



National Economic Council of Somalia

Access to finance and financial inclusion in Somalia

Final Report

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Acronyms

AML/CFT	Anti-money Laundering and Combating the Financing of Terrorism
ATT	Average Treatment on the Treated
ATU	Average Treatment on Untreated
BRA	Benadir Regional Administration
CBS	Central Bank of Somalia
CLA	Cluster Level Association
DFIs	Development Finance Institutions
DRC	Danish Refugee Council
ESR	Endogenous Switching Regression
FCs	Financial Co-operatives
FDI	Foreign Direct Investment
FGS	Federal Government of Somalia
FI	Financial Inclusion
Fintech	Financial Technology
FMS	Federal Member States
FSPs	Financial Service Providers
GDP	Gross Domestic Product
GETS	Growth and Economic Transformation Strategy
IDP	Internally Displaced People
KIIs	Key Informant Interviews
LOC	Letter of Credit
LSD	Licensing and Supervision Department
MDGs	Millennium Development Goals
MFIs	Microfinance Institutions
MIGA	Multilateral Investment Guarantee agency
MMO	Mobile Money Operator
MSMEs	Micro, Small, and Medium Enterprises
MTO	Money Transfer Operators
NBFIs	Nonbanking Financial Institutions
NEC	National Economic Council of Somalia
NRC	Norwegian Refugee Council
ODA	Official Development Assistance
PCA	Principal Component Analysis
PFM	Public Financial Management
PSM	Propensity Score Matching
RCT	Randomized Control Trial
SDGs	Sustainable Development Goals
SDRB	Somali Development and Reconstruction Bank
SHG	Self Help Groups
SMEs	Small and Medium Enterprises
SSA	Sub-Saharan Africa
UNFPA	United Nations Population Fund
UNIDO	United Nations Industrial Development Organization
VSLA	Village Savings and Loan Association
WBES	World Bank Enterprise Survey
WBHFS	World Bank High Frequency Survey

Executive Summary

The role of access to finance has been the focus of increased attention both by development actors and researchers in recent years. Several theoretical and empirical studies have shown that access to finance promotes economic growth at the national and improves productivity at industry and firm levels (Demirgüç-Kunt & Singer, 2018). It has also been shown to be associated with poverty alleviation and empowerment of marginalized groups, including but not limited to women (Ghosh & Vinod, 2017). Recognizing its importance, development actors and policymakers have taken action. As a result, access to finance features in at least 5 of the 17 Sustainable Development Goals (SDGs) established by the United Nations for 2030. Despite the importance given, the focus of various literature in the finance and development space has been on developed countries and macroeconomic variables. It is against this framework that this study attempts to uncover a comprehensive analysis of the status of access to finance and financial inclusion, the impacts of financial inclusion on women's empowerment, and the underlying barrier to access to finance in Somalia. The study consists of eight chapters as follows: Introduction, methodology, an overview of the economy, financial sector development, finance to businesses, financial inclusion, legal and supervisory framework, and recommendations and road map.

Following the introduction, chapter two covers the study's methodology, which employed a cross-sectional design with a mixed research approach in which both quantitative and qualitative data collection approaches were employed to gather relevant information. The quantitative data were collected from secondary sources using document review and analysis from different available sources, while the qualitative data were collected using Key Informant Interviews (KIIs) from purposefully selected key informants.

Chapter three provides an overview of the status of Somalia's economy and the financial sector. According to the National Bureau of Statistics, Somalia's nominal Gross Domestic Product (GDP) in 2020 was USD 7 billion, and the GDP per capita was USD 471. Over the past decade, the average growth of Somalia's GDP has been two percent. The agriculture sector has dominated employment and forex generation in Somalia. It accounts for more than half of GDP, 80 percent of export earnings, and an estimated 65 percent of the country's labor force. Pastoralists who depend on livestock for their livelihood make up a large part of the population. The informal sector largely dominates Somalia's economy, and it has been adversely affected by a scarce financial sector.

The fourth chapter explores the financial sector development in Somalia. The two decades (1991-2011) of conflict and endemic insecurity devastated core government institutions and led to a complete collapse of the nation's financial system. However, with relative stability in the past decade, the country has attained modest economic recovery and financial system revival. At the beginning of 2022, the formal financial industry consisted of the central bank, 13 banks with provisional licenses, ten licensed money transfer operator (MTOs), and two licensed Mobile money service providers. Unlike other countries, the Somali financial sector is dominated by MTO and Mobile money networks. The penetration of commercial banking is minimal, with only 15 percent of the population have a bank

account and fewer than 5 percent of people with bank accounts are active users. All private banks in Somalia adhere to sharia-compliant financial services, including Murabaha, Musharakah, Mudarabah, Istisna, and Ijarah. One of the encouraging developments in the financial sector towards inclusiveness was the expansion of Micro Finance Institutions (MFIs). The largest MFIs include GARGAARA, KIMS, MicroDahab, and Kaaba. Currently, the country has six registered insurance service providers in line with Islamic insurance principles (Takaful). These insurance companies provide health, travel, property, motor vehicles, transit goods, life, and marine insurance. The main challenge of the financial sector in Somalia includes Inadequate financial management structure, scarcity of qualified personnel, insufficient legal framework, and absence of capital markets, among others.

The Fifth chapter examines financial access for businesses. The study findings indicate that access to finance is the second most reported obstacle for firms in Somalia. Since many firms in Somalia do not have a line of credit with formal financial intuitions, the majority rely on internal funds. Excessive reliance on internal funds is an indication that financial intermediation is inadequate and inefficient. The study's findings also showed that mobile money is the most popular tool for financial transactions in Somalia. About 99% of firms in Somalia use mobile money for transactions. The primary purpose of using mobile is to receive payments from customers (94.4%), followed by to save money (91.4%) and pay suppliers (84.4%). Although the financial sector has broadened its outreach in recent years in Somalia, significant challenges still persist; such as (i) firms having little interest for a loan; (ii) collateral requirements, (iii) high bank service charge rate; (i) complexity of the loan procedure; and (v) religious reasons.

The sixth chapter examines the causal impact of access to mobile money on women's empowerment using a composite index for measuring women's empowerment by combining various dimensions such as mobility, political and legal awareness, relative freedom, involvement in significant decisions, economic security, and participation in community and politics. The results of the empirical exercise show that access to finance has a positive and significant impact on women's empowerment; hence, increasing women's access to formal financial institutions, including mobile money, can improve the empowerment of women in Somalia.

The seventh chapter reviews the legal, regulatory, and supervisory framework related to access to finance in Somalia. Somalia's financial sector has introduced limited financial services to the Somali people because of challenging circumstances. This chapter also covers Somalia's legal system, which derives from Italian and British law, customary dispute resolution (xeer) principles, and Islamic law and how they affect the commercial dispute cases. For example, according to World Bank doing business project data in 2019, the average duration of resolved commercial cases in Somalia was 575 days, higher than most East African countries except Sudan.

The final chapter covers the findings and recommendations of the study, and the following points are drawn from the findings of the study as recommendations:

- The findings of the study suggest there needs promoting growth and macroeconomic stability. This is a necessary condition for financial development, improved access to finance for individuals and firms, and financial inclusion for vulnerable populations.

- Financial institutions have reported a lack of centralized data on credit risks as a significant impediment to credit providers and other financial transactions. This has also contributed to higher borrowing costs and higher collateral requirements for some borrowers—notably small enterprises. Therefore, it is recommended to establish a centralized credit bureau and develop the related infrastructure.
- The lack of a comprehensive financial inclusion strategy is one of the major obstacles for marginalized groups to getting access to finance. Therefore, there is a need to promote financial inclusion in the policy discourse.
- Given the lack of long-term funding sources in the banking sector, encouraging the entry of [specialized and development finance institutions and increasing completion through foreign banks entry] would bring longer-term and sustainable funding sources. Thus, the Central Bank of Somalia should consider enabling specialized and foreign banks entry into Somalia.
- Since Small and Medium Enterprises (SMEs) find accessing finance more difficult than larger firms, it is highly recommended to introduce a medium-term strategy for SMEs' development and reduce their financing gap. This may include incentivizing financial institutions that provide loans to SMEs.
- It is also recommended that the government support non-bank financial institutions (NBFIs) and the formal licensing and establishment of MFIs by enacting microfinance legislation or covering them through the financial institution's Act, and improvement in the coverage of existing microfinance institutions would improve the most vulnerable people's living conditions and contribute to the country's economic recovery.
- The finding on the determinants of women's access to finance indicates that risk preference and knowledge are significant predictors of women's access to finance; thus, financial literacy and formal education can improve awareness and women's access to finance.

1. Chapter One: Introduction

1.1. Background and Context

Somalia has made measurable progress toward rebuilding its economy since 2012. It was estimated that the country achieved modest annual economic growth of about 3.3% from 2011 to 2019 (SNBS, 2021). Despite this progress, significant challenges still remain. The country has been confronted with weak institutional capacity, fragile security, and complex politics, which have constrained economic recovery and reconstruction. As a result of this, not only that the country not met the Millennium Development Goals (MDG), but the level of absolute poverty in 2020 was higher than in Sub-Saharan Africa (SSA) (70% vs. 51 %) (World Bank, 2020).

Cognizant of the multidimensional problems the country has faced and the need to accelerate and enhance sustainable development, the National Economic Council of Somalia (NEC) unveiled the Growth and Economic Transformation Strategy (GETS) recently. The key pillars of GETS' vision are long-term reconstruction, recovery, and sustainable development that derive from a comprehensive understanding of the current baseline of the national economy and analysis of the country's development challenges and opportunities. One of the main challenges identified by GETS is access to finance and financial inclusion. Several studies have shown that access to finance promotes national economic growth and improves productivity at industry and firm levels.¹ It has also been associated with poverty alleviation because it allows individuals to build assets, increase asset security, and reduce their vulnerability to income fluctuations. As a result, access to finance features in at least 5 of the 17 Sustainable Development Goals (SDGs) set by the United Nations for 2030.

Somalia's financial system is currently dominated by Money Transfer Operators (MTO), and mobile money is the most popular tool for financial transactions within the country. Three-quarters of the population use mobile money transfers, compared to 15% (and just 7 percent of women) who possess bank accounts for their financial transactions (UNIDO, 2020)². The financial sector is gradually developing from an informal structure to a more formalized financial system with the reestablishment of the Central Bank of Somalia (CBS) in 2009, albeit the capacity of CBS is minimal.³ A sound and efficient financial system is vital for achieving broad-based economic growth and socio-economic objectives, including ensuring macroeconomic stability, mobilizing savings, allocating

¹ Levine, R. (1997). Financial development and economic growth: views and agenda. *Journal of economic literature*, 35(2), 688-726.

- Butler, A. W., & Cornaggia, J. (2011). Does access to external finance improve productivity? Evidence from a natural experiment. *Journal of Financial Economics*, 99(1), 184-203.
- Giang, M. H., Trung, B. H., Yoshida, Y., Xuan, T. D., & Que, M. T. (2019). The causal effect of access to finance on productivity of small and medium enterprises in Vietnam. *Sustainability*, 11(19), 5451.

² UNIDO_MoCI Report Financial Sector_final draft

³ From the outbreak of the civil war in 1991 till 2009, Somalia had no central monetary authority to govern the monetary and financial institutions. Despite this, the financial sector was relatively advanced due to the widespread existence of private money transfer operators (MTO) that have acted as informal banking networks.

resources for productive purposes, promoting private sector development, generating employment opportunities, and reducing poverty. Access to the financial system is essential for generating opportunities for households to be included in the benefits of the market. Families receive credit from financial institutions to finance investments or spending needs, whose timing may not coincide with the current income and expenses. The financial system offers services relevant to investment projects that may negatively affect the return and family well-being and allow for a place to store money.

Somalia has yet to develop an adequate financial infrastructure or strengthen laws pertaining to accounting, insurance, bankruptcy, commercial credit, etc. It should be noted that the ability to enforce legal rights in courts can impact the financial institutions' decisions and, thus, the firms' and/or individuals' access to credit. For instance, it will be easier for banks to lend and recover loans in countries with strong law enforcement systems. In the case of Somalia, limited capacity to enforce the rule of law prevents the development of formal, contract-based credit culture and has thus been a primary impediment to private sector development. One of the other reasons for the low level of financial development in Somalia might be the lack of common accounting and auditing standards. Only a handful of companies produce financial statements, and the great majority of them use different standards.

SMEs' vital role in developing economies is well documented in the literature⁴ as they generate growth, employment, and significant export earnings in many developing countries. SMEs' development is considered a key instrument in poverty reduction efforts.⁵ The development of this sector in Somalia is constrained by several factors, including a lack of access to finance. Therefore, it is essential for the authorities to create a conducive environment to strengthen SMEs' capacity to increase their access to finance.

Undertaking a comprehensive analysis of the status of access to finance and financial inclusion and assessing the potential impediments of access to finance is found critically important. It is with this intention that this study is conducted.

1.2. Objectives of the Study

The major objective of the study is to provide a comprehensive analysis of the state of access to finance and financial inclusion, the impacts of financial inclusion on women's empowerment, and the underlying barriers to access to finance in Somalia. Furthermore, the study identifies and prioritizes

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- ⁴ Liedholm, C. E., & Mead, D. C. (2013). *Small enterprises and economic development: the dynamics of micro and small enterprises*. Routledge.
 - Green, C. J., Kirkpatrick, C. H., & Murinde, V. (2006). Finance for small enterprise growth and poverty reduction in developing countries. *Journal of International Development: The Journal of the Development Studies Association*, 18(7), 1017-1030.
 - ⁵ <https://www.oecd.org/cfe/smes/31919278.pdf>

future interventions for more inclusive access to finance. More specifically, the objectives of the study include:

- To analyze the status of the financial sector development in Somalia using relevant available data;
- To explore the state of access to finance for business and the underlying barriers at different levels;
- To examine the state of access to finance and financial inclusion for households and the underlying causes of financial exclusion;
- To come up with specific policy inputs and recommendations for addressing present and future challenges for the Somali's improved well-being and poverty reduction.

1.3. Scope of the Study

The scope of the study is delimited to FGS Somalia and its Federal Member States. The study covers key dimensions of access to finance and financial inclusion, such as an overview of the financial sector and the legal and regulatory framework related to access to finance. The study also mainly focuses on the delivery of outcomes related to the specific objectives mentioned above.

1.4. Organization of the Report

This study report is divided into eight sections, including this introductory section. Section two presents the study's methodological approach, while Section three covers an overview of Somalia's economy and its financial sector. Section four presents the financial development, and section five describes firms' access to finance with a specific focus on SMEs. Following this, section six discusses the findings related to financial inclusion and the causal impact of financial inclusion on women's empowerment. Section seven presents laws and regulations related to finance, and finally, Section eight concludes the report and provides recommendations.

2. Chapter Two: Methodology

This section briefly presents the overall methodological approaches used to address the study's main objectives. It describes the data sources, study design, sampling strategy, method of data collection, as well as the method of data analysis.

2.1. Study setting and design

The study broadly applied a cross-sectional study design using both qualitative and quantitative approaches.

2.2. Quantitative and qualitative data

Quantitative data were collected from secondary sources. Document review and analysis were used to gather all relevant secondary data from different available sources. These data include 1) World Bank Enterprise Survey; 2) World Bank High-Frequency Survey Wave 2; and 3) existing literature and data from Somali Central Bank, IMF, World Bank, and other organizations.

Qualitative data were also collected using KIIs to triangulate the quantitative data collected through secondary sources and fill in the information gap that quantitative data couldn't capture. Key informants were purposively selected from financial institutions, private sectors, and government officials (The number of KIIs conducted with different stakeholders at different levels is summarized and presented in the Annexes section).

2.2 Data Analysis and presentation

Desk review and critical review of secondary documents were summarized using narrative synthesis to get relevant information. Thematic content analysis was used to arrange the bulk qualitative data and notes from KIIs. The collected qualitative data were transcribed verbatim to local languages and translated to English by experienced language experts. The translated transcript was imported into ATLAS.ti version 7.5.7 for coding and thematic arrangement. The codebook was data-driven after evaluating the objectives and core components of the assignment. Finally, the concept was narrated to answer assessment questions that triangulate the finding of the secondary desk review.

2.3 Limitation of the study

Although this study makes several noteworthy contributions, several limitations need to be acknowledged. First, the study is constrained by the unavailability of data. Only secondary quantitative data was used in the present study because of cost and time considerations. Using primary quantitative data to measure finance access and other correlations if financial resources and time allow would have been better. Therefore, the direction of future studies in this realm is to use primary quantitative data to provide a clearer picture of financial sector development, access, and its impact on the economy.

3. Chapter Three: Overview of the Economy

3.1. Introduction

The World Bank's 2014 Global Financial Development Report found that financial inclusion—typically defined as the proportion of individuals and firms that use financial services (see Box 1 for definitions of terms)⁶—is essential for development and poverty reduction and that the poor stand to benefit considerably from the use of actual payments, savings, and insurance services. Numerous research suggests strong positive linkages between financial sector depth, access to financial services, and economic development outcomes.⁷ Similarly, for firms, including small and newly established enterprises, access to financial services is associated with more robust innovation, job creation, and growth performance.⁸ In this context, policies that promote financial inclusion are increasingly recognized as crucial pillars of effective strategies to accelerate inclusive economic development.

Access to financial services, both for individuals and businesses, is considered the essential building block for achieving the 2030 SDGs and is identified as a critical enabler for achieving SDGs. Related issues are featured as targets in 8 of the 17 goals. These include SDG 1 on eradicating poverty; SDG 2 on ending hunger, achieving food security, and promoting sustainable agriculture; (see Box 2).⁹ Additionally, in SDG 17, on strengthening the means of implementation, there is an implicit role for greater financial inclusion through improved savings mobilization for investment and consumption that can ultimately accelerate growth.

⁶ Financial services can include any form of transaction, payment, savings, credit, or insurance.

⁷ Levine, R. (1997). Financial development and economic growth: views and agenda. *Journal of economic literature*, 35(2), 688-726.

Arora, R. U. (2014). Access to finance: an empirical analysis. *The European Journal of Development Research*, 26(5), 798-814.

⁸ Liedholm, C. E., & Mead, D. C. (2013). *Small enterprises and economic development: the dynamics of micro and small enterprises*. Routledge. // Green, C. J., Kirkpatrick, C. H., & Murinde, V. (2006). Finance for small enterprise growth and poverty reduction in developing countries. *Journal of International Development: The Journal of the Development Studies Association*, 18(7), 1017-1030.

⁹ For additional information visit this link: <http://www.uncdf.org/financial-inclusion-and-the-sdgs>

Box 1. UN Sustainable Development Goals

Box 2. United Nations Sustainable Development Goals



The SDGs were developed as a successor initiative to the Millennium Development Goals (MDGs). The SDGs focus on 169 targets linked to the 17 high-level goals. Each target has between one and three indicators designed to measure progress toward reaching the targets. In total, 304 indicators measure compliance. Some of the 17 SDGs listed below are directly linked to financial inclusion. To discuss the specific targets related to each goal that link to financial inclusion, refer to the United Nations Sustainable Development Knowledge.

1 NO POVERTY	END POVERTY IN ALL ITS FORMS EVERYWHERE	2 ZERO HUNGER	END HUNGER, ACHIEVE FOOD SECURITY AND IMPROVED NUTRITION AND PROMOTE SUSTAINABLE AGRICULTURE
3 GOOD HEALTH AND WELL-BEING	ENSURE HEALTHY LIVES AND PROMOTE WELL-BEING FOR ALL AT ALL AGES	5 GENDER EQUALITY	ACHIEVE GENDER EQUALITY AND EMPOWER ALL WOMEN AND GIRLS
8 DECENT WORK AND ECONOMIC GROWTH	PROMOTE SUSTAINED, INCLUSIVE AND SUSTAINABLE ECONOMIC GROWTH, FULL AND PRODUCTIVE EMPLOYMENT AND DECENT WORK FOR ALL	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	BUILD RESILIENT INFRASTRUCTURE, PROMOTE INCLUSIVE AND SUSTAINABLE INDUSTRIALIZATION AND FOSTER INNOVATION
10 REDUCED INEQUALITIES	REDUCE INEQUALITY WITHIN AND AMONG COUNTRIES	17 PARTNERSHIPS FOR THE GOALS	STRENGTHEN THE MEANS OF IMPLEMENTATION AND REVITALIZE THE GLOBAL PARTNERSHIP FOR SUSTAINABLE DEVELOPMENT

3.2. Economic Context

The GDP of Somalia was \$6.4 billion USD (current price) in 2019 and reached \$6.9 billion in 2020, with a GDP per capita of \$ 471 (NBS, 2021). Through its informal economy, Somalia has maintained modest economic activities thanks to livestock trading, remittances and money transfer companies, and telecommunications. The common feature in the structure of the economy of Somalia is the predominance of agriculture and livestock in the economy. Somalia, on average, recorded 3.3% GDP growth per annum over the past decade and currently has the lowest GDP per capita in the Horn of Africa. Prevalent insecurity and political instability have led to slow GDP growth in Somalia, which has constrained income per capita improvements.

Somalia's economy shrunk by an estimated 0.3 percent in 2020, primarily driven by the simultaneous challenges of COVID-19, erratic weather patterns, and locust infestation. This contraction was considerably less severe than anticipated at the onset of the pandemic due primarily to augmented developmental assistance, fiscal policy measures effected by the government to contain the effect on the private sector and dampen the risk of price rises of critical foodstuffs, and the extension of substantial social protection measures to provide much needed social assistance to the most vulnerable segments of the population (Ministry of Finance 2021)

Agriculture is the most critical sector, along with livestock, accounting for more than half of both GDP and export earnings and employing around 65% of the labor force. Pastoralists who depend on livestock for their livelihood make up a large part of the population. Live animals, crops & vegetable oil, and animal skins products are the most exported goods from Somalia. In contrast, the primary imported goods are food, cars, spare parts, construction materials, clothes and footwear, Khat, medical products, and Oil.

The economy of Somalia has experienced some structural change, but, like many other low-income countries, this transformation is mainly between subsistence agriculture and low-end services. Based on the processing of agricultural products, the industrial sector has been dramatically affected by the conflict in the Somali state, and many factories have been destroyed. The services sector is experiencing positive growth, including Telecommunications services, which offer the lowest rates for international calls on the African continent. Although the formal banking sector is limited, money transfer operators (MTOs) are spread across the country and handle up to \$1.4 billion annually in remittances.¹⁰ According to CBS, aggregate imports of goods were US\$5,818 million in 2020, while exports were only US 1,178 million in the same year.

The informal sector largely dominates Somalia's economy, and it has been adversely affected by inadequate financial services and, in particular low access to credit and other financial instruments. Modest growth has been generated by private sector activity that has stimulated growth in livestock and agricultural industries and the remittance and telecommunications sectors. With the collapse of the central government, the private sector has demonstrated resilience and vitality in the absence of regulations.

The fiscal profile of the FGS Somalia has remained fragile for many decades, and government revenue and expenditure as a percent of GDP have increased at modest rates since 2018, reflecting efforts by the government to improve its public financial management and public administration. However, the simultaneous impact of COVID-19, locust swarms, and erratic weather patterns contributed to a major decline in the exports, worsening the current account balance and leaving an increasing trade deficit that is not expected to return to 2019 levels until 2023. (Ministry of Finance, 2021)

¹⁰https://www.iom.int/sites/g/files/tmzbd1486/files/press_release/file/covid19_and_the_state_of_remittance_flow_to_somalia_-_iom_somalia_august_2020.pdf

Box 2. Somalia Economic Context



Sources: Somalia National Bureau of Statistics

4. Chapter Four: Financial Sector Development in Somalia

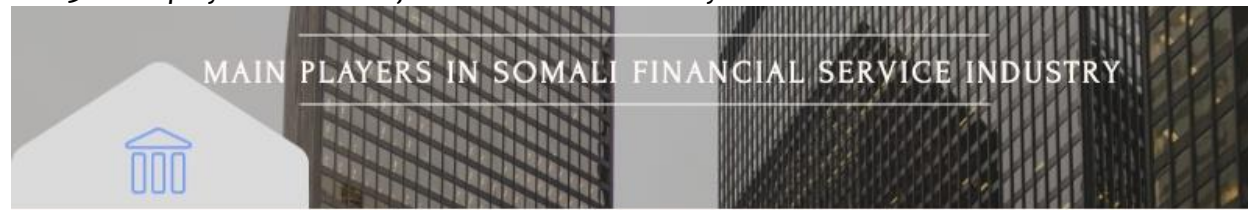
The financial sector in Somalia is in its early stage of development. The country is emerging from a lengthy civil war and insecurity that has devastated core government institutions, including the commercial banks and the Central Bank of Somalia (CBS), for many years. This collapse of the formal financial system is being gradually reversed with several financial institutions such as commercial banks currently becoming relatively active in the economy. These financial institutions are expected to provide various financial products and services by mobilizing financial resources and channeling them to productive investments¹¹.



Substantial improvement has been made over the past decade. This includes improvement in licensing and supervision of the financial sector. In addition, lending to the private sector has been growing rapidly, albeit from a narrow base, since the beginning of the recovery.

The Central Bank of Somalia (CBS) has improved its capacity to license and supervise the financial sector. The bank is working with international partners to promote financial development, inclusion, and stability in the country. At the beginning of 2022, the formal financial industry consisted of the Central Bank, 13 commercial banks with provisional licenses, ten licensed money transfer firms, and two Licensed Mobile money service providers.

¹¹ - Somalia Vision for Private Sector Development Report, NEC Working Paper No.5 December 2019. P. 23

Box 3. Main player in Somalia financial Service Industry



CATEGORY	DESCRIPTION	KEY ACTORS
 COMMERCIAL BANKS	<p>Commercial Banks accept deposits and give short-term and medium-term loans for consumption and investment for profit. They provide a variety of financial products and services. Currently, 11 licensed and operational private banks exist in Somalia.</p>	<p>Salaam Somali Bank, Dahabshil Bank, International, Amal Bank, Premier Bank, IBS, etc</p>
 MICROFINANCE INSTITUTIONS	<p>MFIs are financial companies and organizations that provide small loans to individuals and small businesses that do not have access to traditional banking and related services. Some commercial banks also offer microfinance services. However, there is no specific regulation currently supporting these institutions in Somalia</p>	<p>GARGAARA, MicroDahab, K-MFI, KIMS, MMIC, MAAL, HMFI, Raas, Bushra.</p>
 FINANCIAL CO-OPERATIVES	<p>FCs are owned and operated by their members. They are necessary financial services providers to poor and middle-income people, including those who live in rural areas. Thus, FCs are significant drivers of financial inclusion. In Somalia, the FCs sector is at a primitive stage. The existing types include Self Help Groups (SHG), saving groups such as VSLA, and traditional saving mechanisms known as Ayuto or Hagbad as a form of pooling money or resources together.</p>	<p>Dadihiso CLA, Somaliland Association of Self Help Groups, Danwadaag CLA, Daruruo CLA.</p>
 NON-GOVERNMENTAL ORGANIZATIONS	<p>International and local N.G.Os are significant players in the financial service sector in Somalia. They link the poor with financial services and provide direct grants or credit to the poor. They support other microfinance and commercial institutions to facilitate access to finance for poor and low-income households and create employment opportunities for youth and women.</p>	<p>Sa'id foundation, Shuraako, Shaqodoon, Dalbile youth Fund (UNFPA), Concern, World Vision, DRC, and NRC.</p>

Sources: Concern-Worldwide-Somalia-Mapping-Financial-Services-Report-May-2020.pdf (concernusa.org)

4.1. Banking Sector

Although banks are the most significant financial providers in a stable and healthy economy, the banking sector in Somalia is in its infancy. The population with a bank account is only about 15 percent, and fewer than 5 percent of people with bank accounts are active users¹². Despite this, the public's confidence in formal banking institutions is increasing. For instance, the bank deposits continue to grow, reaching \$650 million in March 2021, compared to US\$350 million recorded in the first quarter of 2019.

In this regard, the number of registered and operating commercial banks has also doubled in the past couple of years, reaching eleven banks. Two other new banks are licensed but not yet operational¹³. However, the participation of the formal banking system in the country's GDP is still small.

Loans to asset finance (credit to the private sector) decreased by 10% percent, to USD 586.4 Million in 2020, from USD 650.3 Million in 2019. COVID-19 may impact the significant contraction in the loan demand for the private sector. The sectoral distribution of loans for 2020 and 2021 is highlighted in the chart below.

Figure 1 Economic Sector

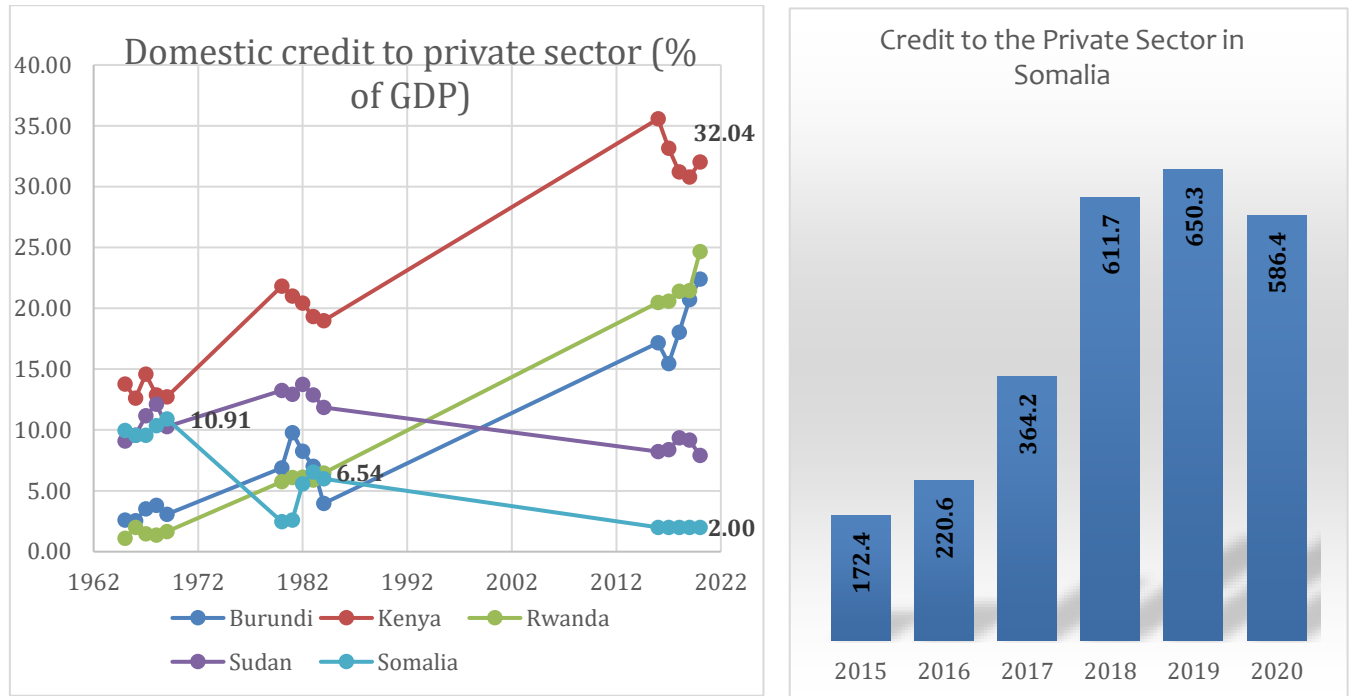


¹² - Somalia financial sector technical report, UNIDO, Mogadishu, January 2020. p. 5

¹³ - <https://centralbank.gov.so/licensed-banks>

Bank credit to the private sector (asset finance) in Somalia is defined as the credit extended by the banking institutions to the private sector only: both firms and households. It does not include lending to the government. Countries in East Africa have varied levels of financial sector development. However, all countries except Somalia share a common feature: they have bank-led financial sectors.

Figure 2: Domestic credit to the private sector



Source: CBS, 2021

The relative importance of the banking system in the selected countries in east Africa is demonstrated by the level of domestic credit as a share of GDP (Figure 2). Large banking sectors will enable a relatively high proportion of firms and individuals to have bank loans. If the banking credit to the private sector is about 70 percent of GDP and more, then the country is said to have a relatively well-developed financial system. The amount can even exceed 200 percent of GDP in some very advanced economies.

In contrast, the credit to GDP ratio could be as low as 1% in developing countries. For instance, the ratio of Somalia's credit to the private sector to GDP is less than 3%, indicating the financial sector's underdevelopment and the difficulty households and firms face accessing credit for investment and various purchases. The figure below compares the ratio of private credit to GDP for selected Eastern African countries. The figure below shows that the ratio is above 32% for Kenya and 20% for Rwanda. It should be noted that the ratio for Somalia was nearly equal to Kenya in 1968.

Box 1: Policy Principles for Expanding Financial Access

1

INSTITUTIONAL INFRASTRUCTURE FOR PROMOTING ACCESS

Principle 1:
Promoting entry of and competition among financial firms

The policy should encourage the competitive provision of financial services to customers such as low- and middle-income households and small firms. The policy should favor the entry of qualified suppliers that are likely to improve the quality and price of services to such customers (in a manner consistent with financial stability and consumer protection). Competition policy should empower the active investigation of anticompetitive behavior.

Principle 2: Building legal and information institutions and hard infrastructure

Policymakers should work with market participants to eliminate barriers and identify gaps in the institutional infrastructure relevant to small-scale supply. This includes ensuring that payments and collateral systems and hard infrastructure elements for retail transactions are available and have a low unit cost. In particular, collateral and information infrastructures need modern supportive legislation and regulations. The state has a central role in ensuring the availability and maintenance of much of this infrastructure (Where appropriate, the public sector can provide administrative and financial support to help create such infrastructures.)

Principle 3:
Stimulating informed demand

As a complement to other consumer protection activities, policymakers should facilitate education and confidence-building measures among those currently excluded by coordinating, setting standards and curricula, and possibly cofunding private efforts. Financial-service providers play a crucial role in fostering informed consumers, among others, by making information available in a manner suitable to small-scale clients.

2

REGULATION OF FINANCIAL-SERVICE PROVIDERS (FSPs) AND FINANCIAL SERVICES

Principle 4:
Ensuring the safety and soundness of financial-service providers

The rules and procedures for prudential regulation of financial-service providers should be carefully designed for consistency with financial-service provision at a small scale. In particular, regulation should be assessed for its impact on access and should reflect the risks faced by low-income households and small firms. Prudential regulation need not be restricted to deposit takers. To avoid regulatory arbitrage undermining sustainable access, consistent protection should drive cross-agency regulatory harmonization.

Principle 5:
Protecting low-income and small customers against abuses by FSPs

Low-income and small customers need regulatory protection against abuses by service providers. FSPs should be subject to legislation designed to ensure that they do not sell customers products that are unsuitable for their needs. Market conduct and other regulations in this area (including anti-money laundering and combating the financing of terrorism, AMF/CFT) need to minimize compliance costs while retaining effectiveness.

Principle 6:
Ensuring usury laws, if used, are effective

Regulated ceilings on interest rates have often proved to be an ineffective or even counterproductive measure against predatory lending and have often tended to work against increasing access. Where such ceilings are retained, they should be pitched at realistic levels in relation to FSP costs in each market segment and adjusted over time, in line with movements in the wholesale cost of funds.

Principle 7:
Enhancing cross-regulatory agency cooperation

Where regulation of financial firms or services is split, agencies should cooperate in policy/regulatory development and supervisory practices to ensure consistent standards of consumer protection, especially of activities related to low-income households and small firms. Even if some FSPs are not covered directly by a regulator, policymakers should ensure that access-related issues relating to those FSPs are not neglected.

3

DIRECT POLICIES USING PUBLIC RESOURCES

Principle 8:
Balancing government's role with market financial-service provision

The design of any direct government interventions should seek to respect the commercial market logic as much as possible—especially in regard to cost-effectiveness—and avoid damaging distortions to market functioning. All policies for improving access should have clear and measurable objectives and their effectiveness should be quantitatively monitored with transparent public reporting.

Principle 9:
Ensuring data collection, monitoring, and evaluation

Governments should ensure the collection of sufficient data to: allow for the determination of the gaps in access to financial services that will facilitate private-sector solutions; provide accountability of public policy for monitoring and evaluation of the effectiveness of pro-access policies; and, help build a better, research-based understanding of what works in relation to access.

Source: Claessens, S., Honohan, P., & Rojas-Suarez, L. (2009). Policy principles for expanding financial access. Center for Global Development Working Paper.

Source : Claessens, S., Honohan, P., & Rojas-Suarez, L. (2009). Policy principles for expanding financial access. Center for Global Development Working Paper.

4.2. Non-Banking Sector

4.2.1. Microfinance institutions

Poor, vulnerable, and unbanked families need financial services to generate income, reduce risk, and protect against vulnerabilities often exacerbated by economic crises, diseases such as health pandemics, and natural disasters. They look for a wide range of financial services, including loans, savings, insurance, money transfer remittances, and payment services. They invest in micro and small businesses, buy assets, and access health and education services. However, formal financial intermediaries such as commercial banks often don't serve these households. The traditional banks have failed to serve this market for various reasons. First, their business models are usually unsuitable for managing a microfinance business, characterized by high-volume, low-value transactions. Second, they use traditional lending technologies based on collateral requirements (which unbanked people often do not have access to). And in many cases, traditional banks wrongly believe that those without a bank account are unwilling and unable to repay loans and save money

Microfinance Institutions provide a broad range of financial services to those left out of the conventional formal financial system. The exclusion process not only for lack of wealth but also for cultural, social, and gender barriers. Microfinance lending criteria are developed primarily around analyzing clients' character, cash flows, and commitment to repay a loan, rather than on collateral conditions characteristic of asset-based lending criteria of traditional banks. Various institutional models have emerged globally to serve microfinance markets, including specialized microfinance banks, non-governmental organizations (NGOs), credit unions, credit cooperatives, nonbanking financial institutions, and commercial banks that develop new lines of business or specialized subsidiaries that focus on the microfinance market segments.

4.2.2. How does Microfinance fit within the broad policy environment?

Extending the frontier of finance contributes to a range of policy imperatives, including support for poverty alleviation, vulnerability reduction, and broad-based economic growth. Effective macroeconomic policies, legal and regulatory frameworks, and financial policies influence the enabling environment that supports the emergence of more profound and more inclusive financial systems. Sound macroeconomic management and financial sector policies are critical elements for financial sector deepening.

According to the 2017-18 Somalia High-frequency Household Survey, more than 70% of the Somalis lived below the poverty line, with the rural poor being particularly vulnerable. Safe savings facilities, payment services, access to credit, and reliable insurance mechanisms will thus enable poor households to reduce vulnerability by smoothing consumption and mitigating risks. Access to financial services allows them to build assets that they can benefit from in times of economic downturn and maintain their level of consumption for food and other services, such as education and health care. A temporary loss of income for

vulnerable households can drop them deeper into poverty and make it difficult, even impossible, to work their way out of poverty.

While poor and low-income people depend on access to financial services, financial sector development (and its accompanying economic benefits) relies on potential clients with saving capacity and the ability to borrow and pay back loans. This largely depends on the availability of economic opportunities to generate revenues and profits. Broad macroeconomic and sectoral policies influence *access to productive assets* (for example, land and inputs), the *profitability of producers* (by influencing input and output prices, bank service charge rates, and access to markets), and the *capacity of financial intermediaries to develop sustainable businesses* (by their management of systemic and other risks).

4.2.3. Fighting Poverty Through Microfinance

Poverty can be described as the inability of individuals to meet their physiological and social needs and the lack of income necessary for a humane life. *Absolute poverty* is the state of being deprived of the income necessary to meet the basic needs (such as nutrition, shelter, and clothing) *necessary for a person to survive*, while *relative poverty* is the welfare level of the individual below a certain rate of the average welfare level of the society. While the poverty rate has declined globally, it has not fallen fast enough to keep up with population growth in Sub-Saharan Africa. Currently, more than 490 million people in the region have a daily income of less than \$1.90 ppp\$/day. In Somalia, nearly 70% of Somalis live in poverty, the 6th highest rate in Africa.¹⁴ In recent years, more particularly in 2019 and 2020, the country was hit by several shocks, including drought, floods, locust invasions, and the COVID-19 pandemic. As a result, real GDP grew by 3.3% in 2019 and declined by 0.3% in 2020, owing mostly to the COVID-19 impact. Due to the nonexistence of formal insurance, most Somali households rely on strategies that include selling, pledging, or mortgaging physical and productive assets and borrowing from friends, relatives, and money lenders.¹⁵

Various methods are used in the fight against poverty. One of these methods is "**microfinance**."¹⁶ as an application in reducing poverty, which was developed and successfully implemented by Grameen Bank in Bangladesh, which the World Bank recommends as a model, and many countries imitate this model. It is challenging for the poor to benefit from limited commercial credit institutions in Somalia. Microfinance programs developed to fill this gap can help the poor to establish their own businesses by providing low-cost credit. In this respect, it can be said that *microfinance programs are an effective means of reducing poverty among the poor who are capable of starting their own business*.

Therefore, when commercial banks and financial institutions cannot meet the credit needs of women and the poor, alternative institutions should be established to meet the financial service demands of

¹⁴ Somalia high frequency survey.

¹⁵ From data to development: Poverty and policy in Somalia (worldbank.org)

¹⁶ Some sources use "microcredit" (microcredit), while others use "microfinance" (see HOLCOMBE, 1995; KHANDKER, 1998; REMENYI and QUINONES 2000). In this study, the concept of "microfinance" was used

these groups. However, microfinance should never be a stand-alone poverty alleviation tool. For instance, providing financial products to the extremely poor who lack human capital (without education and poor health) will not lift them out of poverty. For this reason, MFIs should be integrated with other anti-poverty programs such as education, training, and health.

4.2.4. Microfinance institutions in Somalia

The MFIs in Somalia are still in their infancy and, most importantly, unregulated. The Financial Institutions law (FIL) of 2012 grants the Central Bank of Somalia (CBS) full powers to regulate all the financial institutions but there is a vital need for a microfinance law, that gives the CBS to include micro-finance operations under its jurisdiction¹⁷. However, the revised FIL under consultation includes MFIs under the mandate of CBS

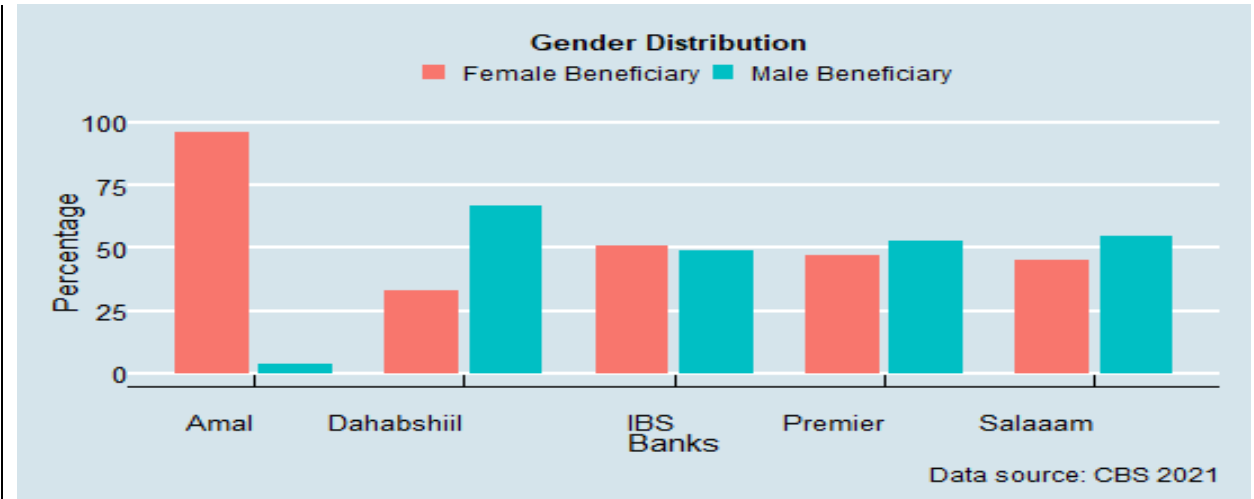
Nevertheless, this is a vibrant and growing sector as the demand for micro-credit from small businesses and individuals has increased gradually in the past couple of years. It is also anticipated that this trend will continue. In the light of this view, private commercial banks operationalized divisions for microfinance to tap into the un-met micro-credit demand, including credit needs from the informal sector. It is also worth mentioning that, besides private banks, NGOs play a crucial role in this sector, with "six major M.F.I.s operate in Somalia either as affiliated subsidiaries of commercial banks or registered as non-governmental organizations." The government of Somalia established GARGAARA Company, a new financial institution to facilitate access to finance for Micro, Small, and Medium Enterprises (MSMEs). Some of the key actors in the microfinance sector in Somalia are Gargaraa, MicroDahab, Kobciye, Kaah International Microfinance Services (KIMS), Kaaba Microfinance Institution (K-MFI), Halalmaal Micro-Finance Institution (HMFI), RAAS Microfinance and Bushra Microfinance.

The KII findings suggested that microfinance projects implemented by the NGOs in person or in partnership with other financial intermediaries do not have the same impact as market-oriented programs since the investment projects' return on investment and the sustainability of the investment projects are not strictly audited or followed up. . Therefore, de-risking efforts are ongoing, and Gargaara Company is an example with an authorized share capital of \$100 million.

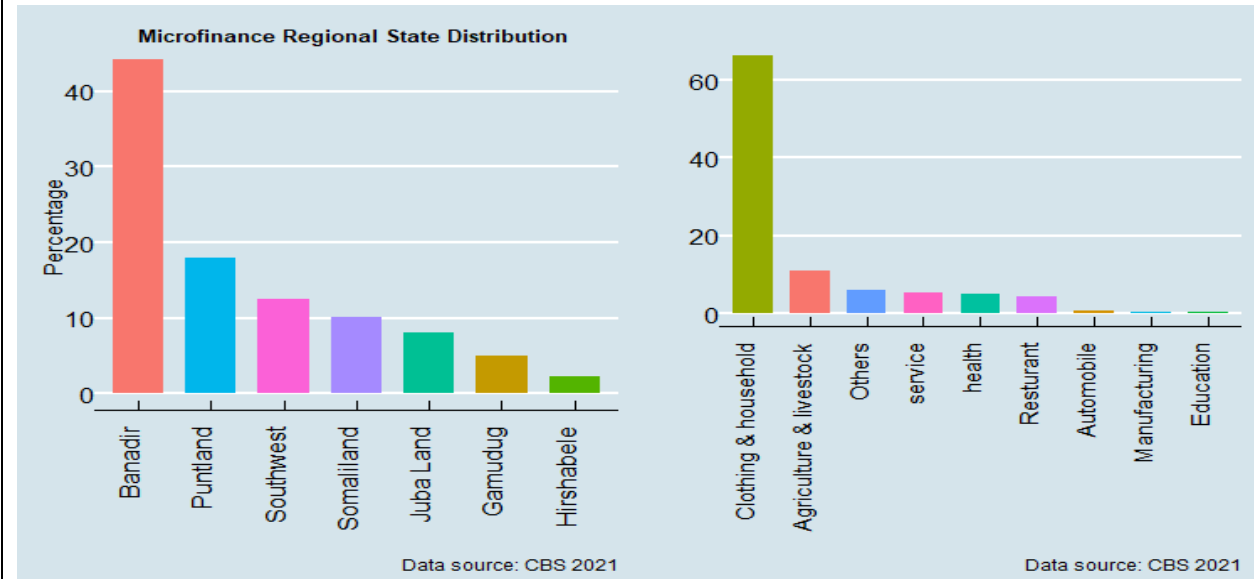
Box 4: *How Microfinance works in Somalia (an example of the CBS initiative)*

In September 2014, the FGS received a USD 3,000,000 interest-free grant from the Kuwait Fund for the Arab Economic Development. The purpose of the fund was to offer micro-finance funding to small businesses in Somalia to support the growth of the private sector. The Bank launched on Jan 2017 a Pilot Initiative of microfinance services. Microfinance loans were provided to 6 commercial banks (currently five banks). These loans were interest-free and were to be repaid fully after 18 months. Since its inception in 2017, more than 6,310 direct beneficiaries were reached; most were women, mainly un-bankable due to lack of collateral.

¹⁷ - Somalia financial sector technical report, UNIDO, Mogadishu, January 2020. p. 5



Number of the commercial banks	Five Banks
Total fund provided	\$2,910,000 (Shared equally)
Total funds financed	\$2,268,612 (78%)
Maximum duration financing	One year
Minimum duration financing	Six months
Number of the beneficiaries	Total 2,840 (64.5% female and 36.5% male)



The distribution of MFIs beneficiaries across different regional states indicates a wide variation (Figure above). The figure demonstrates that Banadir beneficiaries consist of 44 percent of the total microfinance beneficiaries in Somalia, followed by Puntland state (18%) and Southwest state (12.5%). The majority of the MFI beneficiaries used the loan for buying apparel and household goods, followed by agricultural and livestock, and health facilities

4.3. Insurance Companies

Six registered companies in Somalia provide insurance services in line with Islamic insurance principles (Takaful), including health, travel, property, motor, goods in transit, life, and marine insurance, among other products. All key insurance/takaful players are registered with the CBS, which allows the Bank to keep an eye on the sector.

The insurance industry is in its embryonic state, and the number of organizations buying insurance services from local Takaful companies is still limited. These include government institutions, NGOs, the private sector, and the diaspora. Nevertheless, several challenges are hindering the development of this critical industry, including the lack of information on the availability and the importance of insurance. For instance, Somali businesses lose millions of dollars each year due to recurrent fire outbreaks at the main markets in Mogadishu, Hargeisa and elsewhere in the country. Additionally, the lack of reinsurance/retakaful companies in Somalia is another obstacle facing the industry. Currently, local insurance providers seek overseas reinsurance companies that do not accept some of the existing risks in Somalia, and this could represent an extra burden on the local insurance companies. However, there are ongoing reforms in the insurance industry in Somalia. An insurance bill was drafted in 2020, and when enacted, the law will help regulate and supervise insurance/Takaful business in the country.

Another significant milestone was achieved in February 2020, when Somalia signed the Multilateral Investment Guarantee Agency (MIGA) with the World Bank and became a member of MIGA, which provides political risk insurance and credit enhancement for the private sector investors and lenders. This was an excellent opportunity for entrepreneurs, investors, and the insurance industry's growth in Somalia and will contribute to the advancement of investment and attract FDI.

4.4. Financial co-operatives

The cooperative financial sector in Somalia is at a rudimentary stage. Financial Cooperatives (FCs) are member-owned and member-controlled financial institutions. They are essential financial services providers to poor and middle-income people, including those who live in rural areas; thus, FCs are significant drivers of financial inclusion. It is, therefore, difficult to precisely characterize the size of this industry. However, the existing FCs include Self Help Groups (SHG), saving groups such as Village Savings and Loan Association (VSLA,) and traditional saving mechanisms known as Ayuto or Hagbad as pooling money or resources together.

Self Help Groups (SHG) are usually composed of 10 to 25 local women. Are established to collect money from those who are able to donate and give to members in need by taking loans from their collective savings in times of emergency or financial scarcity, significant life events, or to purchase assets¹⁸. Self Help Groups form Federal Level Associations and register with the government to obtain legal status and are financially self-sustaining¹⁹. It is worth mentioning that N.G.O.s are the main drivers of SHG

¹⁸ - Kabeer, Naila (2005). "Is Microfinance a 'Magic Bullet' for Women's Empowerment? Analysis of Findings from South Asia"

¹⁹ - Building resilience through Self Help Groups, Evidence review. USAID, January, 2021. p. 4

and saving groups in the country. However, banks also play a facilitation role by creating specific types of accounts for these groups.

The VSLA model usually used in Somalia, Ayuto, is the traditional saving mechanism utilized by women, and so far, it is the most popular type of FCs in the country. On the other hand, a saving group is a voluntarily organized group comprised of 15 -25 self-selected individuals who save together and take small loans from those savings. Local and international NGOs support poor and economically marginalized groups such as youth and women., They are the drivers of new models of FCs such as SHG and saving groups. They also directly support the poor by providing grants or credit²⁰. A mapping study conducted by Concern Worldwide in 2020 highlighted several NGOs that play a vital role.

4.4.1. The gaps in the Financial Services and Products

In regard to the existing gaps in the financial products and services, Somalia lacks a range of products available in the rest of the region and the world: including basic correspondent banks, wire transfer services, specialized investment, and other banks. The table below presents the financial products and services that are either missing or rarely used in Somalia.

Table 1: Missing financial products/services

SN	Financial Products/Services	Availability	Remarks
1.	Digital credit	Missing	KAABE, which is a qardul Hasan service, is offered by eDahab
2.	Fintech (Internet banking)	Growing	WAAFI app, Premier Wallet, DahabPlus, T-PLUS
3.	Takaful	Rare	Six are registered, but the industry is unregulated
4.	Correspondent banking services	Missing	Restrictions globally
5.	Wire transfer service	Missing	
6.	Clearinghouse	Rare	The National Payment System
7.	Money and Capital markets	Missing	
8.			
9.	Mudharabah/Musharakah (joint venture),	Rare	Joint venture and profit-sharing finance represent less than 10% of total finances
10.	Ijar (leasing)Wadiah (safekeeping), Bai Salam, Ijarah wa-iqtina	Missing	
11.	Istisna'	Rare	
12.	Letter of Guarantee	Rare	
Missing Financial Service Providers			
SN	Financial Service Provider	Availability	Remarks
1.	Development Finance Institutions (DFIs)	Rare	They provide medium and long-term finance

²⁰ - Mapping of Financial Services for SHGs and Barriers for Women to Access Microfinance Services in Somalia, Concern Worldwide, May 2020. P. 16

Access to Finance and Financial Inclusion in Somalia

2.	Mortgage companies	Missing	They do not exist
3.	Representative offices of foreign banks	Missing	One bank has been reported which is registered in Bosaso
4.	Public commercial and saving banks	Missing	Assets recovery related to the former Commercial and Saving Bank of Somalia (CSBS) is underway
5.	Foreign exchange bureaus	Missing	Money Transfer Businesses perform these services
6.	Post Office Savings Bank	Missing	
7.	Savings and Credit Co-operative Organizations	Rare	They exist on a small scale. They are mainly supported by NGOs.
8.	Credit reference bureau	Missing	Effort to establish is ongoing
9.	Deposit-taking microfinance institutions	Missing	Existing MFIs only provide microfinance and do not accept deposits
10.	Pension funds/ Mutual funds	Missing	
11.	Islamic Interbank Money Market	Missing	
12.	Investment banks	Missing	

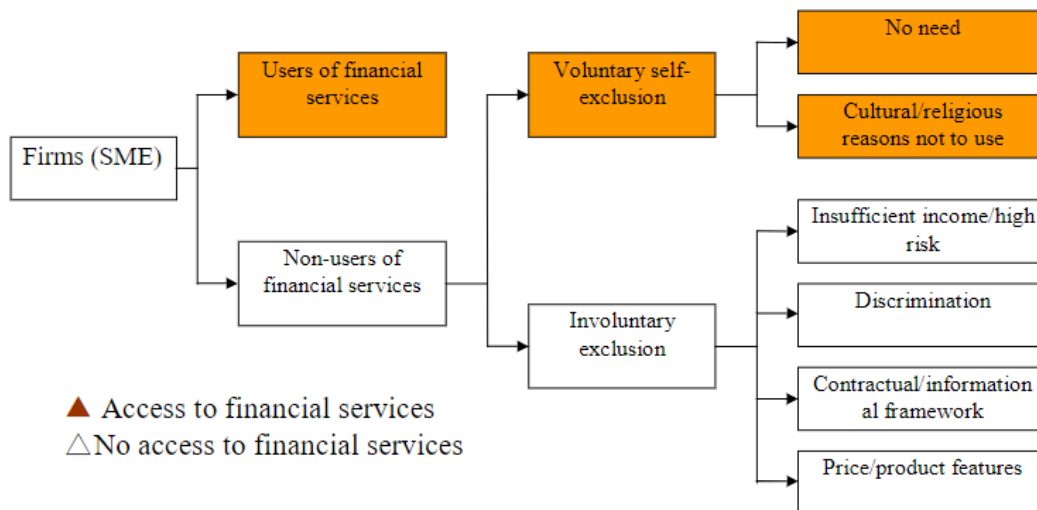
5. Chapter Five: Business Access for Finance

For many years, business access to finance has been a subject of significant research interest to academics and an issue of great importance to policymakers for both developed and developing economies. These studies documented that inadequacies in access to finance are one of the critical obstacles to firm growth. These studies have further claimed that SMEs find accessing financing more difficult than larger firms.²¹ This section of the report aims to scrutinize the situation of access to finance for businesses in Somalia with a special focus on SMEs. To this end, documentary analysis and critical examination of secondary sources such as the World Bank Enterprise Survey along with KII were used.

5.1. Introduction

Access to financial services is defined as an absence of price and non-price barriers in the use of financial services. Then, improving access to finance means improving the degree to which financial services are available to all at affordable prices. It is easier to measure the use of financial services since the data of users can be observed, but use is not always the same as access. Access essentially refers to the supply of services, whereas use is determined by demand and supply. The figure below captures the definition of access to finance for firms.

Figure 3: Access and use of financial services

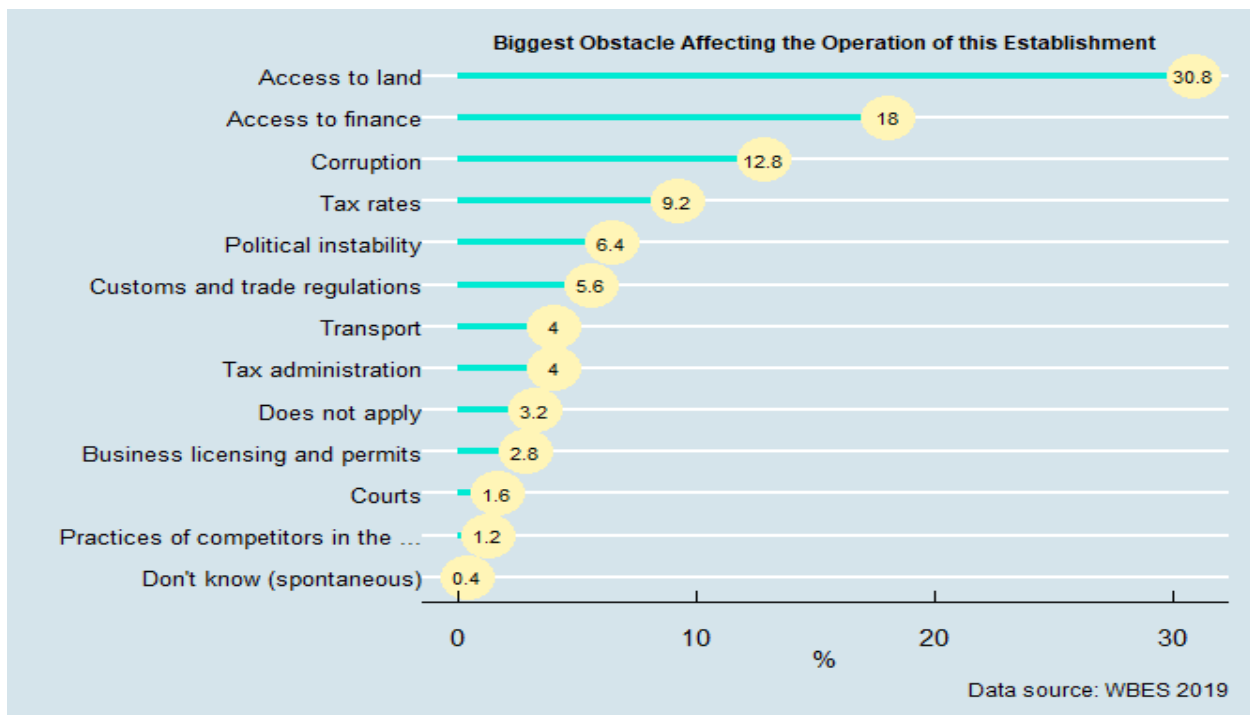


- ²¹ Yoshino, N., & Taghizadeh-Hesary, F. (2017). Solutions for small and medium-sized enterprises' difficulties in accessing finance: Asian experiences (No. 768). ADBI Working Paper.
- Chandrayanti, T. (2022). The Influence of Business Performance on Credit Accessibility to Micro and Small Enterprises (MSEs). *Ilomata International Journal of Management*, 3(1), 78-89.
- Kemiso, Y. B. (2021). Assessments of growth of micro and small enterprises (MSEs): A review of empirical evidence from Ethiopia. *International Journal of Management IT and Engineering*, 11(6), 30-35.

5.2. Financing constraints and their severity

In general, firms in developing countries, particularly in most of Africa, report financing constraints to be among the important business constraints they face. The recent World Bank Enterprise Survey of 2019 (WBES) asked business enterprises in Somalia about different possible hindrances to their business's current operations ranging from political instability, access to land, access to finance, obstacles related to corruption, and tax administration, and transport. Figure 2 below reveals the response of the business enterprises. Access to land was the most frequently cited as a top obstacle (30.8%). The second most reported obstacle was access to finance (18%), implying that access to finance is one of the leading constraints. Corruption was the third-ranked obstacle (12.8%) faced by the business in its day-to-day operations.

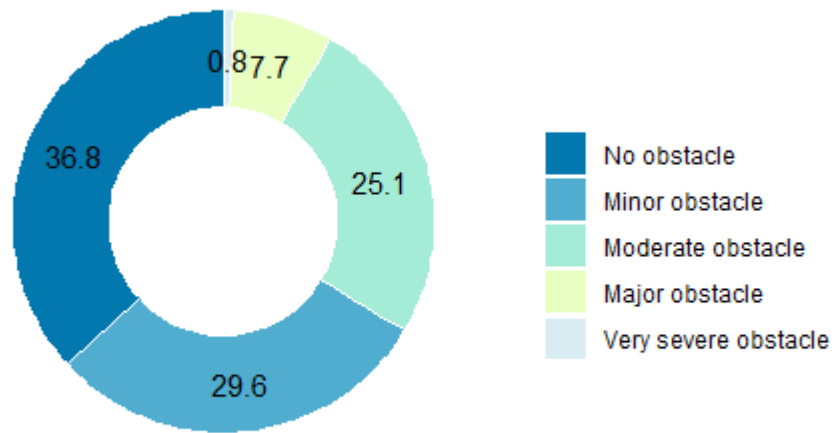
Figure 4: Biggest obstacle affecting business in Somalia



Findings from KIIs with selected firms and MSEs in Mogadishu showed that firms face several challenges in running their business, including lack of business knowledge, financial constraints, and inadequate economic infrastructure. In addition, lack of business laws and regulations and security concerns were identified as among the main challenges for business. Therefore, both the qualitative and the quantitative analysis indicated that access to finance is one of the significant constraints that businesses face in Somalia.

In order to examine the extent of severity of access to finance, the WBES asked business owners to rate the degree of the obstacle to access to finance on a scale ranging from no barrier to a very severe obstacle. The answers though subjective, contribute to a better understanding of the nature and degree of constraints firms face in Somalia and are shown in Figure 3 below

Figure 5: The extent of severity of access to finance



Data source: WBES 2019

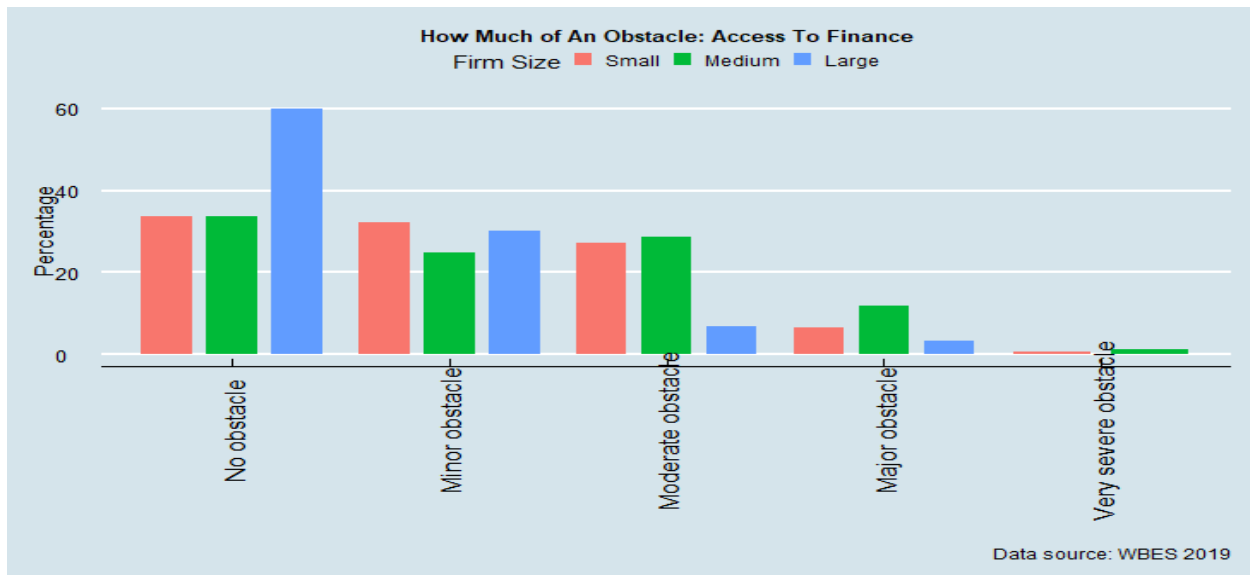
As shown in the figure above, of those who participated in the survey, a high proportion of respondents indicated that access to finance is an obstacle, ranging from minor to severe obstacle, to their business.

5.3. Access to finance and SMEs

SMEs can be taken as an instrument in bringing about the economic transition of Somalia by effectively using the skill and ability of the people, mainly women and youth, without demanding high-level training, much capital, and sophisticated technology. Despite the massive importance of the SME sector, many of the SMEs in Somalia are unable to realize their full potential due to the existence of different factors that constrain their growth and performance.²² One of the leading elements contributing to the low performance of SMEs is limited access to finance. The WBES asked business enterprises the extent to which access to finance is an obstacle to them. The result indicates that SMEs find accessing finance more difficult than larger firms. As shown in the figure below, access to finance is not an obstacle to 60% of the large firms, but it is a ‘major’ obstacle for 10% of SMEs and a ‘moderate’ obstacle for 28% of SMEs, respectively.

²² Ahmed, B. (2020). The Impact of Small and Medium Enterprises (SMEs) on Economic Growth and Job Creation in Somalia. *Journal of Economic Policy Researches*, 8(1), 45-56.

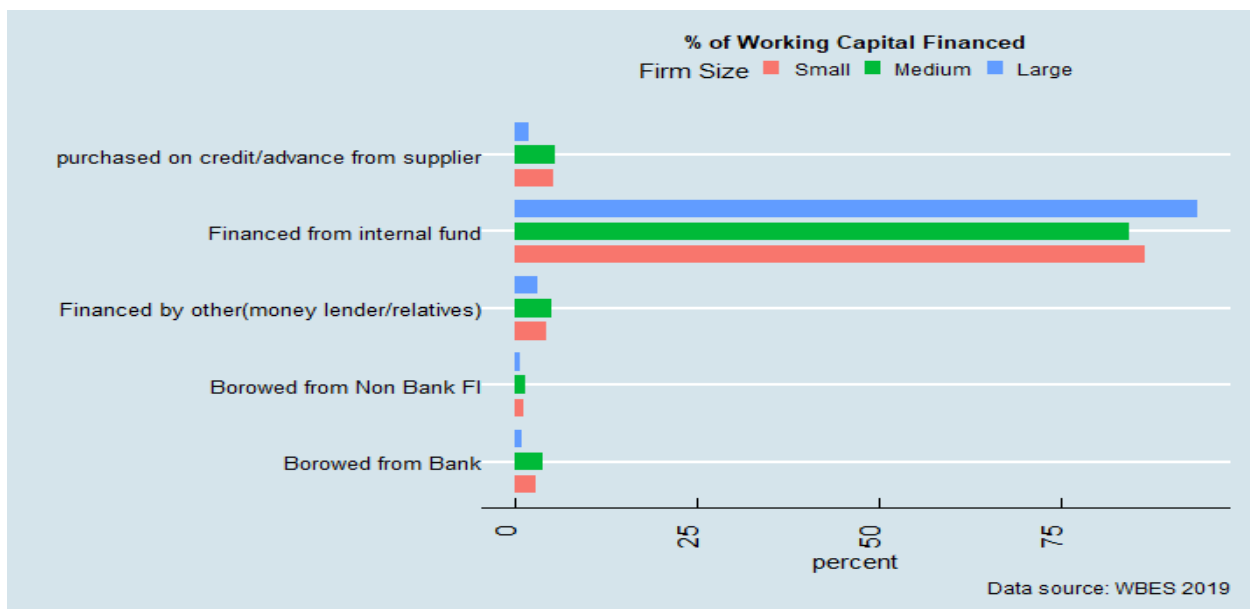
Figure 6: How much of an obstacle: Access to finance



Well-developed financial markets deliver payment services, mobilize deposits, and ease funding to purchase fixed assets – such as buildings, land, machinery, and equipment – as well as working capital. Efficient financial markets reduce reliance on internal funds or informal sources such as family and friends by connecting creditworthy firms to a broad range of lenders and investors.

The WBES provides indicators on the sources of firms' financing and the characteristics of their financial transactions. The figure below compares the various sources used to finance working capital. It should be noted that excessive reliance on internal funds is an indication that financial intermediation is inefficient.

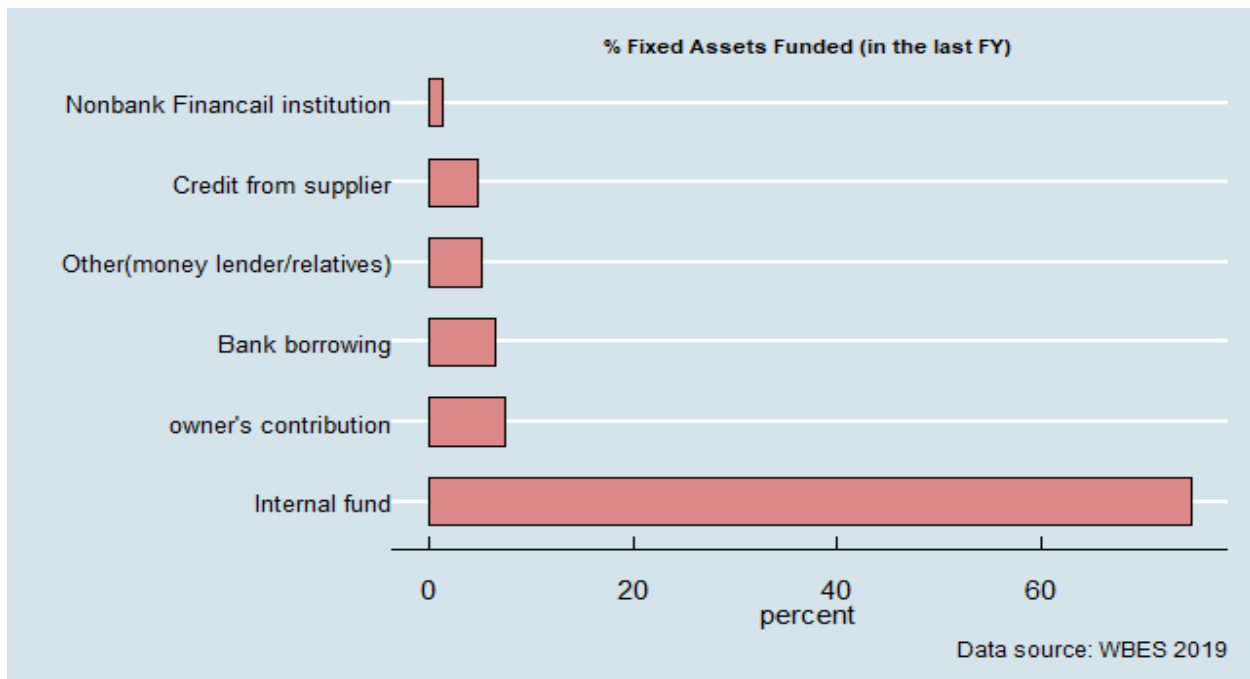
Figure 7: Percentage of working capital financed from different sources



The figures above clearly indicate that more than two-thirds of the firms in Somalia finance their working capital from internal sources, irrespective of its size. An exciting fact reflected in the working capital source is that large firms are more likely to finance their working capital from internal sources than medium and small firms. The second-largest form of financing working capital is from other sources such as money lenders and/or relatives, implying the problem of credit availability in the country.

The findings from the qualitative study through KIIs also confirm that most businesses rely on their funds and loans from friends and relatives to start a business and for the day-to-day operation of the business. The figure below further compares the various sources used to finance fixed-assets purchases (investments). Investment purchases can be funded by internal sources, banks, inputs' supplier credit, or other sources, including nonbank financial institutions or personal networks. The figure indicates that more than 70% of the firms in Somalia rely on internal funds, followed by the owner's contribution.

Figure 8: Percentage of investment financed from different sources



The source of firms' financing for day-to-day operation is similar to that of investment and working capital. The large majority of firms in Somalia rely on their own funds for firms day-to-day operations, followed by friends/relatives. This result is also confirmed by the qualitative data collected through KIIs, in which the majority of key informants said that they either use their own funds or loans from families or relatives for running the day-to-day operations of their business. The figure below

compares the various sources used in daily operations. It should be noted that excessive reliance on internal funds is an indication that financial intermediation is inefficient.²³

Figure 9: Percentage of day to day operation financed from different sources



²³ Informal firms in the context of this study implies firms that are unregistered but derive income from producing legal goods and services.

The other question relevant in the context of access to finance is whether the firm has a line of credit. In response to the question asked about whether the firm has a line of credit or not, only 11% of firms indicated that they have a line of credit, while the remaining 89% said that they didn't have a line of credit with formal financial institutions. This indicates the firms' unavailability of credit permits to fund various investments and projects.

According to the WBES 2019, 94% of small firms, 91% of medium firms, and 100% of large firms have checking or saving accounts.

The survey further asked whether the establishment had an overdraft facility during the interview. Only 37.6% of the firms indicated that they had an overdraft facility. Across different locations, the highest positive response was obtained from Mogadishu. The percentage of positive responses was numerically lower for small firms

5.4. Mobile Money

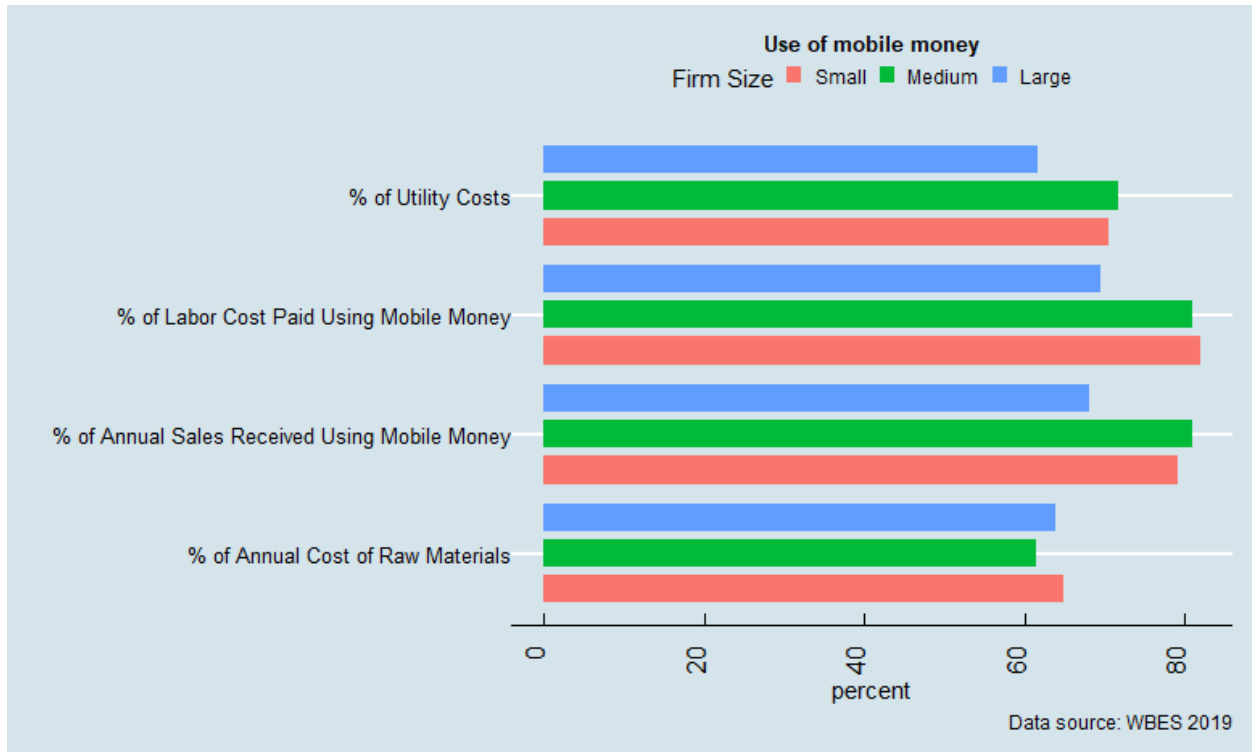
Mobile money is the most popular tool for financial transactions in Somalia. In 2017, the World Bank estimated that three-quarters of the population over the age of 16 use mobile money transfers, compared to 15% who possess bank accounts for their financial transactions.²⁴ Mobile money is the main transaction instrument not only for individuals but also for businesses. When firms were asked whether they use mobile money for the transaction, a large percentage of them (99%) confirmed the use of mobile money for financial transactions.

About 80% of the labor cost for a typical firm in Somalia is paid using mobile money. Similarly, about 80% of annual sales were received using mobile money. The figures below present a snapshot of the usage pattern of mobile money.

The figures below further present the usage pattern of mobile money by the size of the firm. Although no significant difference is observed in the usage of mobile firms across firms, medium and small firms tend to use mobile money more than large firms.

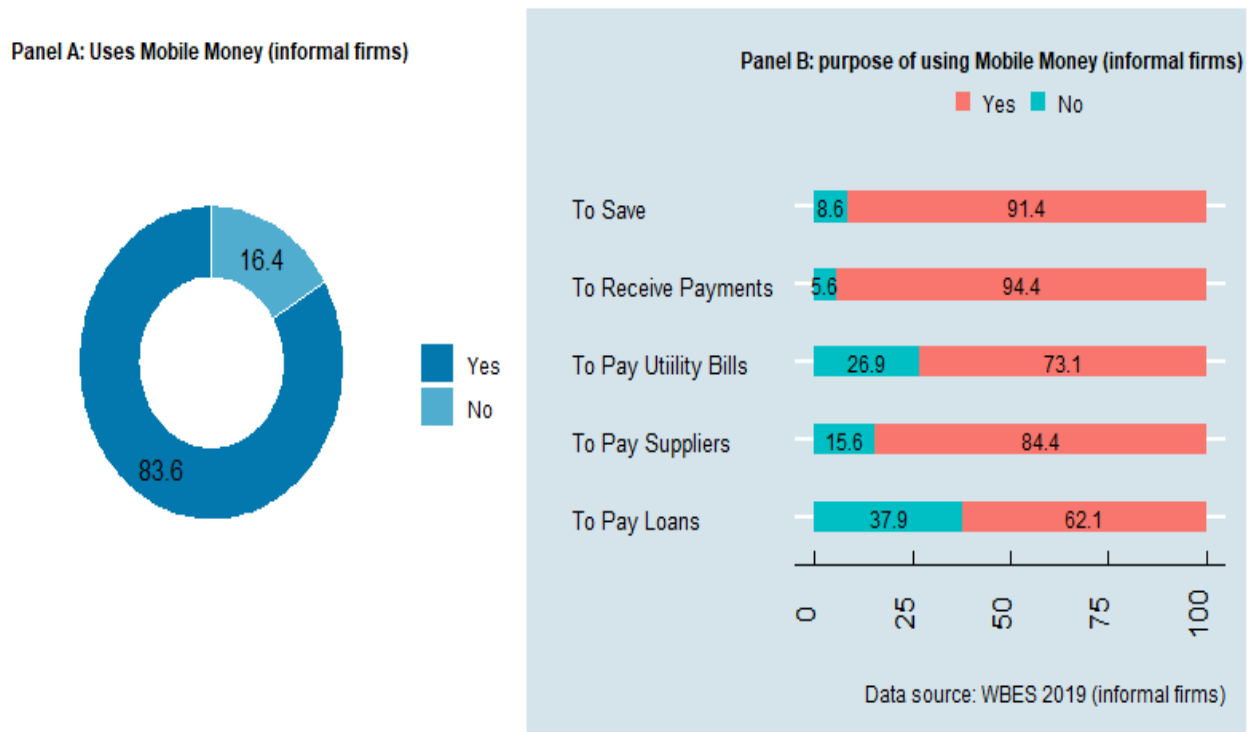
²⁴ Elmi, M., & Ngwenyama, O. (2019, July). The role of mobile money in Somalia's remittance system. In *International Conference on Human-Computer Interaction* (pp. 119-136). Springer, Cham.

Figure 10: Use of mobile money by region



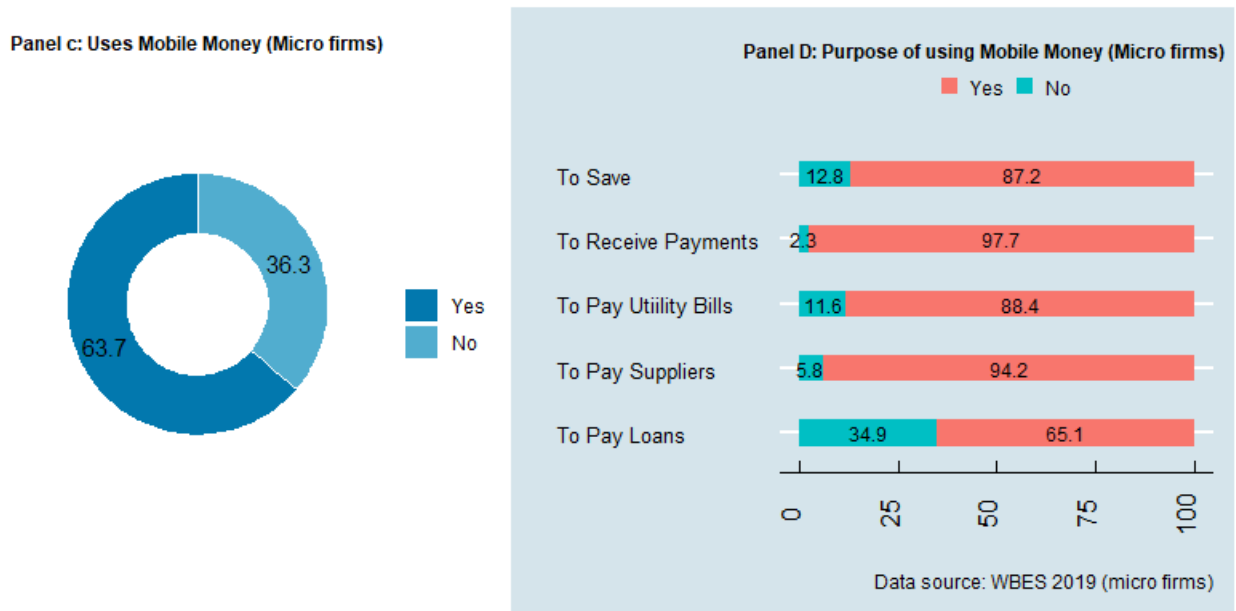
Firms were asked the main reason for using mobile money: and 32 % t of firms indicated that using mobile money reduces the time spent on financial transactions.; 31 % cited the reason for using mobile money is because it satisfies customers' requests, and 17 % said that it reduces the costs of financial transactions. The figure below shows the percentage of informal firms using mobile money and the purpose of the usage. As indicated, more than 83% of informal firms use mobile money. The main purpose of using mobile is to receive payments from customers (94.4%), followed by to save money (91.4%) and pay suppliers (84.4%).

Figure 11: Use of mobile money by informal firms



As for micro firms, about 63% of firms indicated that they used mobile money. The main reason for using mobile money is to receive payments (97.7%), to pay supplies (94.2%), and to pay utility bills (88.4%).

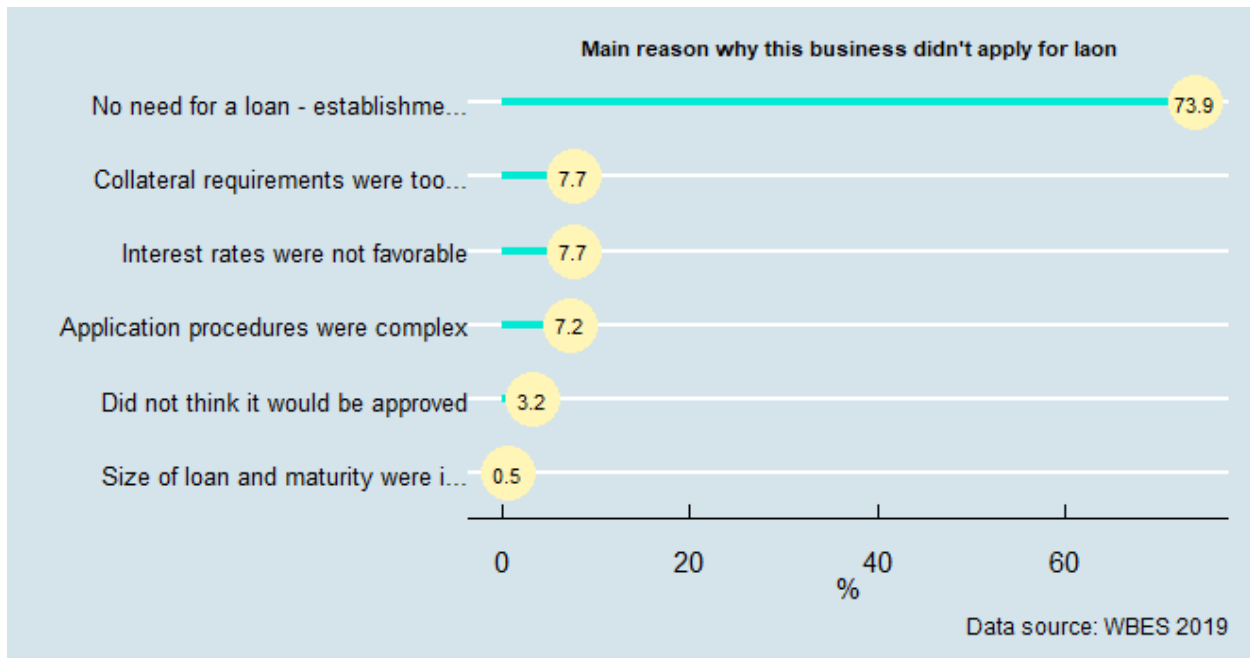
Figure 12: Use of mobile money by Micro firms



5.5. Key Barriers for business access to finance

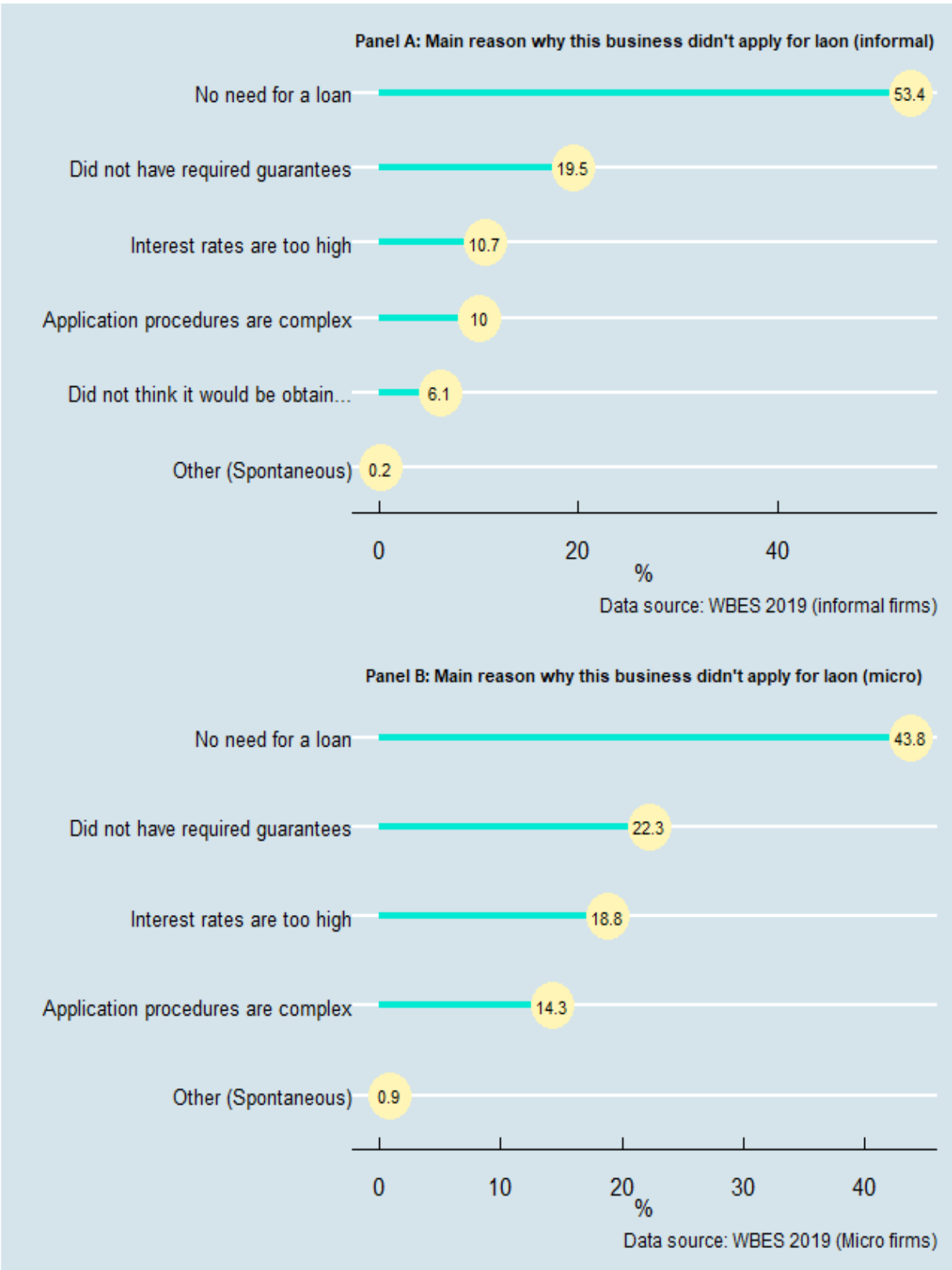
Although the financial sector has broadened its outreach in recent years in Somalia, several challenges persist. The challenges are both demand and supply sides. From the demand side, firms face barriers such as (i) lack of information about the available credit schemes; (ii) collateral requirements; (iii) high bank service charges rate; (iv) complexity of the loan procedure; and (v) religious reasons. According to the World Bank Group’s Enterprise Survey 2019, only 11% of all firms in Somalia indicated that they applied for new loans/lines of credit in the previous fiscal year. When asked not to apply for a new loan, the majority (73%) indicated that they didn’t need the loan, while 7.7% of firms said that the collateral requirement was too high.

Figure 13: Main reason why the business didn’t apply for the loan



The survey asks respondents whether they had access to a loan for the business. Only 17% of the respondents indicated that they have access to loans, while the remaining didn’t. The majority of those who had access to loans indicated that the main source of the loan was money lenders (43%), banks (27.4%), and input suppliers/customers (16.7%).

Of the surveyed informal firms, only about 16.5% applied for the loan, while the largest percentage of the respondents indicated they didn’t apply for the loan. The main reasons for not applying include “no need for a loan,” “didn’t have required guarantees,” “bank charges are too high, and application procedures are complex.



Findings from KIIs with selected firms showed that most of them are aware of the existence of financial services such as Banks and MFI, but they failed to access credit because most of the firms don't meet the requirements set by firms such as collateral, failure to provide historical proof of their business asset capacity, and lack of business certifications. The information from KIIs also indicates that bank service charges (profit rates) and lack of networking are major challenges that hamper firms, especially MSEs, from accessing a loan from existing financial institutions. When asked about their opinion on improving firms' access to finance, the majority of the respondents suggested (i) increasing awareness about the existing financial services; (ii) establishing public trust in financial institutions; (iii) easing administrative difficulties; (iv) reduce the profit rate, and (v) remove impediments such as civil instability. In addition, the key informants were of the view that the federal government should develop a policy that provides the legal framework for SMEs and other entrepreneurial activities comprehensively and inclusively.

5.6. Lessons from other countries

Rwanda

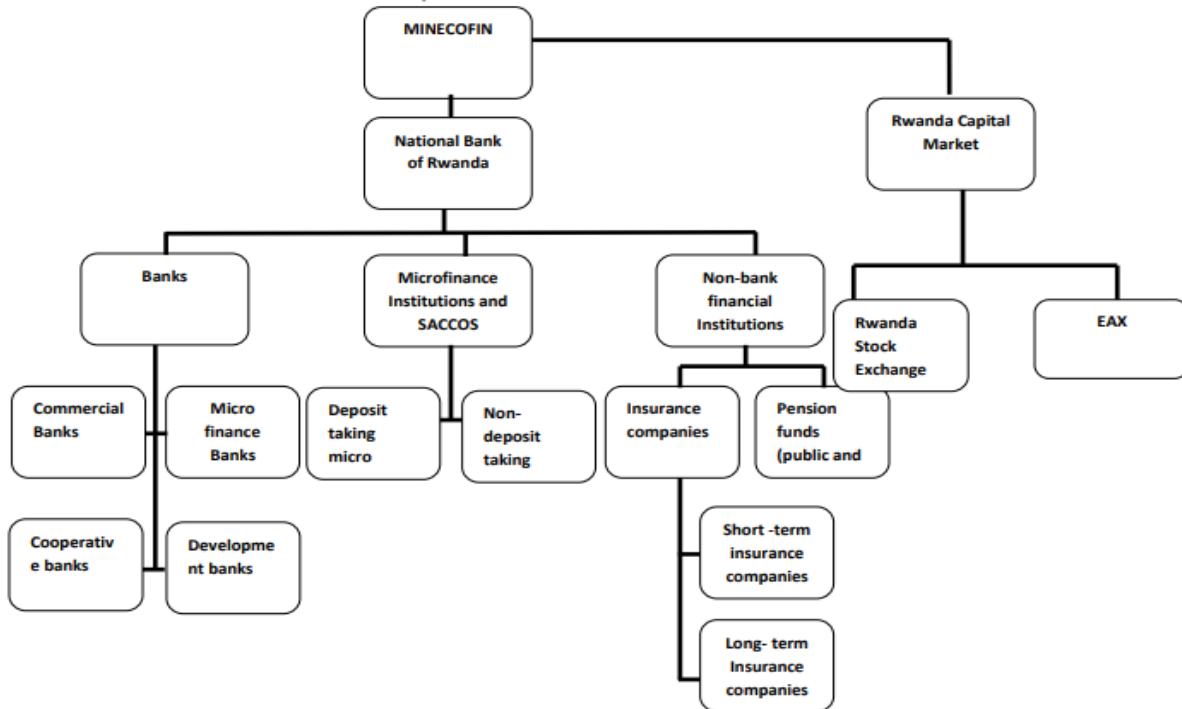
The government turned the post-genocide adversity into an opportunity by creating what is called 'Vision 2020'. The vision sets forth the country's aspiration to transform Rwanda into a middle-income country by 2020. The vision presents a framework and key priorities for Rwanda's development and is a guiding tool to overcome poverty and foster unity and reconciliation in the future.²⁵ To contribute to this goal, the Government of Rwanda recognizes the significance of the financial sector and made the Financial Sector Development Program (FSDP) one of the key components of driving the country. Over the last 20 years, Rwanda's financial sector has undergone significant changes, including the entry of international and regional players into the sector as shareholders and competitors.²⁶ The significant changes have shaped the formal financial landscape, which now comprises banking and non-banking institutions. The figure below indicates the structure of Rwanda's financial system.

There are presently 16 commercial banks in Rwanda and a number of microfinance institutions and rural savings and credit cooperatives. The three largest commercial banks in descending order of market share are Bank of Kigali, Banque Populaire du Rwanda (BPR), and I&M Bank. Other banks present in Rwanda are Ecobank, GT Bank, Equity Bank, Kenya Commercial Bank, NCBA (formerly the Commercial Bank of Africa (CBA)), Access Bank, Bank of Africa, Cogebanque, Urwego, Development Bank of Rwanda, etc. The banking sector has been the key driver of Rwanda's financial sector, and a lot has been achieved in terms of financial depth, profitability, soundness, and stability. In addition to banks, microfinance institutions, SACCOs, and nonbank financial institutions are widely spread across Rwanda and continue to play a significant role in accelerating financial inclusion.

²⁵ The country recently adopted vision 2050

²⁶ <https://www.minecofin.gov.rw/1/accountant-general-1-1-1>

Figure 14: Structure of Rwanda’s Financial System²⁷



As stated in Vision 2020, Rwanda targeted achieving 80 percent financial inclusion by 2017 and 90 percent by 2020. The Progress toward reaching this target to date has been excellent. In this regard, The National Bank of Rwanda plays a significant role in Rwanda’s financial inclusion agenda. The bank implements the national financial inclusion strategy through its regular engagements with financial sector players. In a survey conducted in Rwanda by the Pockets of Effectiveness project, the Central Bank was listed as among the top-performing government organizations in the country.²⁸

The bank implements the national financial inclusion strategy through its regular engagements with financial sector players. Rwanda established a capital market in 2011 under the Capital Market Act of 2011. The establishment of a capital market facilitates firms' access to capital by issuing shares or debt directly to the public through the RSE; private sector businesses and government can raise funds for the expansion of existing businesses or new projects.

²⁷https://www.minecofin.gov.rw/fileadmin/user_upload/Minecofin/Publications/STRATEGIES/Sector_Strategic_Plans/Financial.pdf

²⁸ Behuria, Pritish, The Political Economy of Central Bank Effectiveness: The Case of National Bank of Rwanda (July 27, 2020). ESID Working Paper No 151. Manchester: Effective States and Inclusive Development Research Centre, The University of Manchester, Available at SSRN: <https://ssrn.com/abstract=3661614> or <http://dx.doi.org/10.2139/ssrn.3661614>

6. Chapter Six: Financial Inclusion and Women Empowerment

6.1. Introduction

Financial inclusion refers to “vulnerable and marginalized individuals groups and communities having access to useful and affordable financial products and services that meet their needs—transactions, payments, savings, credit, and insurance—delivered responsibly and sustainably.”²⁹ ; Financial inclusion promotes entry and utilization of low-income people and those excluded from basic financial services in the formal financial sector.³⁰

At the individual and household level, inclusion in the use of financial services is essential due to its positive impact on their well-being; it helps smooth consumption, providing the opportunity to save, expand investment opportunities, and insure against risks. The accumulation of savings allows resources to be channeled towards productive investments, making it possible to carry out profitable projects and the emergence of entrepreneurs. In addition, in the face of potential shocks that could cause imbalances between income and expenditure flows, the FS provides instruments for risk mitigation and transfer. And lastly, beyond the essentially economic aspects, access to financial services empowers the citizen by giving him the right to use an essential service, similar to health services education.

It is also essential to note that the inclusion of the vulnerable communities to f the financial sector is central to meeting Somalia’s developmental goal of poverty alleviation and private sector growth. It is increasingly understood that sufficient financial services such as loans, savings products, insurance, and payment services for poor households, promote equality and productivity. Cognizant of this fact, this part of the report discusses the current status of inclusion of marginalized communities to finance in Somalia and its impact, in particular, on women's empowerment.

Several studies indicated that financial inclusion is a multidimensional concept that directs its efforts toward various axes or lines of action, which, articulated, aim to reach the well-being of people.³¹ Although there is still no consensus on one definition of financial inclusion, The focus and scope of financial inclusion could be determined through the combination of seven dimensions or pillars, which must work under a systemic complementary approach for their excellent interaction (see figure below). As a product of the consolidated qualitative data analysis, the interaction between the dimensions is summarized in the figure below.

²⁹ World Bank. 2018. “Financial Inclusion Overview.” World Bank, Washington, DC.
<https://www.worldbank.org/en/topic/financialinclusion/overview#1>

³⁰ Ozili, P. K. (2018). Impact of digital finance on financial inclusion and stability. *Borsa Istanbul Review*, 18(4), 329-340

³¹ Sarma, M., & Pais, J. (2011). Financial inclusion and development. *Journal of international development*, 23(5), 613-628.

Figure 15: Dimensions of financial inclusion



Regulation appears as the first dimension of financial inclusion. It provides the normative foundations and outlines the field of action where they interact with financial institutions and users of the services offered. Followed by financial education and quality; financial education focuses on adequate education and training favors decision-making on money management and the use of financial services. On the other hand, quality allows for meeting the needs of the financial user through the provision of services adjusted to the real needs. With these three components, a favorable environment can be promoted.

This should be backed by user protection, a system that evidences the transparent, ethical, and fair work that financial institutions that self-determine as inclusive tend to express normally. Finally, it should be remembered the key element and the ultimate goal of financial inclusion is to translate into how to improve the "well-being" of society

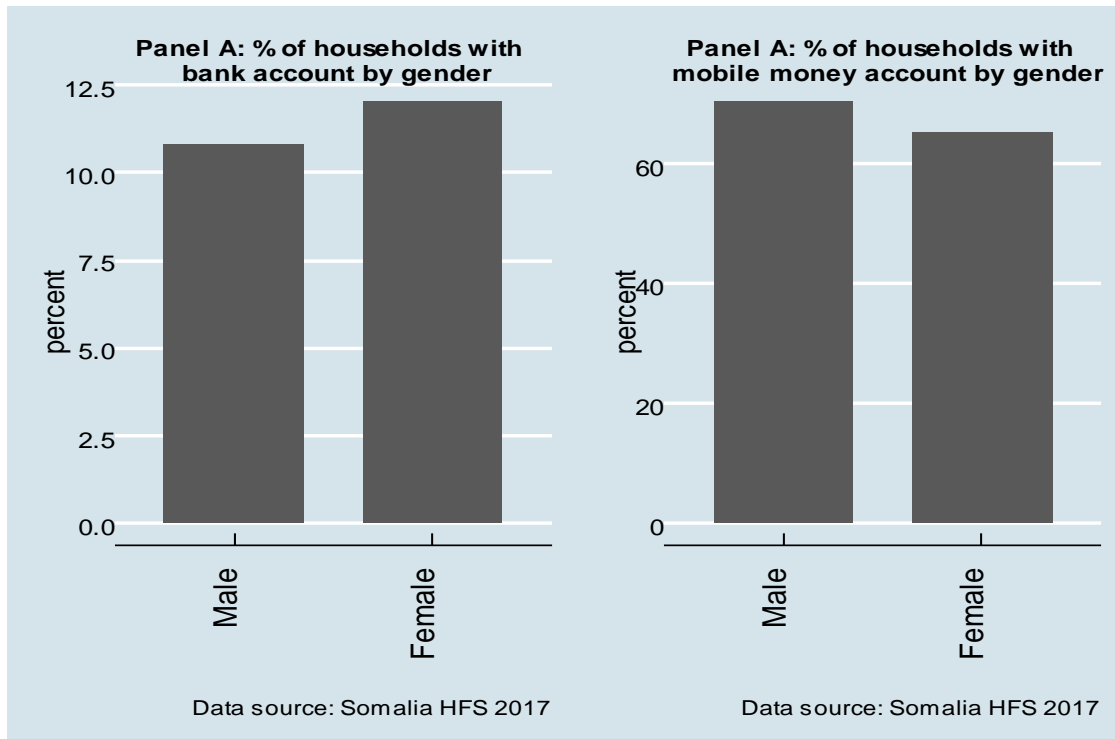
6.2. Financial Inclusion as Public Policy

Promoting an inclusive financial system means making all kinds of financial services available to low-income people (from transactions and remittances, savings, microcredit, credit cards, housing loans, and insurance system also requires changing the institutions' vision and way of doing things: financial entities, regulators, supervisors, and operators. And also, to have a solid infrastructure. Financial institutions must "reinvent the factory" by simplifying processes supported by robust technological platforms with accessible and close channels. They must also design products suitable for the target population regarding financial liabilities, not only focus the Murabaha. As for financial assets, having clear costs and diverse uses is key. Other fundamental elements are the credit bureaus since their information prevents over-indebtedness and the generation of an adequate regulatory and operational framework that guarantees competition.

6.3. Financial services inclusion in Somalia

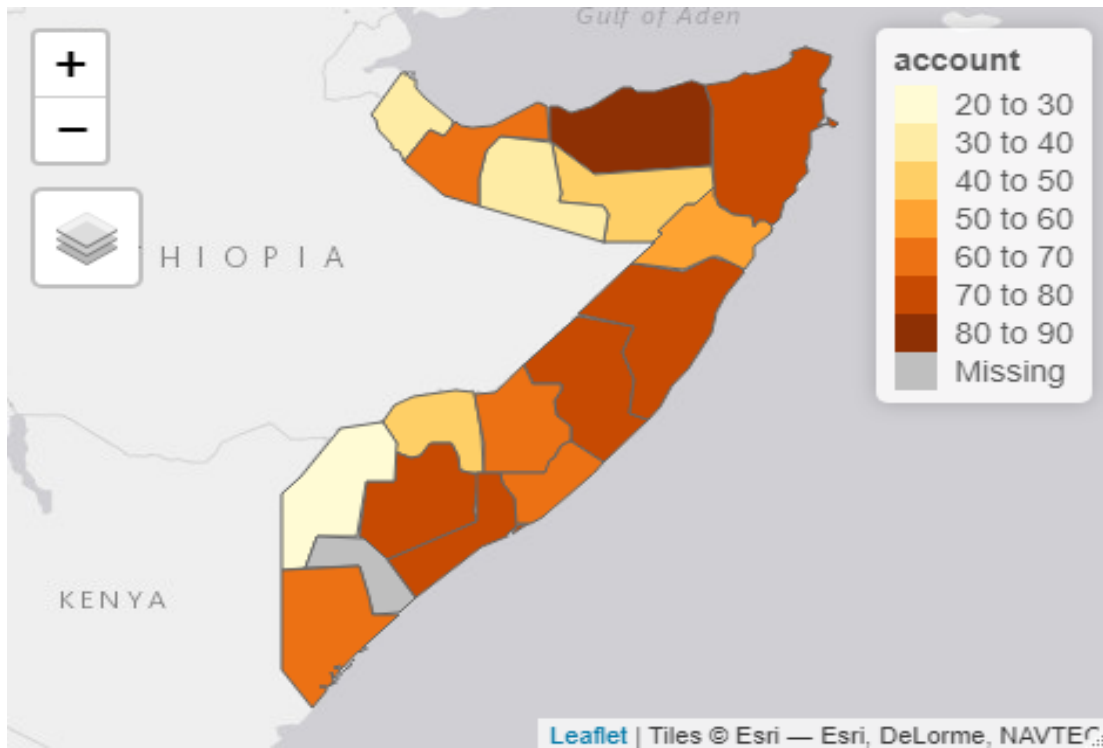
The World Bank high frequency survey in 2017 (wave 2) showed that only 11.43% of households possess bank accounts for their financial transactions. The data further showed that mobile money is the most popular tool for financial transactions within the country. More than 67% of the households stated ownership of a mobile money account. As shown in the figure below, the gender gap in ownership of both bank accounts and mobile money accounts is negligible.

Figure 16: ownership of bank and mobile account in Somalia (Male vs. Female)



As indicated earlier, the outreach of mobile money in the country is phenomenal, with almost 67% of the households owning a mobile money account. However, ownership of a mobile money account varied significantly across different regions of Somalia, as shown in the figure below. While about 83.1% of households in the Sanaag region own a mobile account, mobile account ownership is the lowest in Gedo (27.6%).

Figure 17: Mobile money account ownership across the region



6.4. Financial inclusion and Women empowerment

While economic inclusion can lead to financial inclusion and vice versa, gender dynamics hold women back in both aspects. In many countries, particularly in sub-Saharan Africa, women have more difficulty accessing financial services than men. First, women rarely own the property financial institutions require as collateral for a loan. Studies show that Commercial banks often focus on men and formal businesses, neglecting women, who make up a substantial and growing segment of the informal economy. Many microfinance institutions (MFIs) have risen to the challenge, focusing mainly on women. Still, much more is needed to change the status quo, from formalizing MFIs to providing financial literacy to women in Somalia. Second, most banks in Somalia are located in urban areas, which are difficult for rural populations to access. These factors impede economic growth because, without financing, women cannot invest in their livelihood activities or improve their productivity and income. This hinders the economic development of households and communities.

One of the indicators of women's empowerment is their ability to access finance and manage their money. Their access to financial services means benefits for their households and the community. Women who have access to traditional financial services and can save money in their own bank accounts are more likely to have other opportunities, such as access to more lucrative markets for their products. A financially self-sufficient woman will help the community understand that a woman also has a role in development.

Prior studies indicated that women's Financial Inclusion (FI) increased women's decision-making power in the household (Murshid, 2018),³² improved earned income opportunities (Demirgüç-Kunt, Klapper, & Singer, 2017),³³ increased the empowerment of women (Swain & Wallentin, 2009),³⁴ and enhanced gender equality (Al-Shami, Razali, Majid, Rozelan, & Rashid, 2016).³⁵ The main question is, thus, why do women use financial products to improve their well-being if the use of financial products is crucial for women's empowerment.

As discussed by Demirgüç-Kunt et al. (2020),³⁶ it is because women are less financially included compared with their male counterparts. Women face several barriers to FI, including, but not limited to, level of education and wage discrimination (Ghosh & Vinod, 2017; Morsy, 2020)³⁷, low level of financial literacy (Arpita, 2019)³⁸, physical and geographical factors (Kempson, 2006)³⁹, collateral (Khiera, 2018), regulatory frameworks of the country (Ozili, 2020)⁴⁰, and political and social factors (Ghosh & Vinod, 2017).⁴¹

Given the entrenched gender inequality in African countries, it is surprising that the literature on this realm is still nascent. The existing few studies indicated that—like previous studies in other regions—FI is a catalyst to greater empowerment and identified several barriers to women's FI (Asuming, Osei-Agyei, & Mohammed, 2019; Koomson, Villano, & Hadley, 2020; Zins & Weill, 2016). Yet, these studies have not comprehensively addressed the issue.

Several studies indicated that women in Somalia are confronted with intensified marginalization. Furthermore, since unique characteristics of gender relations exist in Somalia, it is imperative to explore the peculiar nature of barriers to women's FI and its impact on empowerment in Somalia.

³² Murshid, N. S. (2018). Microfinance participation and women's decision-making power in the household in Bangladesh. *Journal of Social Service Research*, 44(3), 308-318.

³³ Demirgüç-Kunt, A., & Singer, D. (2018). Financial inclusion and inclusive growth: A review of recent empirical evidence. *World Bank Policy Research Working Paper*(8040).

³⁴ Swain, R. B., & Wallentin, F. Y. (2009). Does microfinance empower women? Evidence from self-help groups in India. *International review of applied economics*, 23(5), 541-556.

³⁵ Al-Shami, S. S. A., Razali, M. M., Majid, I., Rozelan, A., & Rashid, N. (2016). The effect of microfinance on women's empowerment: Evidence from Malaysia. *Asian Journal of Women's Studies*, 22(3), 318-337.

³⁶ Demirgüç-Kunt, A., Klapper, L., Singer, D., Ansar, S., & Hess, J. (2020). The Global Findex Database 2017: Measuring financial inclusion and opportunities to expand access to and use of financial services. *The World Bank Economic Review*, 34(Supplement_1), S2-S8.

³⁷ Ghosh, S., & Vinod, D. (2017). What constrains financial inclusion for women? Evidence from Indian micro data. *World Development*, 92, 60-81.

³⁸ Manta, A. (2019). Financial inclusion and gender barriers for rural women. *International Journal of Management*, 10(5).

³⁹ Kempson, E., Atkinson, A., & Pilley, O. (2006). Policy level response to financial exclusion in developed economies: lessons for developing countries. *Report of Personal Finance Research Centre, University of Bristol*.

⁴⁰ Ozili, P. K. (2020). Social inclusion and financial inclusion: international evidence. *International Journal of Development Issues*.

⁴¹ Ghosh, S., & Vinod, D. (2017). What constrains financial inclusion for women? Evidence from Indian micro data. *World Development*, 92, 60-81.

This is crucial for academic debate and policy enactment so as to provide evidence-based solutions for its quest to eradicate poverty and achieve gender equality by 2030.

Against this background, this part of the report concentrates on two separate but related topics: a barrier to women's FI and the impact of women's FI on women empowerment. Therefore, its objectives are twofold: First, it aims to explore the barriers to women's FI in Somalia. Using two indicators—access to bank and mobile money—as a measure of FI, the study examined the factors that affect the probability of women's access to these financial services. Second, the study also aims to investigate the causal impact of women's FI on women's empowerment using an impact evaluation methodology.

6.5.2 Empirical analysis of the impact of financial inclusion on women empowerment

Investigating the impact of financial inclusion on women's empowerment is non-trivial. This is due to two aspects. The first is related to the measure of women empowerment and the other is related to fact that the empirical exercise requires constructing the counterfactual: what would the level of women empowerment have been if financially included women had instead been excluded and if the excluded women had been involved?

One of the most daunting tasks in such studies is to find a good measure of women's empowerment (outcome variable). This is because different authors define empowerment differently. Although various definitions have been suggested in the literature, most of them agree that empowerment is a process whereby those who had been denied the ability to make choices acquire such a capability (Kabeer, 2005).⁴² We adopt this definition in this study, and we consider empowerment as a multidimensional process. Accordingly, a variety of indicators describing characteristics of empowerment can be combined using statistical tools such as principal component analysis (PCA) and (average) to create one unique composite index. Drawing on previous literature on this realm, including, but not limited to, (Hashemi et al., 1996),⁴³ the study measure women's empowerment using a composite empowerment index by combining various dimensions:

- i) **Mobility:** - Three components from WBHFS were used to calculate a comprehensive measure of the mobility index. First, respondents were asked if they feel free to move in and out whenever they choose. Second, respondents were also asked whether they felt safe waking at night. Third, respondents were asked whether they felt safe waking in the daytime. These variables were used as a measure of mobility. Each of the three indicators was rescaled to have a minimum of 0 and a maximum of 10 in order to make it comparable to other indicators. Then the average value of the above three indicators was calculated to gauge the mobility index.
- ii) **Political and legal awareness:** - two indicators were used to measure the political and legal knowledge of women. First, respondents in the survey were asked if they had

⁴² Kabeer, N. (2005). Gender equality and women's empowerment: A critical analysis of the third millennium development goal 1. *Gender & Development*, 13(1), 13-24.

⁴³ Hashemi, S. M., Schuler, S. R., & Riley, A. P. (1996). Rural credit programs and women's empowerment in Bangladesh. *World development*, 24(4), 635-653.

heard or read about human rights previously. Second, the respondents were also asked if they think that people in the country are equal before the law. These variables were used as a measure of political and legal awareness of women. Similarly, each of the indicators was rescaled to have a minimum of 0, and a maximum of 10 and then the average value of the above the indicators was calculated to estimate the political and legal awareness index.

- iii) **Relative freedom:** - In the survey, respondents were asked to indicate on four-point scales (1= No control, to 4= Complete control) the extent they have control over their life. This variable is thus used as one indicator of empowerment. This indicator was rescaled to have a minimum of 0 and a maximum of 10.
- iv) **Involvement in significant decisions:** In the survey, respondents were asked to indicate on a four-point scale (1= no say in making most decisions, to 4= I am the only person in my household to decide) the extent they have in making decisions on the household asset and education in the household. This variable is thus used as one indicator of empowerment after rescaling it into 0 to 10.
- v) **Economic security:** - in the survey, respondents were asked to indicate on a five-point scale (1= Much worse, to 5= Much better) their expectation of the household's standard of living over the next six months. This indicator is used as a proxy for economic security after rescaling it into 0 to 10.
- vi) **Participation in community and politics:** - in the survey, respondents were asked to indicate on a three-point scale (1= women have no voice in the community, to 3= women have a lot of say in the community). This indicator is used as a proxy for the participation of women in the community and politics after rescaling it into 0 to 10.

A composite indicator of women empowerment is thus calculated in two ways: (i) by calculating the mean value of the above six empowerment indicators; and (ii) by using principal component analysis (PCA).⁴⁴

As for the empirical investigations, the study employs the Endogenous Switching Regression (ESR) approach developed by Lokshin & Sajaia (2004) that account for both observable and unobservable factors.⁴⁵

In this approach, the treatment effects of getting access to financial services can be obtained by comparing the conditional expectations or expected outcomes of the treated and counterfactual scenario from the endogenous switching regression as presented in the table below.⁴⁶

⁴⁴ See annex for the PCA procedure.

⁴⁵ Lokshin, M., & Sajaia, Z. (2004). Maximum likelihood estimation of endogenous switching regression models. *The Stata Journal*, 4(3), 282-289.

⁴⁶ See Annex for more detail on the empirical methodology of ESR approach.

Table 2: Conditional expectation and treatment effect

Subsamples	Decision stage		Treatment effect
	Financial access	No financial access	
Women's who got the finance	$E(y_{i1} f_i = 1)^a$	$E(y_{01} f_i = 1)^b$	ATT
Women's who didn't get finance	$E(y_{i1} f_i = 0)^c$	$E(y_{i0} f_i = 0)^d$	ATU
Heterogeneous effect	$\emptyset H_1$	$\emptyset H_0$	ATH

Note:

a = represents the conditional expectation of women's who get access to finance (observed)

b= represents the conditional expectation of women's who get access to finance if they didn't get finance (counterfactual)

c= it represents the conditional expectation of women's who didn't get access to finance if they did get finance (counterfactual)

d=represents the conditional expectation of women's who didn't get access to finance (observed)

Where ATT (Average Treatment on the Treated) indicates the effect of getting financial access for the treated (a-b), ATU (Average Treatment on Untreated) represents the effect of getting financial access for untreated (c-d). ATH is the transition heterogeneity and calculated by differencing ATT on ATU. In doing so, we will assess whether the effect of getting financial access on women empowerment is higher for women that have access or for women who did not get access than in the counterfactual case they had.

The data source for this study is from the World Bank high-frequency survey (wave 2), which was collected in 2017 by using a multi-level cluster. The survey interviewed 4,011 urban households, 1,106 rural households, 468 households in Internally Displaced People (IDP) settlements, and 507 nomadic households. The surveys collected a wide range of household demographic and socioeconomic variables, economic conditions, employment, access to services, security, perceptions, and details before displacement for displaced households. It also includes comprehensive information on assets and consumption. Since the main objective of this study is to investigate the causal impact of access to finance on women's empowerment, the dataset for this study contains only female-headed households.

The result of the empirical exercise is presented in Table 7. The table presents the expected values of women empowerment under the actual and counterfactual conditions and the resulting treatment effects. The results show that access to finance has a positive and significant impact on women's empowerment. The expected total women empowerment index for the households that have access to finance is 6.43, while it is 6.28 for those who do not have access. In the counterfactual case, households who have access to finance would have obtained a women empowerment index of 5.02 had they not had access to finance. Hence, access to finance has increased women's empowerment by 1.41 points for households that have access to financing. In the counterfactual case, households

that did not have access to finance would have increased the women empowerment index equivalent by about 2.52 points had they had access to finance. ⁴⁷

Table 3: Endogenous switching regression-based treatment effect (Women empowerment average)

	Y1 (Choose to adopt)	Y0 (Choose not to adopt)	Treatment Effect	Label
A1 (Adopted)	6.43 (0.17)	5.02 (0.32)	1.41*** (0.006)	ATT
A0 (Not adopted)	8.79 (0.22)	6.28 (0.355)	2.52*** (0.009)	ATU
Heterogeneity Effect	-2.36 (0.008)	-1.26 (0.013)	-1.10*** (0.011)	ATH

⁴⁷ Please see annex I to see the result using PCA to calculate women empowerment index

7. Chapter Seven: Legal, regulatory, and supervisory framework

Financial system development depends on the legal framework to determine property rights, ensure contract enforcement, define the rights of creditors and debtors, and the rules governing financial institutions. The efficacy of the judiciary also has a significant effect on the availability and cost of credit. When finance's legal and judicial fundamentals are weak, banks tend to circumvent unfamiliar risks. They require higher profit rate spreads to cover recovering problem loans' added cost and uncertainty. Therefore, legal and judicial reforms are essential for overcoming some root causes of inadequate access to credit and high borrowing costs for local businesses.

The government of Somalia has been pursuing legal and regulatory reforms through its financial sector development. But a great deal remains to be done. The court system is weakened by inadequately trained judges and court officers, poor oversight of judicial performance, and widely reported corruption. These deficiencies are reflected in the World Bank's Doing Business report for 2020. For example, Somalia ranks the lowest among the fragile states in the world for enforcing simple commercial contracts. The country also gets a low score on legal rights for lenders and borrowers based on laws relating to collateral and bankruptcy.

This chapter begins with an overview central bank's recent legal reforms followed by the judicial system in Somalia and then focuses on topics of direct relevance to the financial system: property rights and registration; bankruptcy and insolvency; the execution of claims; and laws governing the financial system itself. Each section includes a discussion of significant issues and possible solutions.

7.1. The Central Bank Recent Reforms

Somalia's financial sector has registered measurable progress in providing financial services to the Somali people despite challenging circumstances. However, the industry has grown mainly unregulated, and it confronts numerous obstacles. CBS has established a financial sector reform program outlined in the Financial Sector Development Roadmap in response to these difficulties. In 2019–20, CBS made some progress toward implementing the roadmap, focusing on strengthening its core functions and organization, developing a national payments system and facilitating international transfers, reforming the legal and regulatory framework, and developing financial infrastructure.

The CBS employs a three-level supervisory system to promote a healthy financial industry. To begin, CBS's Licensing and Supervision Department (LSD) engages in periodic financial sector outreach activities to encourage adherence to existing financial sector regulations and laws through information sharing, training, stakeholder consultations, and the publication of industry guidelines. Second, LSD conducts risk-based examinations regularly to ensure compliance with financial sector laws and regulations. Finally, the team observes and analyzes industry practices and trends through frequent reporting requirements and follow-ups.

The Central Bank of Somalia has regulations for establishing new banks, standardizing banking practices, and regional administrative regulations. Still, there is a long way to enforce existing

regulations and develop supportive legal frameworks for new industries (such as microfinance and mobile money operators MMO legal frameworks). This has ramifications for the products available across the entire financial ecosystem. The existing laws, regulations, and guidance developed and approved over the last ten years and the other already existing laws.

Table 4. Existing Laws, Regulations, and Guidance

<p>Existing Laws</p> <ol style="list-style-type: none"> 1. Central Bank Act, 2012 2. Financial Institutions Act, 2012 3. AML & CFT Act, 2016 <p>Others;</p> <ol style="list-style-type: none"> a. Procurement act, 2020 b. PFM act, 2020 c. Revenue act, 2019 d. Statistics act, e. Customs act f. Natural resource act; Extractive industry act, oil and gas act, Tuna licensing act. 	<p>Existing Regulations For Commercial Banks</p> <ul style="list-style-type: none"> • Licensing, 2014 • Capital adequacy, 2015 • Liquidity risk management, 2015 • Internal audit, 2016 • Audit committee, 2016 • Related person transactions, 2016 • Opening and closing branch offices, 2016 • Asset classification and provisioning regulation, 2018
<p>Existing Guidelines for Commercial Banks</p> <ul style="list-style-type: none"> • Corporate Governance Guidelines, 2018 • Operational Risk Guidelines, 2020 • Shariah Governance Framework (2020) • Islamic Financial Reporting & accounting Guideline (2020) 	<p>Existing Regulations for Money Transfer Businesses (MTBs)</p> <ul style="list-style-type: none"> • MTB Registration Regulation, 2014 • MTB Licensing Regulation, 2014 • MTB AML Regulation, 2015 • MTB Customer Registration, 2016 • MTB Operations Regulation, 2016
<p>Existing Regulation For Mobile Money Service Providers</p> <ul style="list-style-type: none"> • Mobile money regulation, 2020 	<p>Anti-Money Laundering And Counter Financing Terrorism</p> <ul style="list-style-type: none"> • AML/CFT Regulation for Financial Institutions, 2019
<p>Existing Circulars for Licensed Financial Institutions</p> <ul style="list-style-type: none"> • New Requirements to Introduce Anti-counterfeit Currency Measures by Licensed Financial Institutions in Somalia (Circular No.1 of 2021) • Additional Requirements to Strengthen Anti-Counterfeit Currency Measures & Acceptance of the \$50 Note by Licensed Financial Institutions (Circular No.2 of 2021) 	<p>Main Tax Laws</p> <ul style="list-style-type: none"> • Law No. 1 of March 31, 1961, on customs, • the Legislative Decree No. 5 of November 1966 on direct taxes; • Law No. 2 of January 7, 1984, on sales tax.

Among the missing legislation are the Islamic bank's legislation, credit reference, Microfinance, land registration, competition, cyber security, and government securities laws. In addition, development finance, money lenders, deposit protection and consumer protection, and arbitration and financial dispute resolution legislation are required.

The Central Bank of Somalia employs well-balanced on-site and off-site assessment techniques. All financial institutions require annual on-site examinations (banks and nonbanking businesses). In addition, between on-site assessments, off-site examinations are conducted at regular intervals to assess the health of the institutions. While the on-site rating is given based on inspection findings encompassing broad-based criteria, off-site ratings are given based on a set of financial soundness indicators, computed quarterly and monthly.

Against the brief background above, there are some gaps in the AML-CFT system that needs to be filled; for instance, establishing a digital ID system is a requirement for better suspicious transaction reporting under the AML-CFT framework, as well as eventual support for efficient lending and intermediation. The Financial reporting and accounting requirements should also need to be improved. In addition to that, Somalia will require property rights and contracts that are adequately defined and enforced, as well as a collateral or movable asset registry and a financial dispute resolution (bankruptcy) process.

7.2. Overview of The Justice System

Somalia's legal system derives from Italian and British law, customary dispute resolution (*xeer*) principles, and Islamic law. The Federal Government of Somalia adopted the Provisional Constitution on August 1, 2012. The federal parliament has yet to enact laws clarifying the precise structure of the judicial branch; article 105(2) states that a law enacted by Parliament shall regulate the "judicial structure."

In the absence of that important legislation, the courts in the federal member states and the Benaadir Regional Administration (BRA) have adopted different structures that align with their sociopolitical realities⁴⁸. They use a three-tiered justice system inherited from the Somali Democratic Republic.

- The Court of First Instance (CFI) is usually located at the lowest administrative division, which is the district level. The CFI deals with routine civil and minor criminal cases in most states.
 - Above that is the Appeals Court, which is typically located in the province's capital (region). This court deals with the cases that the CFI escalates due to their complexity and scope.
 - On top of that pyramid is the State Supreme Court (SSC), the highest court in the FMS. It adjudicates serious crimes (such as capital and rape cases) and acts as the constitutional court at the state level should there be a dispute between government institutions.⁴⁹
- there is FGS of parallel Three Tier Court System, and this creates the need for order—and coordination

⁴⁸ [Justice-Report-Jan-6-.pdf \(heritageinstitute.org\)](#)

⁴⁹ Ibid

7.3. Time required to enforce a contract in Somalia

Governments can also undertake judicial reforms to reduce contract enforcement delays and create courts or divisions dedicated to commercial disputes. The duration and cost required to perform a contract vary considerably across East African countries; according to World Bank doing business project data in 2019, the average duration of resolved commercial cases in Somalia was 575 days, which is higher than most East African countries except Sudan. South Sudan, the newest country in Africa, has an average of 228 days and could be an example for Somalia.

Table 5⁵⁰: Time required to enforce a contract

Location	Time (days)	Filing and service	Trial and judgment	Enforcement of judgment
Ethiopia	530	30	290	210
Kenya	465	40	365	60
Somalia	575	30	365	180
South Sudan	228	28	155	45
Sudan	810	90	310	410
Uganda	490	20	365	105

Source: World Bank, Doing Business project (<http://www.doingbusiness.org/>).

7.4. Credit bureaus and registries

The federal government should include its Short-term priorities in developing the financial infrastructure to support effective intermediation and strengthening the sector's capabilities (human and institutional)—the other financial infrastructure, such as a credit reference bureau and information technologies, aid decision-making. There is a need to be mitigating the collateral/credit guarantee difficulties. The World Bank introduced the Doing Business project in 2002, which provided objective measures of business regulations and their enforcement; it covered 11 indicator sets and 190 economies. In the 2020 report, Sub-Saharan Africa remains one of the regions underperformed in ease of doing business with an average score of 51.8 percent, well below the global average of 63.0 percent. Somalia sits at the bottom 190 rated countries, below the average score of the 11 bottom-ranking economies.

⁵⁰ Time required to enforce a contract is the number of calendar days from filing the lawsuit in court until the final determination and, in appropriate cases, payment.

Table 6: Ease of doing business rank (2020)⁵²

Country	Rank
Congo, Rep.	180
Timor-Leste	181
Chad	182
Congo, Dem. Rep.	183
Central African Republic	184
South Sudan	185
Libya	186
Yemen, Rep.	187
Venezuela, RB	188
Eritrea	189
Somalia	190

“According to the Doing Business report⁵¹ of 2020, thirty economies pursued reforms **facilitating firms’ access to credit**. Five reformers either created unified and functional systems for secured transactions or expanded the scope of movable assets that can be used as collateral. Djibouti, Jordan, and Tajikistan launched geographically centralized, unified, and notice-based collateral registries in 2018/19. Moreover, Jordan, Kenya, and Tajikistan introduced online features to their existing registries. Twenty-three economies implemented reforms improving credit information systems. One of the most common reform features was the expansion of coverage of individuals and firms in credit registries or bureaus. Six developing countries carried out this type of reform. Niger, Senegal, and Togo passed laws allowing the credit bureau to collect broader historical data. With more credit data and data from alternative sources, these three economies were able to boost coverage rates.”

The most common reform features included improving the functionality of credit bureaus and registries, developing or improving online platforms to comply with regulatory requirements, improving power supply reliability, reducing specific taxes, strengthening small investor protections, streamlining property registration processes, and automation of international trade logistics.

7.5. Land and Property Rights

When property rights are clearly defined, secure, and readily transferable, land and buildings serve as the most key form of loan security for small businesses. On the other hand, weak or precarious land and property rights and limitations on title transfer pose serious obstacles to the development of credit markets. Somalia was formed from two colonies, namely British Somaliland and Italian Somalia, which explains the complex nature of the land tenure system at this time. The Agricultural Land Law of Act of 1975 abolished private ownership and was embarking on major conversions to leasing from the state, but the current situation in this country is uncertain. The land-use system in Somalia is therefore complex and unclear.

Within community-based ownership systems, access to land, rights and/or control over land often depend on one’s social identity. The fall of the government saw the rise of traditional xeer law take center stage in managing relations between clans. It deals with aspects of land management by focusing on rural land use and sees pastures as a collective clan entity, but clans allow other clans

⁵¹ [Doing Business 2020 \(worldbank.org\)](http://www.worldbank.org)

⁵² The ease of doing business ranking ranges from 1 to 190. The ranking of economies is determined by sorting the aggregate ease of doing business scores.

to graze on the land in times of need. It prohibits the construction of fences or permanent settlements on pasture lands.

Land can be acquired by individual clearing or demarcation, inheritance, request from the village council, purchase or gift. Transactions are not entirely a matter between the parties and may require the approval of the community elders, especially if the transferee is not a native.

Somalia has established formal legal frameworks and institutions that function alongside traditional systems to administer land rights. Land administration in Somalia is weak, and there is no special ministry responsible for the land⁵³

A key means for securing the gains toward peace of the last few years will be strengthening the ability of the Somali land tenure system to justly resolve ongoing disputes and provide a stable and clear framework for investment in both urban and rural areas. Critical to this effort will be finding means to smooth the interaction of the three legal systems which govern different aspects of land ownership and use today, namely the neglected formal legal system, the customary xeer system, and the Islamic system of sharia law.⁵⁴

The main problem for the private sector is that land cannot be used as genuine collateral within the current situation. Secure property rights have been a major concern since the end of the civil war when many municipal records were lost or destroyed, and the land registration system is still being rebuilt. The property registry is not automatically updated after a new property transfer, it remains largely incomplete, and there is no system for non-encumbrance verification to ensure that a property is free of charges and liens

7.6. Registry for Other Real Property

In addition to land and buildings, many other assets are suitable as security for loans. However, the use of other real property requires a convenient and effective system—clear rights and procedures—for registering and transferring titles. Legal rights facilitate the use of movable assets as collateral because of the ability to enforce claims in the event of default. Movable assets like machinery, inventory, or accounts receivable—not fixed assets like land or buildings—often account for a large share of the capital stock of small and medium-sized enterprises. In the developing world, 78% of the capital stock of businesses is typically available in movable assets and only 22% in property.

However, banks in these countries prefer fixed assets as collateral. In economies with a modern secured transactions system, these movable assets could easily be used as collateral. But in most developing economies, the movable property would likely be unacceptable because the law does not provide sufficient protection for creditors.⁵⁵ Establishing a well-managed property registry covering a wide range of assets, in which registrations are quick, simple, inexpensive, and reliable, would unquestionably help expand access to credit for many enterprises.

⁵³ Ibid

⁵⁴ Ibid

⁵⁵ DB_Hargeisa_2012_WEB.pdf (somalilandlaw.com)

8. Chapter Eight: Conclusions, Recommendations, and Roadmap

8.1. Conclusion

Several theoretical and empirical studies have shown that access to finance promotes economic growth at the national and improves productivity at industry and firm levels. It has also been shown to be associated with poverty alleviation and empowerment of marginalized groups, including but not limited to women. Despite the importance given, the focus of various literature in the finance and development space has been on developed countries and macroeconomic variables. It is against this framework that this study attempts to uncover a comprehensive analysis of the state of access to finance and financial inclusion, the impacts of financial inclusion on women empowerment, and the underlying barrier to access to finance in Somalia. This study was conducted with the objective of conducting a comprehensive analysis of the state of access to finance and financial inclusion, the impacts of financial inclusion on women's empowerment, and the underlying barrier to access to finance in Somalia.

The findings of the study indicate that the formal financial industry in Somalia consists of the central bank, 13 commercial banks, ten licensed MTOs, and 2 Licensed Mobile money service providers. Almost all private banks that operate in Somalia adhere to Islamic banking and provide sharia-compliant financial services utilizing modes of Islamic banking finance, including Murabaha, Musharakah, Mudarabah, Istisna, and Ijarah. The main challenge of the financial sector in Somalia includes Inadequate financial management structure, scarcity of qualified personnel, insufficient legal framework, and absence of capital markets, among others.

As for firms' access to financial services, the study findings indicate that access to finance is the second most reported obstacle. As a result of this, the majority of firms rely on internal funds and the owner's contribution to finance investments and other financial needs. In addition, many firms in Somalia do not have a line of credit with formal financial intuitions mainly because either they didn't apply for a loan or their last application was turned. Mobile money is the most popular tool for financial transactions in Somalia. About 99% of firms in Somalia use mobile money for transactions. Lack of collateral, high bank service charges, and the complexity of the loan proceeds are major challenges for firms in getting access to finance.

The findings of this study also indicate that access to finance has a positive and significant impact on women's empowerment; hence, increasing women's access to formal financial institutions, including mobile money, can improve the empowerment of women in Somalia.

The study further shows that despite challenging circumstances, Somalia's financial sector has shown considerable entrepreneurialism in recent decades, successfully introducing several financial services, including mobile money, to the Somali people.

8.2. Recommendations and Roadmap

The study's findings indicate that access to finance is one of the leading obstacles to firms' growth and day-to-day operation in Somalia. One of the reasons for failing to access credit from formal financial institutions is that most firms don't meet the condition required by formal banks. Therefore, they rely on friends/relatives for their financial needs, and for the majority of firms, working capital is financed from internal sources. The findings further showed that some firms even had not approached financial

institutions believing that they wouldn't get the required finance because of lack of collateral, high-interest rate, lack of networking, and the complexity of application procedures. The findings further showed that mobile money is the most popular tool for financial transactions in Somalia. Thus, expanding mobile money access appeared to matter the most for promoting access and usage of financial services to firms.

According to the study, the Somali government should **enhance access to financial services that require improving the legal, regulatory and supervisory framework and the financial infrastructure**. The main areas of improvement in the legal, regulatory and supervisory framework include (i) encouraging the entry of foreign banks to bring longer-term funding sources and improve competition; (ii) developing the Microfinance sector and its regulation; and (iii) strengthening the current financial Institution law, creditor rights, and insolvency regime; (iv) credit reporting system; and (v). In addition, it is vital to ensure that effective government policies are put in place to support SME finance, financial literacy, and women's education

For firms—notably smaller enterprises—a lack of credit risk information and KYC and other institutional issues may hinder access. For example, Somalia fares poorly on most World Bank Doing Business indicators, reflecting that it lacks a credit bureau, low contract enforcement & a lack of property registry. This is likely to drive high collateral-to-loan ratios for some firms—particularly smaller ones.

In this context, authorities should consider policies and initiatives to explore further and address barriers to financial access and inclusion. While an exhaustive review of international best practices in related areas is beyond the scope of this paper, a few key initiatives worthy of consideration include:

- **Promoting growth and macroeconomic stability.** The continued pursuit of policies that support sound and stable macroeconomic performance is necessary for financial development, improved access to finance for individuals and firms, and financial inclusion for vulnerable populations.
- **Availability of information regarding credit histories, KYC and financial risks.** Financial institutions have reported a lack of centralized data on credit risks as a significant impediment to credit providers and other financial transactions. This has also contributed to higher borrowing costs and higher collateral requirements for some borrowers—notably smaller enterprises. Prioritizing the establishment of a centralized credit bureau and developing related infrastructure should be a high priority in Somalia.
- **Promoting financial inclusion in the policy discourse.** Somalia does not currently have a comprehensive financial inclusion strategy, and the policy discourse in this area has been limited to date. Other countries in East Africa—for example, Kenya—have made quick and impressive progress in related areas, based in large part on the development of comprehensive national financial inclusion strategies involving multiple agencies of government, the financial sector, as well as interest groups representing individuals and domestic enterprises. These strategies have acted as a catalyst for information gathering and analysis of existing and potential challenges across sectors and for

developing new data and measures of access and inclusion used for benchmarking progress.

- **The Central Bank of Somalia should consider encouraging foreign bank entry in the market to bring longer-term funding sources and increase competition, which could, in turn, improve borrowers' financing terms.** Given the lack of long-term funding sources in the banking sector, encouraging the entry of foreign banks would bring longer-term and sustainable funding sources, more sophisticated credit risk appraisal and management techniques, and more developed financial products.
- **Establishment of the moveable collateral registry.** A moveable collateral registry should be established, using an online registration system for encumbrances over moveable assets, which is easy to access, reliable, and secure. To avoid redundancies and costs, this collateral registry should be linked to other asset-based registries, such as the registry for vehicles, etc.
- **Address the land governance and establish effective reforms.** The formal land registration system is to be revived, and some significant revisions will need to be made. Its purpose should be to confirm traditional rights-holders control of the land. The registration process should be more efficient, less expensive, and decentralized so that smallholders can partake in it; the district level is the most appropriate at which to conduct registration procedures.
- **Effective creditor rights and insolvency regimes are fundamental to sound financial intermediation and stability.** Stronger creditor rights help improve access to finance. A reliable legal system and judiciary are necessary for lenders to enforce contracts and foreclose collateral on loans. Inefficient legal processes and court proceedings increase the risk for lenders and make the foreclosure processes time-consuming and expensive. Similarly, inadequate creditor rights can diminish the incentives for borrowers to meet their financial obligations. In turn, these factors translate into market inefficiencies, with less financial intermediation taking place and a higher cost of financing for borrowers.

Develop Programs to Support the priority segment of SMEs & Households (HH). Government support programs for SMEs & Low income HH should be prioritized. Authorities are advised to consider the following recommendations:

- **Develop a medium-term strategy for SME development, including SME finance.** The SME strategy should be a matter of high priority. The government needs to measure the SME financing gap and carefully design and evaluate all public programs to accurately measure their outreach and sustainability effectiveness. Carry out further research on the current initiative of Gargaara to inform expansion. Donor programs could support training for SMEs.
- **Support expansion of asset finance by commercial banks and other players:** The objective is to increase the range of bank and finance company asset finance products tailored to SMEs through targeted capacity support. This initiative is to be coordinated by the CBS
- **Developed microfinance law** and improved the existing microfinance institutions to enable a broader range of providers to provide SMEs and low-income segments, as a result, contribute to the country's economic progress and prosperity.

- **Improve financial awareness:** The findings of the study showed that some of the respondents are not even aware of the existing financial products; thus, it is essential to improve awareness about the various financial products available
- **Broader support for the low income:** Focus needs to be created at a policy level for intra-household financial inclusion, especially for the elderly, women, and disabled. Since increasing women's access to formal financial institutions (mobile money) can improve women's empowerment in Somalia, it is essential to carry out financial sector reforms to promote financial inclusion.
- **Improve education and financial literacy.** The result indicated that women's risk preference and knowledge are significant predictors of access to finance; thus, financial literacy can improve awareness and women's access to finance. Also, women without education have a lower probability of financial access; therefore, it is essential to improve women's education.

ANNEX I: Empirical Analysis, Data Sources & variables

The data source for this study is from the World Bank high-frequency survey (wave 2), which was collected in 2017 by using a multi-level cluster. The survey interviewed 4,011 urban households, 1,106 rural households, 468 households in Internally Displaced People (IDP) settlements, and 507 nomadic households. The surveys collected a wide range of household demographic and socioeconomic variables, economic conditions, employment, access to services, security, perceptions, and details before displacement for displaced households. It also includes comprehensive information on assets and consumption. Since the main objective of this study is to investigate the causal impact of access to finance on women's empowerment, the dataset for this study contains only female-headed households.

Table 6 provides the variable names and descriptive statistics for households with access to finance and households without access to finance. Households with access to finance are characterized by a larger women empowerment index (both using PCA and average) than households with no access to finance. Furthermore, households with access to finance are generally associated with smaller household sizes and lower ages than households with no access to finance.

Table 7: Variable names and descriptive statistics for those who have access and not

Variable	No access to finance	Access to finance	Difference ²	95% CI ²³	p-value ²
Women Empowerment Index using average	6.25 (1.71)	6.42 (1.41)	-0.17	-0.29, -0.04	0.007
Women Empowerment using PCA	-0.13 (1.43)	0.07 (1.20)	-0.20	-0.31, -0.10	<0.001
Age	35.53 (11.59)	35.24 (11.20)	0.30	-0.56, 1.2	0.5
Marital Status					
Married	844 (81%)	1,518 (77%)			
Separated	10 (1.0%)	35 (1.8%)			
Divorced	57 (5.4%)	132 (6.7%)			
Widow or widower	93 (8.9%)	214 (11%)			
Never married	43 (4.1%)	64 (3.3%)			
Education (write or not)					
Not write in any language	703 (67%)	979 (50%)			
write in any language	341 (33%)	987 (50%)			
Household Size	5.40 (2.02)	5.40 (1.97)	0.00	-0.15, 0.15	>0.9
Money today or money in installments					
today	775 (74%)	1,643 (84%)			
installment	271 (26%)	321 (16%)			
would you say that most people can be trusted					
Not trusted	296 (30%)	588 (31%)			

Variable	No access to finance	Access to finance	Difference ²	95% CI ²³	p-value ²
Trusted	701 (70%)	1,316 (69%)			

¹Mean (SD); n (%)

²Welch Two Sample t-test

³CI = Confidence Interval

Empirical Methodology

Investigating the impact of financial inclusion on women's empowerment is non-trivial. This is due to the fact that such kind of empirical exercise investigations requires constructing the counterfactual: what would the level of women empowerment have been if financially included women had instead been excluded and if the excluded women had been involved? The construction of accurate counterfactual outcomes is challenged by the potential presence of selection bias. In our case, the non-random sample of women's financial inclusion could lead to selection bias because financially included and excluded women vary systematically in terms of observed factors such as age, education, geographical location, and unobserved factors such as motivation, risk preference, and managerial ability. These factors—both observed and unobserved—affect women's access to finance and empowerment. If corrective measures are not considered for such systematic differences, the statistical effect of access to finance may be exaggerated.

From a methodological point of view, the preferred approach to address these problems is to use a Randomized Control Trial (RCT). In RCT, the researcher randomly assigns a certain percentage of eligible women as treatment and lets them participate in the program and the remaining as a control group. The difference in the outcome of women who received financial access and the control groups in the later stage represents the causal impact of access to finance on women's empowerment. Since RCT entirely removes selection bias through randomization, if the sampling techniques are appropriately carried out, it is considered to be a gold standard in empirical causal analysis. Despite its advantages, RCT is resource-intensive, practically, and sometimes politically infeasible (Kabeer, 2020).⁵⁶

The commonly used empirical strategy to address selection bias in nonrandomized observational studies, like ours, is Propensity Score Matching (PSM), proposed by Rosenbaum & Rubin (1983).⁵⁷ In this approach, treated groups (women who get access to financial services) with similar observed characteristics are matched to the untreated group based on the propensity score, and the differences in outcomes within pairs are computed. Thus, PSM is conducted in two stages. In the first stage, the propensity score of getting financial access is estimated for each household using a probit/logit

⁵⁶ Kabeer, N. (2020). Women's empowerment and economic development: a feminist critique of storytelling practices in "randomista" economics. *Feminist Economics*, 26(2), 1-26.

⁵⁷ Rosenbaum, P. R., & Rubin, D. B. (1983). The central role of the propensity score in observational studies for causal effects. *Biometrika*, 70(1), 41-55.

estimation method. In the second stage, the households in the treated group whose propensity score is close to that of a treated observation are matched with untreated observations using various matching algorithms, and averages in differences in women empowerment within pairs are computed. Although PSM has several advantages, it has its limitations. The major drawback is that it only accounts for observable factors that are known to the researcher, such as age, income, and educational status. Unobserved factors such as risk preference, trust, and communication ability, which are known to only women, cannot be accounted for in this approach. If these unobservable factors are correlated to the error term, selection bias persists, and the PSM approach yields biased estimates of the causal impact of financial inclusion on women's empowerment.

The other empirical strategy to account for both observable and unobservable factors is to employ the Endogenous Switching Regression (ESR) approach developed by Lokshin & Sajaia (2004).⁵⁸ ESR deals with selection bias by modeling the specification in a two-stage and simultaneously estimating the barrier to financial inclusion and women empowerment using the full information maximum likelihood estimation method. In the first stage, the selection model for getting access to finance is modeled. In this study, the treatment variable used for analysis is mobile money (**mob**). In the survey, respondents were asked if the household had access to a mobile money account. Affirmative answers to this question were coded as 1, while negative responses were coded as 0. Let us assume f_i is a dichotomous variable that takes the value 1 if households get access to finance (**mob**), 0 otherwise.

$$f_i = \begin{cases} 1 & \text{if } f_i^* > 0 \\ 0 & \text{if } f_i^* \leq 0 \end{cases} \text{-----1}$$

Thus, the household's decision to get access to financial services can be represented by the latent variable as follows:

$$f_i^* = \partial Z_i + \mu E_i + \varepsilon_i \text{-----2}$$

Z_i is a vector of observable sets of variables that affect the decision to get access to finance. These variables include women's demographic and socio-economic status such as age, religion, income, education level, etc., and other factors such as geographical location. We assume that these observed factors influence both women's empowerment and financial inclusion. E_i is the instrument variable, which are unobserved factors; risk preference and trust. As a measure of risk preference, we used an indicator from the survey which asked respondents if they prefer to be given 50 USD today or 10 USD in every month for the next 5 months. Second, the respondents were also asked if they trust other people. This also can be used as an additional variable in the selection equation. Communication ability can be measured using indicators from the survey, which asks respondents how often she/he interacted with societal leaders. ∂ And μ are vectors of parameters to be estimated. The significance and the sign of these parameters indicate the barrier to women's access to finance.

Women face two regimes, (1) get access to finance and (2) not access to finance. Thus, the outcomes (women empowerment) are represented by a switching regime as follows:

$$\begin{aligned} \text{Regime 1: } y_{i1} &= \beta_1 X_{1i} + u_{1i} && \text{if } f_i = 1 \text{-----3} \\ \text{Regime 2: } y_{i0} &= \beta_0 X_{0i} + u_{0i} && \text{if } f_i = 0 \text{-----4} \end{aligned}$$

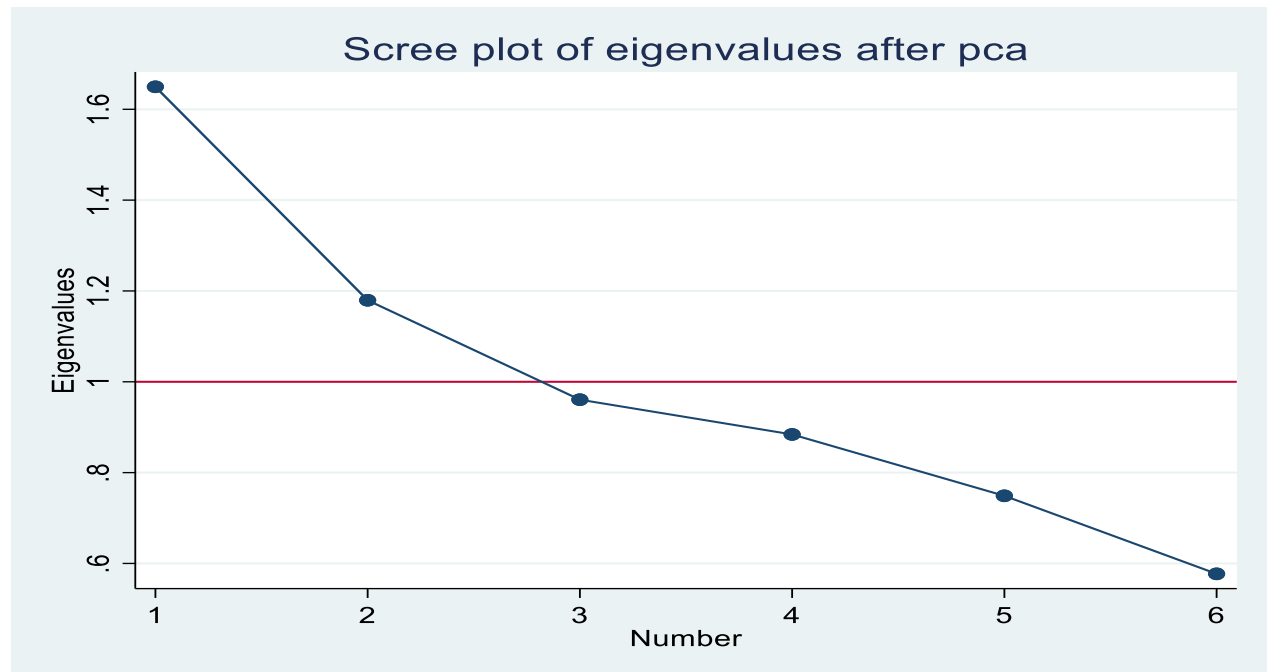
⁵⁸ Lokshin, M., & Sajaia, Z. (2004). Maximum likelihood estimation of endogenous switching regression models. *The Stata Journal*, 4(3), 282-289.

y_{i1} is the finance level of women empowerment for households who get access to finance in regime 1 and y_{i0} is the level of women empowerment for households who didn't get access to regime 2. X_{1i} and X_{0i} are vectors of control variables for regimes one and two, which are assumed to be weakly exogenous. β_1 and β_0 are vectors of parameters to be estimated. u_{1i} and u_{0i} are the random disturbance terms.

Principal Component analysis

Although the significance of women’s empowerment for society and the economy has been widely recognized, finding a proper indicator for women’s empowerment is one of the most daunting tasks for researchers. In general, prior studies quantified the level of institutional quality in two different ways. One strand of literature uses a single indicator in isolation. Several limitations can be pointed out regarding the quantification of women empowerment in these studies mainly because of the fact that women empowerment is multifaceted, one indicator in isolation couldn’t measure the level of women empowerment. This study aims to address the limitation of this approach using PCA. PCA is a method of reducing multiple variable data into fewer components that capture the maximum possible information (variation) from the original multiple variables (Abdi & Williams, 2010). To construct women empowerment using PCA, several indicators were used. The Figure below shows the number of components and their corresponding eigenvalue. According to Kaiser (1974), components whose eigenvalues (λ) are greater than 1 should be considered, while components with eigenvalues (λ) less than 1 should be dropped from further analysis.

Table 8: Scree plot of eigen values after pca



As shown in the above figure, the eigenvalues (λ) of the first two components are greater than 1. Although two components are suggested to be retained using Kaiser’s rule, we retained only one component for simplicity and assuming the largest variation is already explained by this component.

The retained component explains 68.5% of the total variance. Then Promax rotation procedure is employed in order to distribute component loading. This rotation procedure has an advantage because it aligns the component axes as closely as possible to the groups of the original variables. In order to make sure that the data in use is suitable for conducting PCA, Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy is calculated both for each variable and the complete model. The calculated KMO results are presented in the following table.

Table 9: Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy

Variable	kmo
mobility	0.6042
pol_econ	0.6036
life_control	0.6227
women_inv	0.5398
women_voice	0.5508
econ_sec	0.5185
Overall	0.5651

The rule of thumb in the KMO test is that the KMO value must be greater than 0.5 both for each variable and the complete model to ascertain sampling adequacy (Kaiser, 1974). As can be seen in the table above, the KMO values for each of the variables included in the PCA model are greater than 0.5. Moreover, the overall KMO measure is approximately 0.56, indicating sample adequacy and appropriateness of the PCA approach.

Women empowerment PCA

Table 10: Endogenous switching regression-based treatment effect (Women empowerment PCA)

	Y1 (Choose to adopt)	Yo (Choose not to adopt)	Treatment Effect	Label
A1 (Adopted)	0.078 (0.14)	-0.77 (0.325)	0.855*** (0.007)	ATT
Ao (Not adopted)	2.14 (0.18)	-0.11 (0.343)	2.26*** (0.0107)	ATU
Heterogeneity Effect	-2.07 (0.007)	-0.65 (0.013)	-1.41*** (0.012)	ATH

ANNEX II: Consolidated Commercial Bank Data

Table 11: Consolidated Commercial Bank Data (Millions USD)

Year	Months	Consolidated Assets				Consolidated Liabilities and Owner's Equity					
		Financing Assets	Investment Assets	Other Assets	Total Assets	Customers Deposits	Microfinance Loans	Others Liabilities	Total Liabilities	Total Shareholder's Equity	Total Liabilities & Equity
2015	March	43.0	15.6	23.3	168.1	115.5	0.4	4.2	120.2	48.0	168.1
	June	42.2	15.6	19.9	169.9	117.3	0.1	4.8	122.3	47.6	169.9
	Sep	42.0	15.6	21.6	190.8	139.7	0.2	4.7	144.6	46.2	190.8
	Dec	45.2	15.6	21.6	194.4	142.8	0.1	4.9	147.8	46.6	194.4
2016	March	47.3	15.6	22.9	212.5	153.8	2.0	5.9	165.9	46.6	212.5
	June	51.4	15.6	35.9	214.0	158.1	0.9	4.4	163.4	50.6	214.0
	Sep	55.8	15.6	21.7	225.1	167.6	1.0	3.6	172.2	52.9	225.1
	Dec	66.1	15.6	21.0	234.2	177.1	0.9	4.4	182.4	51.8	234.2
2017	March	76.6	15.6	44.4	252.1	194.6	1.6	6.5	202.7	49.4	252.1
	June	86.9	15.6	52.6	282.4	219.7	1.6	10.9	232.2	50.2	282.4
	Sep	95.5	15.6	50.8	305.8	238.3	6.3	9.4	254.0	51.8	305.8
	Dec	105.2	15.6	61.3	345.0	267.2	9.9	15.2	292.4	52.7	345.0
2018	March	154.5	34.9	10.2	347.0	272.6	1.0	23.4	297.0	50.0	347.0
	June	146.8	49.7	13.9	351.3	276.9	1.0	21.4	299.2	52.1	351.3
	Sep	149.0	46.6	13.4	377.3	296.0	1.5	24.6	322.2	55.1	377.3
	Dec	161.4	53.5	8.0	414.9	332.4	1.5	27.1	361.0	53.9	414.9
2019	March	174.3	55.0	14.5	426.1	343.9	1.5	25.5	370.8	55.2	426.1
	June	165.9	72.6	24.7	470.1	362.6	1.5	21.6	387.5	71.8	459.3
	Sep	154.5	90.6	26.9	504.4	382.2	1.5	21.8	406.3	98.1	504.4
	Dec	155.6	109.7	32.9	556.2	430.1	1.5	27.2	459.2	97.0	556.2
2020	March	162.9	112.5	33.6	563.3	413.1	1.5	34.2	455.5	107.8	563.3
	June	139.4	111.6	58.3	572.7	424.7	2.9	21.7	462.7	110.0	572.7
	Sep	138.3	120.5	44.8	615.1	460.7	2.9	29.4	502.9	112.2	615.1
	Dec	145.8	134.6	59.4	845.7	667.2	2.9	32.2	712.3	133.4	845.7
2021	Jan	150.1	134.3	58.7	821.3	643.4	2.9	32.0	687.9	133.3	821.3
	Feb	155.6	141.6	34.8	825.7	641.6	2.9	36.7	691.6	134.1	825.7
	March	163.1	142.7	30.8	840.9	656.9	2.9	35.9	706.7	134.2	840.9

Sources CBS, 2021

ANNEX III: Domestic credit to the private sector

Table 12: Domestic credit to the private sector (% of GDP)

Year	Burundi	Kenya	Rwanda	Sudan	Somalia
1965	2.59	13.76	1.1	9.08	9.95
1966	2.54	12.61	1.98	9.56	9.58
1967	3.52	14.58	1.47	11.16	9.56
1968	3.8	12.89	1.36	12.12	10.36
1969	3.07	12.73	1.66	10.27	10.91
1980	6.89	21.81	5.75	13.25	2.45
1981	9.78	21	6.09	12.94	2.61
1982	8.26	20.44	6.13	13.74	5.58
1983	7.03	19.32	5.87	12.87	6.54
1984	3.97	18.99	6.45	11.85	5.98
2016	17.17	35.57	20.49	8.22	2
2017	15.46	33.15	20.59	8.39	2
2018	18.03	31.2	21.39	9.35	2
2019	20.7	30.78	21.44	9.17	2
2020	22.39	32.04	24.67	7.9	2