars and increased more than 169 percent.



In that period of review the total deposit of banks changed from 120 million dollars to 383 million dollars

CURRENT STATUS OF THE FINANCIAL SECTOR IN SOMALILAND

FINANCIAL PRODUCTS IN THE BANKING SECTOR

In terms of finance products, the banks offer products like

- House financing, trade financing,
- Working capital financing,
- Business financing,
- Automobile financing, and
- Project financing.

Working capital financing is the most common product that banks finance due to the economic nature of Somaliland; most economic activities in the country are trade activities as imports accounted for approximately 56% of the GDP in 2022.

Secondly, automobile finance and house financing are the second and third largest financing activities made by commercial banks in Somaliland according to research interviews held with the managers of the commercial banks.

Murabaha/Profit Rate

Somaliland's banking sector adopts a primary rate of 12%, but averagely they charge 10% per annum, and the rate decreases as number of years increase.

The study analyzed the Murabaha/Profit rate by viewing four different directions; the society, the banks, scholars and comparing the rates of neighboring countries.

- In **public perception**, Among the 68 respondents, an overwhelming majority of 60 individuals (88%) expressed the viewpoint that the bank profit rate is high.
- In **financial institutions argument**, profit rates are not high and banks did not receive great positive economic profit due to that the high costs related to the sector
- The **comparative analysis** with interest rate of neighboring countries (Kenya, Djibouti, Ethiopia, Sudan) are between 7 percent to 13%, and the rates are close to the Murabaha rate charge by Islamic commercial banks in Somaliland.

Country	Rate	Year	Source
Ethiopia	7%	2023	National Bank of Ethiopia
Djibouti	11.2%	2022	Trading Economics
Kenya	13.5%	2023	Central Bank of Kenya
Sudan	9%	2023	Institute of Developing Economies

CHALLENGES FACED BY THE BANKING SECTOR

CHALLENGES IN THE SERVICEABILITY AND SECURITY

Serviceability represents a fundamental aspect determining the borrower's ability to meet the repayment obligations based on their income, financial stability, and existing liabilities. Whereas, security pertains to the measures and collateral put in place to mitigate risks and ensure the repayment of loans.

Challenges:

- Difficulty in furnishing adequate **collateral**
- The financial products holding the potential for significant benefits and high returns are primarily intertwined with a host of challenges. For instance, in financing contracts utilizing the Mudaraba mode, a prevalent issue is **information asymmetry**
- In addition, the potential **collaboration** between banks and businesspersons through the Musharaka mode in business financing and contracts presents its own set of hurdles.
- A significant hurdle lies in the **underutilization** of Sukuk (financial certificates often termed 'sharia-compliant' bonds)
- Lenders and investors typically rely on past financial performance as a predictor of future success and risk assessment. Local businesses often rely on **traditional documentation methods**, and their financial records are either inappropriate or absent altogether.
- In the financing of international trade—the absence of the **Letter of Credit (LC)**.

CHALLENGES FACED BY THE BANKING SECTOR

LEGAL AND POLICY GAPS

List of acts or regulations that are important to financial product, but are not in place:

- **Foreclosure act (draft)** – The absence of this act means that if a bank customer does not repay a loan, the banks should sue him in court, but the banks can't sell the collateral they held against the borrower as there is no legislation for doing so
 - **Risk management regulation**
 - **Consumer protection regulation**
 - **Microfinance regulation (draft)**
-

LACK OF AWARENESS AND FINANCIAL LITERACY

- The lack of awareness and low financial literacy significantly pose formidable challenges
- Many potential customers may not fully grasp the array of financial products available, their respective benefits, risks, or how to choose the most suitable ones for their needs
- In addition, the lack of financial literacy leads to excessive risk aversion.
- The findings show a notable majority of defaulters and individuals with bad debt records lack adequate financial literacy

CHALLENGES FACED BY THE BANKING SECTOR

ECONOMIC CONDITIONS CHALLENGES

- **Low income** – A substantial segment of Somaliland's population grapples with a low income level. The limited disposable income hinders their capacity to engage with and benefit from various financial products(804 dollar per capita income).
- **Informal business** – The existence of a large number of businesses in Somaliland operating in the informal sector. These informal businesses often lack proper documentation and financial records, making it challenging for financial institutions to assess their solvency.
- **Dollarized economy** – This poses a challenge in terms of financial stability and control. The reliance on a foreign currency limits the resources to be used as financing, factors crucial for an effective and diverse financial product portfolio.
- **Low deposits** – relatively low deposits that could be sufficient in the needs of society is missing due to several factors including; shortage of hard currency, high outflow, and low production (383 million in 2022).
- **Lack of lender of last resort** – In times of financial distress or liquidity crises, having an entity that can provide emergency liquidity assistance is essential. The absence of such an institution amplifies risks and creates an environment of caution among financial institutions, potentially impeding their willingness to diversify products and services.

CHALLENGES FACED BY THE BANKING SECTOR

FINANCIAL INFRASTRUCTURE

- **Lack of credit reference bureau** – A customer can apply for a loan from all commercial banks at the same time, or a customer who is already in debt in one bank can take a loan from another bank
- **Ineffective Clearance house and settlement regulation** – was launched but yet not active
- **Missing payment system** - which is challenges faced by the financial sector to operate efficiently.

CHALLENGES IN THE FINANCIAL INCLUSION & TRUST TO BANKS

- **The lack of bank accounts and low bank saving habits** of the population mean wasted financial resources and a reduction in the lending ability of financial institutions. Although deposit levels are low, financial institutions also do not fully utilize the resources they have.
- One of the reasons that managers of the banks mentioned is that few people are in the business sector, and only those in the business sector apply for bank loans and investments.

LACK OF CAPITAL MARKET

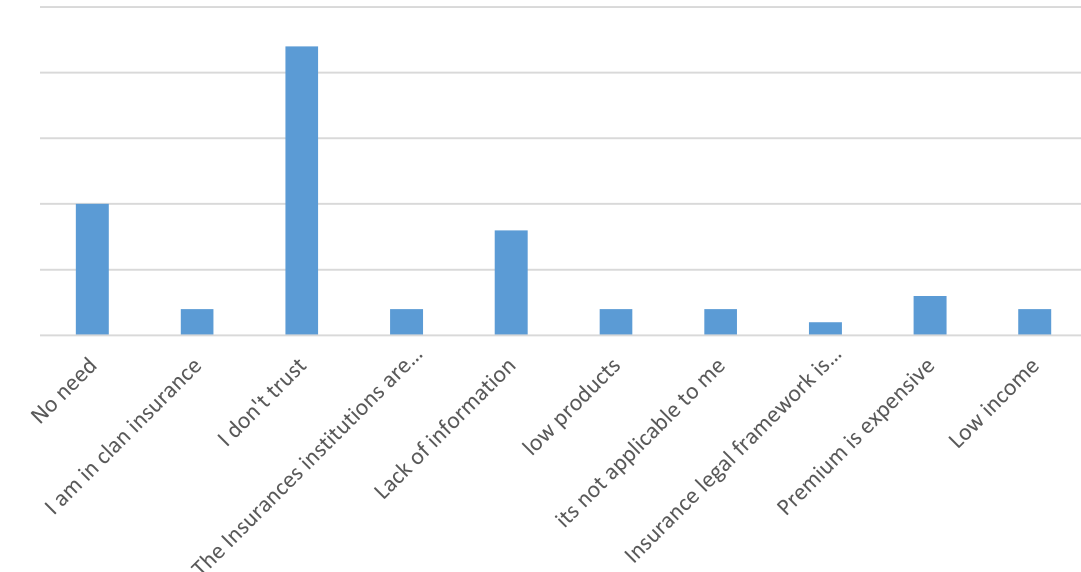
CHALLENGES FACED BY THE INSURANCE SECTOR

SOCIOCULTURAL AND RELIGIOUS FACTORS

- **Cultural factors** – In Somaliland's clan-based or tight-knit communities, individuals often rely on collective financial contributions within the community to manage risks. Only 2% of the respondents have any insurance. People trust that in times of crisis, their clan or community will support them financially, ensuring their needs are met.
- **Religious issues** – This diversity of perspectives has led to confusion among the populace, particularly concerning whether the prevalent insurance practices align with religious doctrines.

LACK OF AWARENESS, INFORMATION AND INSURANCE LITERACY

Why you don't have Insurance



- The study found the low education and awareness of society regarding insurance.
- Most of responses array the abundant lack of awareness and literacy regarding the insurance among the society

CHALLENGES FACED BY THE INSURANCE SECTOR

LEGAL AND POLICY CHALLENGES

LOW HUMAN CAPITAL

LACK OF INSURANCE EDUCATION INSTITUTIONS

OPPORTUNITIES FOR PRODUCT DIVERSIFICATION

- In the context of Somaliland, structuring asset financing products in compliance with Islamic principles is pivotal
- Another opportunity revealed by this study is the potential for advantageous trade relations with neighboring countries, particularly Ethiopia
- a notable opportunity lies in the government's proactive role in identifying safe and viable zones for investment
- The study also highlights the issue of high housing costs and expensive rents, emphasizing the potential for real estate development through low-cost housing projects.
- The responses stressed the opportunities for financing production, particularly agricultural and fishery assets
- One significant opportunity identified in the study relates to financing the manufacturing sector through Istisna in a country that lacks manufacturing factories.

SPECIALIZED PRODUCTS FOR THE POOR

- Microfinance
- Microcredit

OPPORTUNITIES FOR INSURANCE

- MICROINSURANCE
- THIRD-PARTY CAR INSURANCE
- URBANIZATION AND CHANGING LIFE STYLE

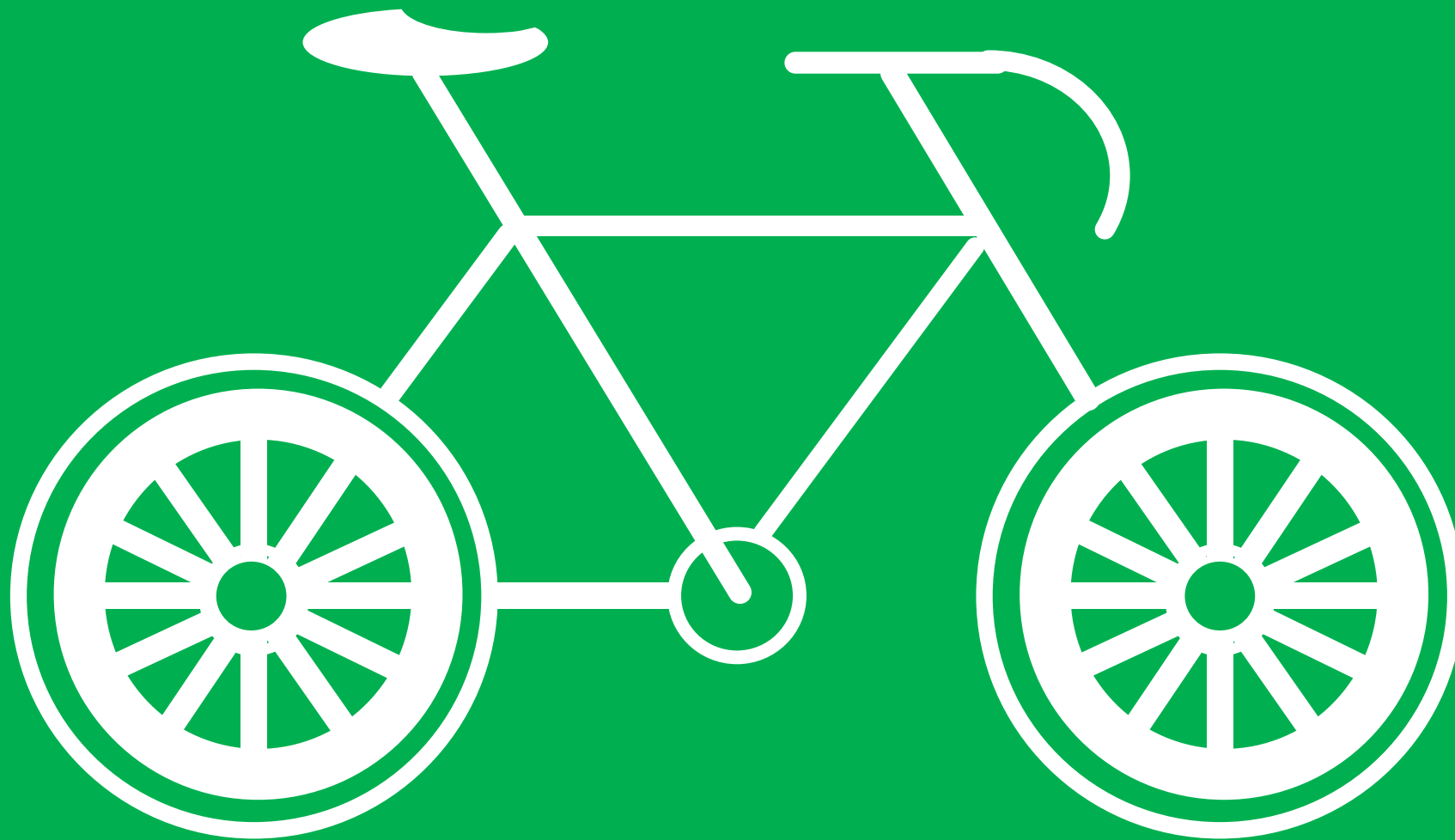
CONCLUSION

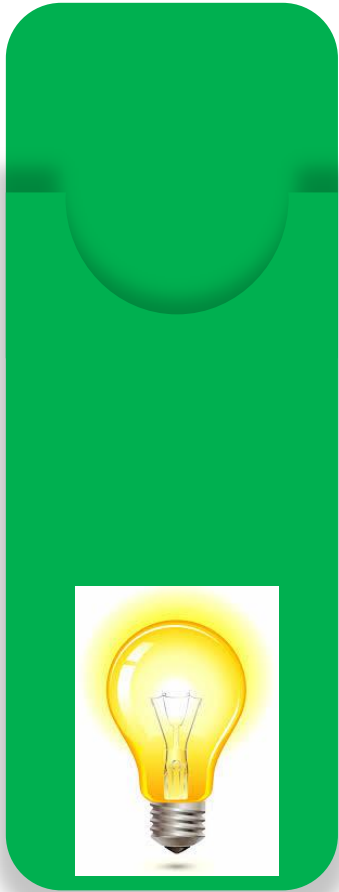
- This study has shed light on the multifaceted challenges faced by the financial sector in Somaliland. Among these challenges, serviceability and security emerge as paramount concerns.
- Furthermore, a critical challenge to financial sector development lies in the lack of awareness and low financial literacy. This hinders the demand for financial products and services, restricting the overall reach and impact of the banking sector.
- The economic conditions, characterized by a majority of informal businesses and a dollarized economy, present another tough challenge. The low-income levels and lack of a formalized economic structure hinder the growth and stability of the financial sector.
- On the other hand, the insurance sector in Somaliland faces challenges that hamper its growth and effectiveness. Among these challenges, religious and cultural factors, lack of awareness, and literacy hold significant influence.

R e c o m m e n d a t i o n s

- Regulatory bodies must play a proactive role by implementing financing profit rate caps
- The government and financial institutions should collaborate to establish innovation hubs, providing a favorable environment for new ideas and technologies.
- The government should strategically intervene in the banking sector, ensuring alignment with national development goals.
- To overcome regulatory challenges, a robust legal and regulatory framework must be established.
- Enhancing financial literacy and awareness among the public is imperative to tackle the lack of understanding within the population.
- Microfinance institutions can play a significant role in addressing the challenges of financial inclusivity.
- To bridge the infrastructure gap and overcome economic challenges, fostering public-private partnerships (PPPs) is crucial.
- Embracing technological advancements, such as fintech solutions and mobile banking, is vital to overcome challenges related to financial access.

THE END





**Thank
You**

