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FOREIGN BANK ENTRY INTO SOMALIA'S MARKET: A BLESSING OR A CURSE

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Background

This policy brief focuses on foreign banks' entry into Somalia's market. So far, the Bank of Egypt and Turkey's Ziraat Katilim have expressed interest. Both are government-owned institutions. The Federal Government of Somalia (FGS) is already on the edge of authorizing the Bank of Egypt. Still, the licensing process is not yet finished. Turkey's Ziraat Katilim Bank is still in talks with the government. It is also awaiting to be licensed. However, before delving into the issues surrounding foreign banks' entry into the country,

Abdirahman M. Abdullahi, Governor of the Central Bank of Somalia

In an interview with Bloomberg, **Abdirahman M. Abdullahi** stated,
"The 13 lenders (fully licensed banks) in the Horn of Africa nation can now become inter-operable, connected to the clearing and settlement system of the central bank and able to transact with each other. The system will facilitate transactions between vendors and their customers more efficiently."

this brief will provide an overview of the country's banking and financial sector. It is essential to mention that Somalia's financial sector has gradually transitioned from an informal to a more formalized regulatory system since the Central Bank of Somalia (CBS) in 2009. Even though Somalia has been without a central monetary authority for more than 15 years, between the start of the civil war in 1991 and the re-establishment of the Central Bank of Somalia in 2009, the country's payment system is quite advanced,

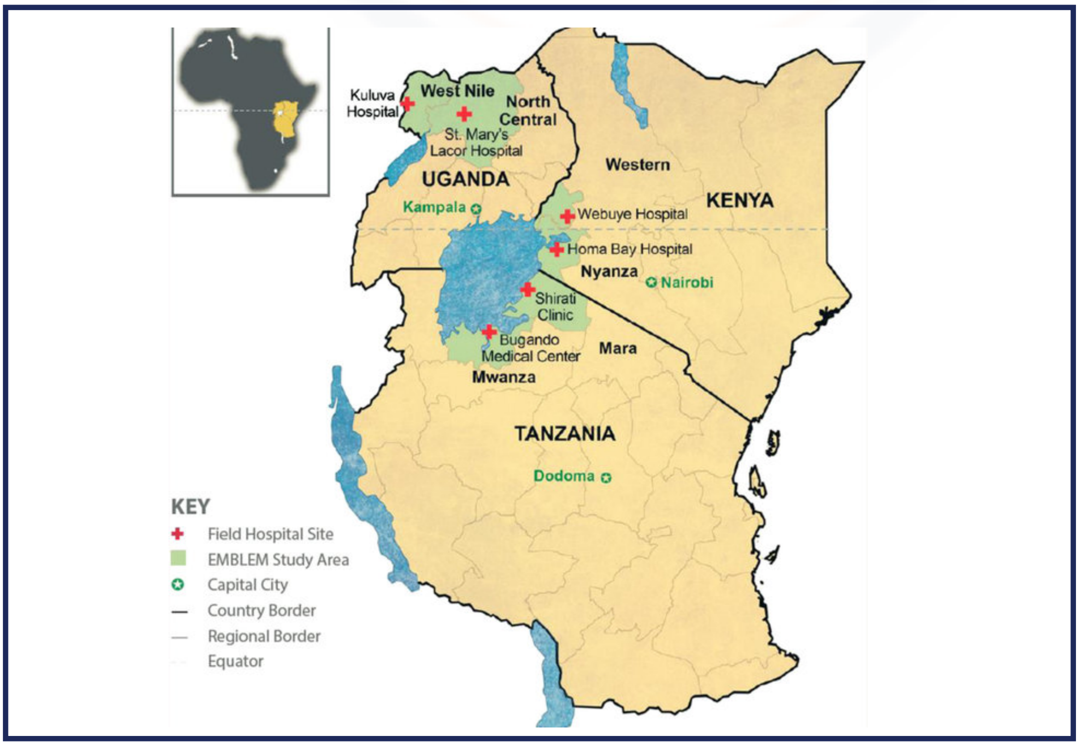
owing primarily to the widespread presence of private money transfer operators (MTOs) acting as informal banking networks. In contrast, commercial banks have now played a key role. The current financial system is comprised of a central bank, commercial banks, microfinance institutions (MFIs), money transfer companies (MTOs), and mobile phone companies are all examples of financial institutions. Mobile money services are provided by mobile network operators (MNOs).

Moreover, the country's banking and financial sector has undergone significant transformation in recent years. More many local banks are entering the market. The competitions in the industry are fierce. The banking business boom was also facilitated by the country's introduction of the national payment system as part of plans to develop and modernize the banking and financial industry by the Central Bank of Somalia (CBS).

The World Bank assists the CBS and private financial institutions in streamlining their efforts to strengthen Somalia's interbank payment, clearing, and settlement systems.

The proposed entry into the country's market of the two foreign banks mentioned above has raised more questions than answers. For instance, why would these banks want to invest in Somalia during political and electoral discontent? What vested interests do they have? How will they contribute to the country's banking and financial development in an already crowded market? What are their target market segments? What role do they intend to play in Somalia's banking and economic reforms? Will they lend loans to local small businesses or entrepreneurs? How would they make pro its? Will they employ locals?

To answer the above questions, the brief employed the desk-review methodology. The research employs documents and case studies to examine the operations of foreign banks in Kenya, Uganda, Tanzania, and South Sudan. It concentrated on these specific countries due to their geographic location (East Africa) and prior experience with foreign banks.



Sector Challenges and Emerging Trends

01

Like many other economic sectors, Somalia's banking and financial industry is confronted with enormous challenges. To begin with, the country's volatile political system had made it difficult for banks and the financial sector, in general, to develop fully. It is no secret that people do not want to invest or deposit/save with banks in such a volatile political environment. Current political and electoral quagmires have slowed the sector's steady growth. According to some analysts, political stability and an inclusive financial sector will be a viable step in leading the country out of its political dilemma.

02

Second, there are inadequate financial and investment regulatory frameworks. This has wholly stalled the modernization of the country's banking system. One could argue that the government is still rebuilding its primary governance institutions and that financial regulations will follow once that is done. In contrast, the Central Bank of Somalia (CBS) has implemented major structural reforms, such as the national payment system mentioned in the introduction to this policy brief.

03

Third, terrorist organizations such as Al-Shabaab and the Islamic State in Somalia (ISIS) pose security risks to bankers. Terrorists have assassinated many bankers in the name of Zakat/tax money. Unidentified shooters, for example, assassinated an Amal Bank Kismayo branch director in October 2020. This is just one example of the dangers that employees in the financial sector face. Security threats also jeopardize businesses and cause losses for banks.

banking industry, and market diversification is good for customers, but unregulated competition will collapse the economy. The government does not regulate the fierce competition among banks, and new entrants are neither barred nor fully registered. Yet, the entries of foreign banks will amplify those competitions. Therefore, it is unwise to accept foreign banks into the country before the domestic ones have been fully regulated and banking and financial laws have been enacted. However, not all is lost in terms of emerging trends.

The country's banking system is undergoing a renaissance due to changing financial technologies. Somalia is poised to become Africa's first cashless society. Digital payment systems now handle almost all transactions. Banks have embraced these technologies. Online, wide ranges of financial services are now available. However, the first ATM was installed in Mogadishu, Somalia, in 2014. The country has a large number of ATMs and a digital payment system. Many banks have obtained swift codes and have introduced Visa and MasterCard into the country. Further, the national payment system will aid the country's fight against counterfeiting and money laundering.

Ahmed Mohamed Yusuf, *Chairman, and CEO of Somalia's most extensive network, Hormuud Telecom, stated in an article for African Business Magazine*

"A burgeoning financial sector will create opportunities for Somalis at home and abroad. Somalia is already a world leader in mobile money use, with over 70% of the 13m population using mobile money services. The national payments system will be an unprecedented boom for the economy that has struggled in the past with widespread counterfeiting."

Policy Implications of Foreign Banks' Entry into Somalia

The financial and banking sector occupies a unique position in the economy. They serve a variety of functions in the economy. They are critical to both the financial system and the economy because they assist people in obtaining capital to fund their businesses, which helps economies grow. In the same vein, they help resolve the problem of investors and borrowers not having the same information, allowing savings to be invested. They are also important because they help smooth out risk over time and protect depositors from unexpected consumption shocks. Finally, they have a considerable influence on how businesses are run.

Foreign banks' roles in developing countries and the policy implications have been hotly debated. Many argue that foreign banks are overly assertive and that, as a result, their presence deprives the domestic banking industry of the opportunity to develop. They also noted that international banks tend to favor large, foreign-owned corporations at the expense of local businesses. Examples of foreign banks' behaviors from four East African countries—Kenya, Tanzania, South Sudan, and Uganda—showed that international banks might not result in increased competition and banking service provision if weak institutions are allowed to remain in the system.

These East African countries, particularly the Kenyan government, do not allow completely pure foreign banks' operations in the country. Locals must own shares in these banks, such as Absa (formerly Barclays) and Standard Chartered Bank. Will the same be true for Somalia? This brief assessment is that it is dubious. Kenya, unlike Somalia, is a regional economic powerhouse with a powerful central bank that regulates financial systems, particularly foreign banks. It is claimed that the two foreign banks entering the Somali market are government-owned and that no one will own shares in them. On the other hand, foreign banks in Kenya are privately held, and locals have the right to buy shares in them, and the government will compel them to have local partners.

Kenyans are the ones working in those institutions. According to some observers, foreign banks entering the country's market have higher lending rates – in Turkey, it is 16.5%, while in Somalia, it is 10%. Many financial analysts are concerned about the lending gap. Another source of concern is that Somalia's law enforcement institutions are underdeveloped. Local banks use their means to obtain the funds they lend to the public. Given the lack of law enforcement in the financial and banking industries, how will these foreign banks reclaim their funds from the crowd?

Furthermore, local banks in Somalia employ many Somalis when it comes to employment. In contrast, foreign banks are considering opening branches inside the Halane camp, and the likelihood of using locals is zero. Besides, the government will find it difficult to regulate them. They are housed in the same complex as the UN and the diplomatic community – both of which have diplomatic immunity. As a result, foreign banks do not contribute to the local economy. Their primary goals are capital flights (taking the money out of Somalia). There are no laws in Somalia that govern foreign bank entry; however, specific amounts are required for local banks to operate. Foreign banks will use the local banks' measures to serve the country.

In this case, Dahabshiil applied numerous times to operate as a foreign bank in Kenya. The Kenyan government refused it [Dahabshiil] a license due to an unspecified internal policy; however, Somalia accepted the foreign banks on the same grounds. Foreign banks wish to conduct business in Somalia similarly to local banks.

South Sudan is another country dealing with complications caused by foreign banks. The government, which has been ravaged by civil war since December 2013, is dealing with hyperinflation, a lack of dollars, poor governance, and high-level corruption. Many observers believe that foreign banks have exacerbated the country's conflict. In many ways, the country that resembles Somalia is also beleaguered by a lack of adequate regulatory laws governing foreign banks. The Central Bank of South Sudan announced on 18 August 2020 that it had depleted its foreign exchange reserves. The oil-dependent country's resources were all stolen. Foreign banks were blamed for that. These foreign banks aided the elites in the theft of public resources and their concealment in Kenya and Uganda. According to the Mail & Guardian, all dollars were distributed in South Sudan by the Qatar National Bank and CFC Stanbic [a subsidiary of South Africa's Standard Bank]. They mainly were transferred to banks in Uganda and Kenya, including Kenya Commercial Bank, Barclays Bank (now Absa), Equity Bank, and Stanbic Uganda. According to the UN report, South Sudanese politicians and bureaucrats have siphoned off at least $36 million in public funds, sometimes with the assistance of international corporations and (foreign) banks. Foreign banks are the country's primary money-laundering institutions.

The case of South Sudan is a great lesson to learn from in terms of foreign bank entry into Somalia. As in South Sudan, foreign banks can destabilize a country by destroying its economy. The Somali elites will use foreign banks to plunder the country’s resources. As in South Sudan, an unregulated financial sector will have disastrous consequences. Somalia should not gamble with the idea of foreign banks entering the country unless the country’s central bank is thoroughly reformed. It is a roll of the dice. It is a considerable risk. If the government does not want to follow South Sudan’s example, it should reconsider issuing licenses to foreign banks. Finally, the four case studies show that foreign banks do not affect the effectiveness of domestic lending or the performance of local banks. Even though except for South Sudan, three of these countries have robust governance systems instead of Somalia. The question is whether the two foreign banks interested in entering Somalia’s market are motivated by the right reasons. Taking advantage of a shaky governance system is a bad business strategy.

Conclusion and Recommendations

This policy brief provided more information about foreign banks' operations in Somalia. It also provided an overview of the country's financial and banking industries. It is encouraging to see Somalia's financial system mature as more commercial banks enter the market. It is worth noting that Somalia is not yet ready for foreign banks. The examples of four East African countries have demonstrated that foreign banks' entry into the country requires a robust political and governance framework. Despite having stable governments, these countries, apart from South Sudan, continue to have problems with foreign banks. The case of South Sudan is terrifying. The foreign banks destroyed its economy and allowed its elites to loot public resources. In addition, the presence of these foreign banks has little impact on the country's banking and financial systems. They contribute more to capital flights than they do to bring in more cash. These banks do not offer any unique services; all of them are similar to those provided by domestic banks. Before granting licenses to foreign banks, Somalia's Federal Government should think long and hard about creating a stable and viable economic environment.

Foreign Banks entry into somalia

This brief recommends the following:

1. Foreign banks should not be licensed at this critical juncture when the country faces political uncertainty. Any agreements will raise eyebrows, and many questions will arise as to why permitted the foreign banks at this time. They are many domestic banks that need licenses, too.
2. The Federal Government of Somalia (FGS) and the Central Bank of Somalia (CBS) must continue strengthening and modernizing the local financial and banking sector instead of bringing in the new foreign banks that will bring in more economic and regulatory problems.
3. The country should create strong competition regulatory policies. More domestic banks and micro-finance institutions are constantly entering the market, and foreign banks will exacerbate competition.
4. The government should investigate these foreign banks interested in investing in Somalia. What were their performances in their own countries? What have been their track records in other countries?
5. The country should conduct a thorough investigation of the impact and effectiveness of foreign banks in East African countries such as Kenya, Tanzania, South Sudan, and Uganda. This will aid the government in implementing a calculated policy to that end

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