T. C.

Social Sciences University of Ankara

Institute for Islamic Studies

Islamic Economics and Finance Department

# Islamic Banks in Somalia: Issues, Practical Solutions and Opportunities

Master Thesis

Adna Ibrahim Farah

Ankara

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## ACCEPTANCE AND APPROVAL PAGE

## ACKNOWLEDGEMENT

O Allah, all praise is thanks to you alone; you're the sunshine of the heavens, and therefore the earth and everything in them. For you alone deserve all praise; you're the keeper of the heavens and also the earth and everything in them. and everyone praise is reserved for you alone; you're the reality, you promise that the truth, your speech is that the truth, the meeting with you is that the truth, paradise is that the truth, hell fire is that the truth, the last hour is that the truth, all prophets are the reality, and Prophet Muhammed (peace be upon him) is that the truth. O Allah you are the one who is worthy of our worship, having no partners, no associates, no sons, no daughters, no one whom he must consult, and no one or anything which has any comparison with him.

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## ABSTRACT

Islamic Banking is a system in which finance is contributed in the form of money in return for equity or rights to a portion of future firm earnings, or in the form of products and services offered in exchange for a pledge to repay their value at a later date. Unlike conventional finance, Islamic finance is based on five fundamental pillars: the prohibition of interest, the prohibition of uncertainty, the prohibition of gambling, profit and loss sharing, and the requirement that all financial transactions are underlying physical assets.

The study's objective is to analyze the challenges and opportunities confronting the Somali Islamic banking industry. The study also intends to focus on a number of the main issues impeding the expansion of Islamic banking within the country and suggest several potential solutions.

Primary data are collected by the survey conducted in the study and analyzed with the Stata program. Our study's target population comprised Islamic Bank employees in Somalia in order to develop a broad understanding of the causes and patterns of issues and opportunities of Islamic banks in Somalia. Moreover, research papers, textbooks, websites, and unpublished thesis were used to get additional information related to the topic.

According to the survey findings, it came out that Somalia's Islamic banks have not yet reached their full potential. Among the issues raised by the employees was the lack of cohesive SSB that deals with all banking issues such as Fatwas and other necessary laws, a shortage of professional employees with a better understanding of technology, and other project management.

Other significant issues were lack of awareness among the society, regulative issues, high pricing finance, lack of Islamic insurance, low rate of return, lack of R&D, competition from mobile companies, shortage of market information, and lack of connection with global banks. Finally, the most significant risk issues raised by the employees were credit risk, liquidity risk, rate of return risk, collateral risk, and foreign exchange risk.

On the contrary, findings indicate that Islamic banking has a significant opportunity in Somalia because the Somali community's acceptance of Islamic banking is higher than conventional banks.


**Key Words:** Islamic Finance, Challenges and Opportunities, Somalia, Employee

# ÖZET

İslami Bankacılık, öz sermaye veya gelecekteki firma kazançlarının bir kısmı üzerindeki haklar karşılığında para şeklinde veya değerlerini geri ödeme taahhüdü karşılığında sunulan ürün ve hizmetler şeklinde finansmanın sağlandığı bir sistemdir. sonraki tarih. İslami finans, geleneksel finanstan farklı olarak beş temel sütuna dayanmaktadır: faiz yasağı, garar yasağı, kumar yasağı, kar ve zarar paylaşımı ve tüm finansal işlemlerin fiziksel varlıklara dayanması gerekliliği.

Çalışmanın amacı, Somali İslami bankacılık sektörünün karşılaştığı zorlukları ve fırsatları analiz etmektir. Çalışma ayrıca, İslami bankacılığın ülke içinde yayılmasını engelleyen bir dizi ana konuya ve çeşitli potansiyel çözümlere odaklanmayı amaçlamaktadır.

Birincil veriler çalışmada gerçekleştirilen anket ile toplanmış ve Stata programı ile analiz edilmiştir. Çalışmamızın hedef kitlesi, Somali'deki İslami bankaların sorunlarının ve fırsatlarının nedenleri ve çeşitleri hakkında geniş bir anlayış ortaya koymak için Somali'deki İslam Bankası çalışanlarından oluşmaktadır. Ayrıca araştırma makaleleri, ders kitapları, web siteleri ve yayınlanmamış tezler, çalışma ile ilgili ek bilgiler elde etmek için kullanılmıştır.

Anket bulgularına göre, Somali'nin İslami bankalarının henüz tam potansiyellerine ulaşmadığı ortaya çıkmıştır. Çalışanlar tarafından dile getirilen sorunlar arasında, fetvalar ve diğer gerekli yasalar gibi tüm bankacılık konularını ele alan uyumlu bir SSB'nin olmaması, teknolojiye daha hâkim profesyonel çalışanların eksikliği ve diğer proje yönetimi yer almıştır.

Diğer önemli sorunlar ise toplumda farkındalık eksikliği, düzenleyici sorunlar, yüksek finansman maliyeti, İslami sigorta eksikliği, düşük getiri oranı, Ar-Ge eksikliği, mobil şirketlerin rekabeti, piyasa bilgisi eksikliği ve küresel bankalarla bağlantı eksikliğidir. Son olarak, çalışanlar tarafından ifade edilen en önemli risk çeşitleri kredi riski, likidite riski, getiri oranı riski, teminat riski ve kur riski olmuştur.

Buna karşılık, bulgular İslami bankacılığın Somali'de önemli bir fırsata sahip olduğuna işaret etmektedir çünkü Somali toplumunun İslami bankacılığı kabulü geleneksel bankalardan daha yüksektir.



**Anahtar Kelimeler**: İslami Finans, Sorunlar ve Fırsatlar, Somali, Çalışanla

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| | |
|---|---|
| **AAOIFI** | Accounting and Auditing Organization for Islamic Financial Institutions |
| **BIB** | Bahrain Islamic Bank |
| **CIS** | Commonwealth of Independent States |
| **CBS** | Conventional Banking System |
| **CBS** | Central Bank of Somalia |
| **DIB** | Dubai Islamic Bank |
| **DBI** | Dahabshil Bank International |
| **DSB** | Dara-Salam Bank |
| **FIAT** | Faisal Islamic Bank of Egypt |
| **FIBS** | Faisal Islamic Bank of Sudan |
| **FIL** | Financial Institutions Law |
| **GCC** | Gulf Cooperation Councils |
| **IBF** | Islamic Banking Finance |
| **IFSI** | Islamic Financial Service Industry |
| **IBEs** | Islamic Banking Entities |
| **IDB** | Islamic Development Bank |
| **IFSB** | Islamic Financial Services Board |
| **IBS** | International Bank of Somalia |
| **IAHs** | Investment Account Holders |
| **KFH** | Kuwait Financing House |
| **K-MFI** | Kaaba Microfinance Institution |

| | |
|---|---|
| **KIMS** | Kaah International Microfinance Services |
| **MGISB** | Mit-Ghamar Islamic Saving Bank |
| **MTOs** | Money Transfer Operations |
| **MFIs** | Microfinance Financial Institutions |
| **MFI** | Micro-Dahab Financial Institutions |
| **NGOs** | Non-Governmental Organizations |
| **R&D** | Research and Development |
| **SSBs** | Shariah Supervisory Boards |
| **SMEs** | Small and Medium Sized Enterprises |
| **SBI** | Somalian Islamic Banks |

# INTRODUCTION

## BACKGROUND OF THE STUDY

It is evocative that the appearance of modern Islamic finance is to contribute alternative shariah-based financial services and provides products for people who do not fit to the commercial services because of religious rationale (S. M. Hailu & Yatoo, 2021).

Islamic Banking is a system in which finance is contributed in the form of money in return for equity or rights to a portion of future firm earnings or in the form of products and services offered in exchange for a pledge to repay their value at a later date (Al-Jarhi, 2004).

According to Franzoni & Allali (2018), unlike conventional finance, Islamic finance is established based on five essential pillars that supervise the principles and regulations of the legality (*Shariah* compliant) of all various kinds of Islamic economics and finance. These fundamental pillars are; the prohibition of interest *(riba*), the prohibition of speculative elements (*Gharar)*, the forbidden of the utilization of haram investment and change of prohibited goods and activities *(Haram*), profit and loss sharing (PLS), and also the obligation to own actual asset underlying any stated financial transactions.

Islamic finance has a 1.400-year history as the chronicle books have written that through the time of the first century of Islam, around (AD 600) few structures of Islamic finance activities existed that are correspondingly very similar to the present-day banking affairs. It can be seen by the evidence of *Al-Zubair bin Al-Awam*, who was among the most influential Muslims in his era. It is said that he would invest deposits given to him by the people as loans (Alharbi, 2015) Moreover, during the era of the Umayyad dynasty, in the 1st Century, Goods Sukuk was used extensively.

Most the Muslim countries accepted a conventional-based financial system in the middle of the nineteenth century (Hailu & Bushera, 2020). Concerning the European financial system, Islamic scholars divided the system into three categories. The first group argued that this type of banking activities is Shariah-compliant, and the promoters of this argument were people such as the founder of the Bank of Egypt. The second group argued that Bank activities are non-Shariah compliant, but it is necessary. Some scholars see that banks are vital in the economy regarding this opinion. Therefore, it is not forbidden to set up banks based on the idea of the European financial system, even though their activities are not Shariah compliant. The final group argued that these banking operations are vital. However, interest is not necessary for their activities. This opinion is the most adopted one since all the scholars agreed that Muslims should not deal with interest (*Riba)* (Alharbi, 2015).

At the end of 19th and early 20th centuries it was the start of the Islamic revival era. People who were accountable for this re-establishment are Muhammad Abduh (1849), Rashid Reda (1865), Abdula Al Muadud (1937), Hassan Al-Banna (1939), Muhammad Iqbal (1975), Anwar Qureshi (1946), Muhammad Uzair (1955), Hifz Al-Rahman (1942), Muhammad Hamidullah (1944), Naiem Siddiqi (1948) and Yusuf Al-Dean (1950), (Shahar et al., 2017).

El-Naggar founded the first Islamic financial institution in Egypt, Mit-Ghamar Islamic Saving Bank (MGISB) in 1963 (Karasik et al., 2006). Moreover, the current application of Islamic insurance (Takaful) was well-established in the 1970s (Hailu & Bushera, 2020). Using the modern practice of Islamic insurance was dispersed to all Muslim and Non-Muslim countries, (Hussain & Pasha, 2011). Furthermore, the Islamic Development Bank (IDB) was established during a meeting in Saudi Arabia, Jeddah in 1974. The purpose was to encourage industrial development and social improvement in all Muslim countries (Turner, 2011).

Dubai Islamic Bank was established on March 12, 1975, and it is considered the first private Islamic banks. Followed by emergence of several Islamic banks in the early 1970s and 1980s, and most of them are still operating until today (Alharbi, 2015).

The first Islamic bank was created more than 45 years ago. Today, the sector has grown quickly and significantly. In 2021, the worldwide Islamic banking industry's increased by 9.5% year on year in terms of assets, while in the year 2020 it was around 4.3%.

Over the last five years, the total Islamic capital market (ICM) sectors, comprising Sukuk, Islamic funds, and Islamic equities, have been the fastest expanding areas in IFSI. Furthermore, the Islamic insurance (Takaful) sector is still representing only 0.8% from the total Islamic finance industry assets. The growth was accomplished for a variety of factors, including improving economic conditions, more digital transformation operations, and increased public knowledge and enthusiasm for Takaful offers.

In 2021, the Gulf Cooperation Council (GCC) was the largest domicile for Islamic financing assets, increasing by 3.5% point to constitute 52.4% of the total Islamic finance assets in the world. Despite a small decline to 23.5% in 2021 (202:24.9%), South-East Asia maintained its second-place regional IFSI market share. The Middle East and South Asia area accounted for the third highest Islamic financing assets in 2021, accounting for 17.4% of worldwide IFSI assets (2020:20.3%). Although the African region's proportion of the worldwide IFSI value has increased, it remains tiny at 2.1% (2020: 1.7%). Furthermore, the other areas, which included Turkey, the United Kingdom, and nations from the CIS regions, represented the remaining 4.5% of total worldwide IFSI assets in 2021 (2020: 4.3%).

Finally, the worldwide Islamic banking sector's growth rate in 2021 was boosted by a global economic recovery and less restrictive pandemic-related regulations throughout the world. It reached $ 2.10 TN. Furthermore, the increase in oil prices contributed to the 2021 growth rate (IFSB, 2022).

On the other topic, regarding Somali, when the government fell in 1991, all national institutions that provided services and managed financial affairs including the economic and financial sectors, disappeared including the central bank and banking system. Conflict and an uncontrollable economic stagnation have afflicted the country, and it has led to a reduction in the work of the national economy, legal and social system. Since then, Somalia has had no financial institutions other than remittance companies which were established directly after the decline of the Somali government to fill the gap left by banks, (Musse et al., 2019). Before the collapse of the central government of Somalia, its financial sectors consisted of the central bank of Somalia, Somali development bank, state of the insurance company, and commercial and saving banks which were all created through the government's forced merger of several banks, (Somalia Unit European Commission, 2004). That demonstrates that the country was ruled by a communist regime that nationalized private financial organizations and merged them into a single bank. Such a situation has worsened the country's economic system after the commercial and saving banks began to shut down. When remittance companies arrived in Somalia after the central government fell, their role was confined to remittances, in which Somalis who are living abroad paid money to support their relatives in Somalia. The establishment of Somalia's federal government and the reintroduction of the central bank caused to the opening of new Islamic banks, and large remittance corporations converted to Islamic banks. This was to revive the hopes of the country's financial sector and especially for Islamic banking industry (Musse et al., 2019).

**PROBLEM STATEMENT**

The banking service in Somalia can be traced back to 1920 and it was responsible for supplying commercial services before the collapse of the Somali central government in 1991. During that time, all national institutions that provided services and managed financial affairs were a non-shariah complaints. Nevertheless, With the formation of Somalia's federal government and the restoration of the central bank, new Islamic banks emerged in 2009 (Abdi, 2014).

Several studies such as Abdi, (2014); Hassan, (2018); Hassan, (2017)s indicated that Islamic banks in Somalia continue to face considerable obstacles such as lack of Shariah Supervisory Boards (SSB), absence of an active central bank, absence of financial institution, unqualified employee, Illiterate, inadequate financial literacy, competition issues, a lack of liquidity tools, a lack of advanced technology and media, and a lack of professional bankers.

Managing and running Islamic banks requires highly trained staff in the administration of Islamic financial tools. However, Somalia does not have adequate professional bankers because Islamic banks are newly emerged in Somalia since the collapse of the Somali central government in 1991. Furthermore, bank managers do not give enough attention to train the bank employees in order to have better understanding of technology, ethics and religion of their business investments. On top of that, there are not many universities in Somalia that provide faculty of Islamic banking and finance. Therefore, most of Somalia's Islamic banks staff have a background in conventional banking only.

Understanding the significance of Islamic banking is critical for both impacting how people deals with these banks and benefit from this industry. As a result, if Somalia's Islamic banks meet these challenges, they will have many opportunities, such as financing new development projects in both the private and public sectors, because they have significantly better societal approval than conventional banks.

In this research, the researcher intends to identify the principal issues, challenges, and opportunities of Somalian Islamic banks.

Secondly, the researcher will offer several practical solutions to the challenges and issues impeding Somalian Islamic bank development.

**RESEARCH OBJECTIVES**

The primary goal of this research will be to assess the obstacles and prospects in Somalia's Islamic banks. More specifically the research objectives:

- To study the major current obstacles to the growth and viability of Islamic banking in Somalia.
- To investigate which opportunities can Somalia gains from the Islamic banking industry.
- To offer several practical solutions and suggestions in order to eliminate the challenges faced by Somalian Islamic banks.

**RESEARCH QUESTIONS**

- What are the current issues impeding the expansion and development of Islamic banks in Somalia?
- What are the opportunities available to Somalia from implementing Islamic banking industry?
- What are the practical solutions and suggestions to reduce the challenges of Islamic banks in Somalia?

**STRUCTURE OF THE THESIS**

The thesis comprises of five chapters including the introduction and conclusion.

Introduction chapter discussed the background of the study, problem statement, research objectives, research questions, methodology, and lastly, a detailed structure of the study.

Chapter one focuses on the literature review. This part studied the literature papers connected to the difficulties and possibilities in Islamic banks generally and specifically in Somalia. It is separated into three categories: Islamic banking theoretical review, empirical review, and Islamic banking challenges and opportunities.

Chapter two focuses on the methodology part, the research design, population of the survey, data collection and data analysis.

Chapter three concentrates on the general outlook of Islamic banking. This section outlines the fundamental ideas and techniques of Islamic banking in general.

Chapter four focus on Islamic banks in Somalia. This section concentrates on the history of the Somalian financial system, its developments, and its regulatory system.

Chapter five focuses on the findings and results of the survey.

Finally, conclusion chapter concentrates on conclusion of the study, policy recommendations, limitation of the study and suggestions for further studies.

# CHAPTER 1. LITERATURE REVIEW

## 1.1. INTRODUCTION

For the previous three decades, the Islamic banking industry has grown significantly. Along these growth, the institutions that provide shariah-based services have also increased. Making way for many conventional banks to open Islamic windows and branches. The development of Islamic finance has earned international recognition. However, the industry is still facing several problems from different angles (Hassan & Lewis, 2007).

This chapter will review existing literature concerning the issues and opportunities in the Islamic banking industry, as well as in Somalia.

There are many studies regarding the challenges of Islamic banking. While some studies have explored the general issues, some have examined them in a particular countries. Nevertheless, the studies concerning the challenges and opportunities in Islamic banking in Somalia are narrow.

This chapter will contain three parts: the theoretical review of Islamic banking, the experimental review of Islamic banking, and the issues and opportunities of Islamic banking.

## 1.2. THEOREITCAL AND EMPERICAL REVIEW OF ISLAMIC BANKING

The notion of Islamic banking and finance (IBF) is not a new concept. Islamic finance emerged during the prophet's time (peace be upon him) where by the transactions were carried out based on *Mudarabah*, where one of the parties contributed the capital, and the other party contributed his effort and experience. In these transactions, the profits were shared according to the agreement of both parties. In terms of loss, the provider of capital would bear the loss while the other party would lose his effort and time (Iqbal & Quibtia, 2017).

In the modern era, around 1940 up to 1960, the theoretical subject of Islamic banking started to materialize in the languages of Urdu, English, and Arabic. However, the study did not concentrate on Islamic banking in specific. Nonetheless, it focused on the Islamic economic system as a whole. Nevertheless, during 1980s, the narrow study of Islamic banking and finance gained vast academic and professional attention but the techniques and principles of the system have been applied and used since Islam began. Several Muslim countries began to get attracted to the idea of Islamic banking and prepare professionals to work in this field. Many different universities start to teach this subject and uplifted many Ph.D. dissertations to this field. During this period, many research centers gave special attention to the study of Islamic economics. As a result, journals provided space for exchanging ideas of information in this topic across the world (Abdi, 2014).

The Islamic banking industry has obtained acceptance from both Muslim and non-Muslim societies due to its expeditious growth in the past years (Munawar & Philip, 2006).

The foundations of Islamic banking are to follow Allah's shariah standards in conducting our day-to-day operations and transactions. The source of earnings in Islamic banking is either profit, service fee, and partnership among the parties. Furthermore, paying or cumulating interest is forbidden in Islamic banking transactions (Ahmad et al., 2011).

## 1.3. CHALLENGES AND OPPORTUNITIES OF ISLAMIC BANKING

Munawar & Philip (2006) stated that Islamic banking has shown great success in different areas. However, it faces a lot of challenges like any other financial system. There are still challenges and unsolved issues, such as theoretical, practical, operational, internal, and external problems that need to be given considerable attention. They indicated that Islamic banks regarding the theoretical issue are complicated because Islamic banks must adopt modern risk management techniques to reduce challenges. Additionally, the study suggests that to overcome the operational issues, Islamic banks must interact with conventional banks with Basel II to engage with modern risk management.

Abozaid, (2015) analyzed the internal challenges of the Islamic banking industry. The investigation uncovered various difficulties, such as absence of Shariah-compliant oversight boards and a product development approach. The study also revealed the challenges of Islamic banking that needs instantaneous action, which is perhaps be overcome by validating shariah governance and improving product methodology. On top of that, Iqbal et al., (1998) examined the development of Islamic banking and focused on the obstacles and challenges. The study listed the challenges as follows: Institutional and operational challenges that includes a lack of support and funding, a lack of a proper legal framework and supportive policies, a lack of a financial supervisory framework, accounting policy, a lack of fair institutions, a lack of an organized secondary financial market, a lack of financial engineering, shariah issues, a lack of profit-sharing investment, the issue of defaulters, and compensation.

According to Sayar, (2020) regarding issues and challenges of participation banking in Turkey. The research revealed several challenges, such as legitimate and regulatory framework issues, administration issues, shariah governance issues, industrial issues, attitudes towards society, and risks. The study also identified that the participation bank in Turkey has not yet accomplished the potential point. Moreover, the study discovers the necessity for additional supervision that would lead to participation banking for the legislative framework. Also Yanīkkaya & Uğur, (2017) studied the causes and solutions for the stagnation of Islamic banking in Turkey. They listed the challenges of Islamic banking in Turkey as follows: absence of shariah governance, absence of regulatory institutions, absence of different instruments, weak perception of society regarding Islamic banking, the effectiveness of operational activity of IBs is lower contrasted with CBS and lastly, lack of academic studies. Another study conducted by Egresi & Belge, (2017) analyzed Islamic banking in Turkey: population perception and development challenges. The findings showed that there is a secularism issue, the majority of the Turkish people disconnected religion from business, trust issues regarding shariah-compliant institutions, and lack of awareness. People are not well-versed in Islamic banking or its products.

Aqilah Zainordin et al., (2016) in an investigation of the challenges and opportunities of Islamic banking and institutions in Malaysia, revealed that several challenges, such as Misinterpretation and absence of harmonization of Islamic financial concept, legitimate challenges, narrow market, and, limited risk administration performance affects the Islamic banking system. The report also highlighted the significant prospects for enhancing Islamic financial banking in Malaysia because of the acceptance of Muslim and non-Muslim populations.

Bello & Abubakar, (2014) in case of Nigeria discovered two different categories of challenges. Institutional challenges and operational challenges such as unprofessional institutional framework, insufficient legal framework, a lack of institutional equity, a deficient supervisory framework, disparities in accounting practices, the absence of short-term financial instruments and institutions, and an absence of supporting financial market, religious and cultural diversification, a lack of financial inventions, a lack of profits finance, shariah issues, a shortage of resources, and an inadequate understanding. Similarly, Idris, (2017) Also, studied the challenges faced in the establishment of the Islamic banking system in Nigeria, he stated that Islamic banking in Nigeria gives good opportunities to both domestic and foreign shareholders. Nevertheless, several serious challenges hinder the improvement of the Islamic banking system in Nigeria, such as unskilled accounting and Auditing standards, insufficient legal and regulatory environment, competitiveness towards conventional banking, dual taxation, non-shariah compliant liquidity governance, absence of public awareness, and lack of Islamic insurance. Another study about Nigeria done by Saidu, (2018) illustrates challenges of non-interest Islamic banking in Nigeria as religious and cultural diversity, shortage of human resources, shortage of financial restructuring, lack of sufficient knowledge, double charging, competitiveness, and insufficient legal framework.

Olad, (2012) studied Islamic Banking; prospects, opportunities and challenges in Ethiopia. According to the study's findings, Islamic banks in Ethiopia face several problems., such as absence of knowledge and understanding, legal, administrative, regulatory, and institutional challenges, bad attitudes towards religion, lack of skilled labor, capital resource constraints, Inadequate demand, and market potential, as well as inappropriate banking policies. A similar study done by Hailu & Bushera, (2020) showed that there are golden opportunities in Islamic banks in Ethiopia. However, the negative aspects concerning Islamic banking emerged as a misapprehension. Additionally, it showed limited banking affairs, restriction on funding banks, fiscal policy, inaccessibility of controlling mechanism, the biggest problems of Islamic banking in Ethiopia are a shortage of specialists and a lack of capital. GIRMA, (2020), Also explored the challenges and prospects of full-fledged Islamic banks in Ethiopia. According to his conclusion, despite the practical perspectives of Islamic banking in Ethiopia, the study revealed the main challenges that need to be focused on such as regulatory challenges and insufficient awareness. Hailu & Yatoo, (2021) Also identified in their study of Islamic finance in Ethiopia: current status, prospects, and challenges that there are several positive opportunities in Islamic finance in Ethiopia, such as high national demand, accessible demand aggregation, and cost-effectiveness. On the other hand, legitimate frameworks, pessimistic attitudes, and lack of human resources are the obstacles to the expansion of Islamic banks in Ethiopia. Abdulhade, (2020) adopts a descriptive analysis to explore the challenges and opportunities of expansion of Islamic banks in Ethiopia's case of the commercial bank of Ethiopia Dire Dawa interest-free branch. The study revealed that Islamic banks in Dire Dawa have both opportunities and issues. However, its challenges are even higher than conventional banks due to its absence of awareness, shortage of human resources, and lack of shariah-based funds.

Iswanaji, (2018) studied challenges facing Islamic banking growth in Indonesia using the Analytical Hierarchy Process. Iswanaji argues that the biggest challenge is the regulatory framework. Therefore the government should increase the market share of Islamic banking. Secondly, unqualified staff and lack of knowledge of Muslim society regarding terms, commodities, and the fundamental principles of Islamic banking are some of the obstacles to the expansion of Islamic banking in Indonesia. Another study from Iran maps the expansion of Islamic banking in Iran: prospects and problems. According to the research, three issues confronted the industry: weak growth, non-performing assets, and a shortage of goods and services (Parveen et al., 2015).

Sarker, (1999) in an attempt to explore Islamic banking in Bangladesh: performance, problems, and prospects. In his investigation he found that there are Micro and Macro operational challenges. Firstly, the study finds banks are successful in planning an interest-free banking system. Secondly, most Islamic banks in Bangladesh have a high probability of implementing profit sharing strategy. Thirdly, there is a lack of legitimate assistance from the central bank. Lastly, there is a shortage of expertise and skilled personnel to observe and evaluate the financing projects. Another study done by Alamgir et al., (2017b) examined in the context of global development, issues and problems for Islamic finance and banking in Bangladesh. Despite the success of the Islamic banking sector in Bangladesh over the previous 32 years, the industry is still struggling with several challenges, including a lack of an actual institutional framework, a lack of proper regulation and supportive protocols, a lack of a functional supervisory framework, a lack of standardized shariah supervisory boards, an issue with accounting rules, a shortage of equity institutions, a lack of a secondary financial market, and a lack of short-term securities, and an absence of shariah governance, limited financial engineering, and innovation, educating shariah scholars, insufficient training and educating, lack of profit-sharing finance, illiquidity of assets, levanters issue, repayment and penalties, lack of deposit mobilization, competition, globalization involvement, risk management issue, and lack of consumer orientation.

Musse et al., (2019), In a study titled "The Emergence of Islamic Banks in Post-Conflict Somalia: Prospects and Challenges." Islamic banking has a lot of potential in Somalia. However, it suffers unique obstacles as a result of civil wars. The problems include a lack of national identity, shortage of trained human capital and specialists, a lack of a shariah supervisory board, a lack of human capital, and competition from mobile money firms. Abdi, (2014) adds that research has shown that there are several obstacles, including a lack of regulators and financial institutions, unqualified employees, and a lack of shariah supervisory boards. This study makes several recommendations, including that bank should train their employees by providing proper facilities and advice to their employees, and the central bank should establish policies regarding financial institutions, and lastly, they should develop a plan to expand shariah supervisory boards across the country. Furthermore, Warsame, (2016) made an investigation on whether Islamic banks would prosper in Somalia after 25 years of the country's whole financial system collapsing. According to the research, the country's banking industry is in desperate need of revitalization. The provision of financial services based on the beliefs of the local population, all of whom are Muslims, has a high chance of success, implying that Islamic banking may prosper in Somalia. In addition, the study discovered that a joint venture with an international bank is the best banking strategy in Somalia. Finally, using internet marketing tools and mobile platforms to promote Islamic banking products and services in Somalia is more effective. Another similar study conducted by Warsame et al., (2021) found that Somalia's Islamic banking potential and the role it may play in reviving the country's faltering economy. Based on the study, the absence of a functioning financial system, a lack of finance and skills, and the effect of bank absence on a firm had a negative and little impact. Moreover, The Islamic banking of Somalia has been influenced by the country's economic and political infrastructure. Law and order measures have a substantial influence on Somalia's banking and financial industry's acceptability. Although only to a limited extent, Shariah-compliant funding assists Somalia's Islamic banking sector. Due to a lack of skilled labor, new banks in Somalia have a lower probability of success. Another research on Somalia was conducted and the following were the findings of this study: a lack of awareness and comprehension, inadequate financial literacy, competition issues, a lack of liquidity tools, a lack of advanced technology and media, and a lack of professional bankers. He continues his research by stating that Islamic banks in Somalia will add capacity to the country's economy ( Hassan, 2017).

Similar studies conducted during the outbreak of Covid 19 are as follows: Hassan et al., (2020)The research looked into the issues that Covid-19 posed to Islamic banking and how Fintech technology labels those challenges. It also introduces a censorious investigation of the Islamic finance and sustainability of the Islamic financial system post-Covid. The study revealed several challenges such as an enormous number of candidates, declining the industry due to the leading market layers, OIFIs are the worst strikes of Covid-19, the downturn of oil prices, delaying payments, low profit, cracked market, reliant on government spending, no new-clients and shortage of liquidity. Mihajat, (2021) explores how the Covid-19 epidemic contributes to the expansion of Islamic banks in Oman also how Islamic banking Entities (IBEs) in Oman cope with the illness. The study also shows how Islamic banks sustain the faith of their consumers during the Covid. Lower revenue, digitalization of remittances and services, expensive financing, ignorance of Islamic financial transactions and affairs, lack of competent human resources, absence of Sukuk insurance, and lack of secondary market were all mentioned in the study. Another intriguing result of the report is that, despite all of the problems, the analysis indicated that Islamic banking in Oman is still doing its utmost to preserve capital reserves and liquidity to achieve a single-digit growth rate in 2021.

In the paper of Grassa & Hassan, (2015) they examined the evolution and prospects of Islamic financing in France. and the concerns and challenges confronting the industry. According to the study, Islamic finance in France provides specific opportunities for the French financial market. Furthermore, it will also assist the French government in reducing congestion and prejudice between French Muslim and non-Muslim populations. Nonetheless, the sector faced several challenges, including a shortage of mobilizing professions, the absence of governmental backing, the lack of a regulatory framework, and a limitation on innovation and goods.

According to the previous literature reviews, all studies on the challenges of Islamic banking were critical and relevant to this field. The purpose of our research is to contribute to the body of knowledge regarding the present difficulties, challenges, and possibilities affecting Somalian Islamic banks from the perspective of Islamic bank employees. Furthermore, this is one of the first studies of its kind to be conducted in Somalia, with the researcher attempting to focus on the challenges and providing practical solutions that will benefit employees of Islamic banks in Somalia, Somali society, and policymakers in the country.

**Table 1: Summary of Literature Review**

| **(Title) Research paper/ book/ thesis** | **Countries** | **Challenges/ Opportunities** |
|---|---|---|
| Thirty years of Islamic banking history, performance, and prospects (Iqbal & Molyneux 2005) | General | The book states that Islamic banking shows great success in different areas. However, it faces a lot of challenges like any other financial system such as theoretical, practical, and operational challenges |
| The internal challenges facing the Islamic finance industry (Abdulazeem Abozaid 2015) | General | Lack of appropriate shariah supervisory board and lack of product development methodology. |
| Challenges facing Islamic banking (Iqbal, Ahmed and Khan 1998) | General | A lack of support and money, a lack of an appropriate legislative structure, and a lack of supporting policies., a lack of a financial supervisory framework, accounting policy, a lack of equality institutions, a lack of an organized secondary financial market, a lack of financial engineering, shariah issues, a lack of revenue sharing investment, the issue of late payments, compensation, and disciplinary actions are all examples of institutional and operational issues. |
| Issues and challenges of participating banking in Turkey: the perception of employee (Sayar 2020) | Turkey | The legitimate and regulatory framework, administration issues, issue of shariah governance, industrial issues, attitudes towards society and risks. |
| Causes and solutions for the stagnation of Islamic banking in Turkey (Yanikkaya & Pabuccu 2017) | Turkey | absence of shariah governance, absence of regulatory institutions, absence of different instruments, weak perception of society regarding Islamic banking, the effectiveness of operational activity of IBs is lower contrasted with CBS and lastly, lack of academic studies and center of learning. |

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| Islamic banking in Turkey: population perception and development challenges (Egresi & Belge 2017) | Turkey | A secularism issue, the majority of the Turkish people disconnected religion from business, trust issues regarding shariah-compliant institutions, and lack of awareness. People are not well-versed in Islamic banking or its products. |
| Challenges and opportunities of Islamic banking and financial institutions in Malaysia (zainordin, selvaraja, yee man and Hoong 2016) | Malaysia | opportunities: Because of the acceptance of Muslim and non-Muslim civilizations, there is a significant chance to improve Islamic financial banking.<br>Challenges: Misinterpretation and absence of harmonization of Islamic financial concept, legitimate challenges, narrow market regarding financial institutions and products and limited risk administration performance |
| Challenges inhibiting Islamic banking growth in Indonesia using Analytical Hierarchy process (Iswanaji 2018) | Indonesia | A Framework of lows and regulation, shortage of qualified staff and illiteracy of Islamic banking principles. |
| Islamic banking in Bangladesh: performance, problems, and prospects (Mr. sarker 1999) | Bangladesh | Micro and Macro operational challenges. Firstly, unsuccessful in planning an interest-free banking system. Secondly, most Islamic banks in Bangladesh have a high probability of implementing profit sharing strategy. Thirdly, there is a lack of legitimate assistance from the central bank. Lastly, there is a shortage of expertise and skilled personnel to observe and evaluate the financing projects. |
| Issues and challenges for Islamic finance & banking in Bangladesh in the perspective of global development (Alamgir, Hossain and Faisal 2017) | Bangladesh | challenges, including a lack of an actual institutional framework, a lack of proper regulation and supportive protocols, a lack of a functional supervisory framework, a lack of standardized shariah supervisory boards, an accounting standards issue, an inadequate equity, a lack of a secondary financial market, a shortage of short-term instruments, a lack of shariah governance, limited financial engineering and innovation, educating shariah scholars, |

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| | | insufficient training and educating, lack of profit-sharing finance, illiquidity of assets, levanters issue, repayment and penalties, lack of deposit mobilization, competition, globalization involvement, risk management issue, and lack of consumer orientation. |
| Evolution of Islamic banking in Iran: prospects and problems (Parveen, Zadeh and Muzakkirsyed 2015) | Iran | challenges such as slow growth, an instance of non-performing assets, and product and service scarcity. |
| Challenges and solutions to the Islamic banking system in a pluralistic-secular country like Nigeria (Bello & Abubakar 2014) | Nigeria | Weak institutional structure, insufficient legal framework, institutional inequity, and inadequate supervisory framework |
| Challenges faced in full establishment of the Islamic banking system in Nigeria (Idris 2017) | Nigeria | Opportunity: Nigeria gives good opportunities to both domestic and foreign shareholders.<br>Challenges: Lack of skills towards accounting and Auditing standards, insufficient legal and regulatory environment, competitiveness towards conventional banking, dual taxation, non-shariah compliant liquidity governance, there is a dearth of public awareness, as well as a lack of Islamic insurance. |
| Challenges & solutions Nigerian Non-interest Islamic banking (Saidu 2018) | Nigeria | Religious and cultural diversity, shortage of human resources, shortage of financial restructuring, lack of sufficient knowledge, double charging, competitiveness, and insufficient legal framework. |
| Islamic banking: prospects, opportunities and challenges in Ethiopia (Olad 2012) | Ethiopia | Inadequate information and understanding, legal, administrative, regulatory, and institutional problems, a negative attitude toward religion, a lack of skilled labor, capital resource limits, insufficient demand and market potential, and ineffective banking policies. |

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| Interest-free banking in Ethiopia prospects and challenges (Hailu & Bushera 2020) | Ethiopia | Lack of confidence regarding Islamic banks, regulatory framework, and unqualified experts. |
| Challenges and prospects of full-fledged Islamic banks in Ethiopia (Girma 2020) | Ethiopia | Illiteracy of interest-free banking system, insufficient understanding of shariah laws, regulatory challenges, and unassociated institutions. |
| Islamic finance in Ethiopia: current status, prospects, and challenges (Hailu & Yatoo 2021) | Ethiopia | Opportunities: high national demand, accessible demand aggregation, and cost-effectiveness. Challenges: Non-Muslim nations' gloomy outlook, real framework problems, and a lack of human resources. |
| Challenges and opportunities of expansion of Islamic banks in Ethiopia: a case of a commercial bank of Ethiopia Dire Dawa interest-free branch (Abdulhade 2020) | Ethiopia | The Islamic banks in Dire Dawa have both opportunities and challenges. However, its challenges are even higher than conventional banks due to its absence of awareness, shortage of human resources, and lack of shariah-based funds. |
| The emergence of Islamic banks in Somali in the post-conflict era: prospects and challenges (Musse & Ab Rashid & Zinol 2019) | Somalia | Absence of national identity, absence of skilled human capital and specialists, shortage of human capital and competition from mobile money companies. |
| Islamic banking in Somalia; challenges and opportunities (Abdi 2014) | Somalia | Lack of shariah supervisory board, absence of an active central bank, absence of financial institution, and unqualified employees. |
| Can Islamic banks flourish in Somalia after 25 years of the collapse of the country's entire financial system (Warsame 2016) | Somalia | The restoration of the country's financial system is highly desired. The supply of financial services based on the beliefs of the local community, who are all Muslims, has a fair chance of success., meaning that Islamic banking may thrive in Somalia. In addition, a joint venture with an international bank is the best banking strategy in Somalia. Finally, using |

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| | | internet marketing tools and mobile platforms to promote Islamic banking products and services in Somalia is more effective |
| Can Islamic banking revive Somalia’s ailing economy (Warsame & Abdalla &Lasyoud) | Somalia | The absence of a functioning financial system, a lack of funds and experience, and the impact of bank absence on a firm all had a negative and little influences. Moreover, The Islamic banking of Somalia has been influenced by the country's economic and political infrastructure. Law and order measures have a substantial influence on Somalia's banking and financial industry's acceptability. |
| Interest-free banking: challenges, opportunities, and prospects in Somalia (Hassan 2017) | Somalia | Opportunities: Islamic banks in Somalia will add capacity to the country's economy.<br>Challenges: a lack of awareness and comprehension, inadequate financial literacy, competition issues, a lack of liquidity tools, a lack of advanced technology and media, and a lack of professional bankers. |
| Islamic banking in Somalia; challenges and opportunities (Hassan 2018) | Somalia | Opportunity: significant demand to revive the country's banking system by Islamic law as the population is 100% Muslim.<br>Challenge: Lack of shariah supervisory board, lack of proper market regulation, illiteracy, a proper understanding, and shortage of skilled bankers. |
| Challenges for the Islamic finance and banking in post-Covid era and the role of Fintech (Hassan & Ali & Raza Rabbani 2020) | | An enormous number of candidates, declining the industry due to the leading market layers, OIFIs are the worst strikes of Covid-19, the downturn of oil prices, delaying payments, low profit, cracked market, reliant of government spending, no new-clients and shortage of liquidity. |
| Oman’s Islamic banking performance amidst Covid-19 outbreak: prospects and challenges (Mihajat 2021) | Oman | Lower revenue, digitalizing of remittances and services, overpriced finance, illiteracy of Islamic financial transactions and affairs, |

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| | | lack of qualified human resources, absence of Sukuk insurance, and lack of secondary market. |

Ref: Author

**Table 2 Difference Between this Study and the other Studies**

| Item | Our Study 2022 | Musse, Abrashid& Zainol 2019 | Abdi 2014 | Hassan 2017 | Hassan 2019 |
|---|---|---|---|---|---|
| **Objectives** | To analyze the challenges and opportunities confronting the Somali Islamic banking industry. The study also intends to focus on a number of the main issues impeding the expansion of Islamic banking within the country and several potential solutions | Possibilities and Difficulties of the Growth of Islamic Banks in Post-Conflict Somalia | To investigate the issues and prospects of Islamic banks in Somalia | To assess the possibilities, opportunities, and constraints of interest-free banking in Somalia, particularly in Mogadishu. | To obtain the issues and opportunities that Somalian Islamic banks are facing |
| **Methodology** | Quantitative & qualitative | Secondary data | Quantitative &qualitative | Qualitative | Qualitative & quantitative |
| **Target Population** | Islamic bank employee | | Customers | SMFI employees, Commercial banks employees, Government employee and entrepreneurs. | Households, Financial institutions, Government institutions and Education and research centers. |
| **Region** | Hargeisa & Mogadishu | | Mogadishu | Mogadishu | Mogadishu |

| | | | | | |
|---|---|---|---|---|---|
| **Findings** | the lack of cohesive SSB, a shortage of professional employees, were lack of awareness among the society, regulative issues, high pricing finance, lack of Islamic insurance, low rate of return, lack of R&D, competition from mobile companies, shortage of market information, and lack of connection with global banks, credit risk, liquidity risk, rate of return risk, collateral risk, and foreign exchange risk. | Islamic banking has a lot of potential in Somalia. However, it suffers unique obstacles including Absence of national identity, absence of skilled human capital and specialists, shortage of human capital and competition from mobile money companies, | Lack of shariah supervisory board, absence of an active central bank, absence of financial institution, and unqualified employees. | Opportunities: Islamic banks in Somalia will add capacity to the country's economy. Challenges: a lack of awareness and comprehension, inadequate financial literacy, competition issues, a lack of liquidity tools, a lack of advanced technology and media, and a lack of professional bankers. | Opportunity: significant demand to revive the country's banking system by Islamic law as the population is 100% Muslim. Challenge: Lack of shariah supervisory board, lack of proper market regulation, illiteracy, a proper understanding, and shortage of skilled bankers. |

Ref: Author

# CHAPTER 2. METHODOLOGY

## 2.1 INTRODUCTION

This chapter discussed the study's conceptual structure, as well as its methodology and research design. It provides information about the study's population, data collection, and how data is analyzed. This section also discusses the methods used to conduct the survey and explains them in great detail. The methodology section of any research is critical because it comprises a comprehensive overview of how the study has been taken.

## 2.2 RESEARCH DESING

The research design, in general, is the framework for a researcher's selected study methodologies and approaches. The thesis is more effective and efficient when the research is well-designed.

Various social scientists describe study design in diverse ways. Some definitions include Zikmund, which is described as “a master plan clarifying the methods and procedures for collecting and analyzing the required information," (Akhtar, 2016). While (Asenahabi, 2019) states that "research design is a true representation of the researcher's idea." Basically, there are three main types of connecting research: qualitative, quantitative, and mixed method”.

Methodologies describe how probes should be done by suggesting which problems should be studied, how to structure an issue to allow it to be explored, how to build appropriate data creation, and how to make a logical relationship between the variables, data collected, analysis, and conclusions (Jackson et al., 2007). This study used both quantitative and qualitative methods to gather enough information and come up with better suggestions at the end of the study.

“Qualitative research focuses on investigating and assimilating the meaning that an individual or a group of individuals ascribe to human issues. This method allows the researcher to explore even unexpected ideas disclosed by participants. It also focuses on the goal or reality based on the views and perceptions of the respondents (Asenahabi, 2019). Based on this, our study used qualitative research design to obtain further information about the issues faced by Somalian Islamic banks.

Quantitative research is assumed to be an empirical approach to study (Asenahabi, 2019).The study also used quantitative research design in order to analyze the issues and opportunities of Somalian Islamic banks by conducting survey questions with different Islamic Banks in different regions in Somalia. The study's goal is to highlight the opportunities and issues of Islamic banking in Somalia. The goal is to look at some of the primary difficulties inhibiting the expansion of Islamic banking in the country and then come up with many feasible solutions.

## 2.3 POULATION OF THE SURVEY

A population is a group of individuals in a single location or the total group of people, events, and interesting things that the researcher want to explore. The researchers made drawing broad inferences from a study of merely a subset of the population straightforward and practicable.

A sample is a group of people who, in terms of features and attributes, are representative of the total population in order to offer true and reliable information about the entire population (Abdi, 2014). Because of the size of the population, approaching is difficult or impossible. As a result, gathering data on the entire Somali population will also be challenging. Therefore, This study made survey for Somalian Islamic bank professionals who are working in several Islamic banks. The survey was designed for the managers and employees of Somalian Islamic banks who have greater expertise in managing and being accountable for the development and maintenance of the bank's management. The survey was contained 18 questions, and it was randomly distributed to the employees of Somalian banks in different regions, and in total 106 employees participated in our survey.

## 2.4 DATA COLLECTION

Primary and secondary data are utilized in this study to confirm that information has its relevance. Primary data is obtained through the distribution of questionnaires to the professionals and employees of Islamic banks in Somalia who have more experiences about Islamic Banking and Finance via surveys and the other social media platforms due to the distance and restrictions of Covid-19.

The researcher also referred to a secondary source to get practical information to complete the study. Secondary data is critical for the researcher to understand the study's problems and explain primary data comprehensively. Most of the secondary sources were obtained from research papers, textbooks, websites, and unpublished thesis to get additional information related to the study.

The survey which we designed was consist of three parts; part one was demographical background of the employee, part two was issues and challenges faced by Somalian Islamic Banks. and part three was focusing on the opportunities of Somalian Islamic Banks.

The questionnaire was created with the assistance of supervisor and other diverse baking professionals and was made in a way that both employees and specialists could participate and contribute. Furthermore, the questionnaire was written in English first and translated into Somalin in order for Somalin people to understand it well.

## 2.5 DATA ANALYSIS

Data analysis is the process of defining and interpreting data (Merriam, 2009). The study attempts to analyze issues, challenges and opportunities of Somalian Islamic Banks. Afterwards, all information gathered from participants was used to further the study's objectives. As a result, the data obtained from Somalian Islamic Banks' experts and employees are reviewed and scanned to ensure its correctness for analysis.

The data was presented in an informative and well-organized manner that is appropriate for the research. The STATA program was used to process and analyze the structural questionnaire data.

# CHAPTER 3. THE OUTLOOK OF ISLAMIC BANKING

## 3.1 INTRODUCTION

Islamic banks can be found almost all over the world and used by Muslim and non-Muslim societies. This section will look at the emergence, evolution, and spread of Modern Islamic banking. It will also examine the principles and modes of Islamic banking. Finally, it will highlight the differences between conventional and Islamic banking.

## 3.2 THE EMERGENCE, EVOLUTION, AND SPREAD OF MODERN ISLAMIC BANKING AND FINANCE

Islamic banking is a zero-interest-rate system based on a collaborative economy, equity investment, partnerships, investment cooperation, leasing, innovation, and profit assurance, because of the reciprocal fairness in transactions and the depiction of actual reality, Islamic banks are sometimes called interest-free banking (Khan & Bhatti, 2008). It is a financial system founded based on Shariah law and driven by Islamic economics (Saif Al Nasser & Muhammed, 2013). The system was developed from the year 661 to 850 under the control of the Muawiyah and Abbasid caliphates. Then it was led by numerous Islamic rulers, including Andalusia (Spain) in 1031, Granada until 1492, the Malacca Sultanate until 1511, and the Ottoman Empire (Turkey) until 1918. This method has been in place for 1,435 years. It vanished, however, due to the changes in Islamic rules and procedures over the millennia (Alamgir M et al., 2017)

According to several studies such as, Alamgir M et al., (2017; Perry & Rehman, (2011b) , claimed that in the mid-1940s, Malaysia hosted the first Islamic banking experiments, followed by Pakistan in the late 1950s. The primary purpose of the Malaysian bank was to invest possible pilgrim funds in Shariah-compliant real estate and plantations. However, it was not successful. While in Pakistan, the establishment of local Islamic banks started in rural areas. Throughout that period, landowners who followed Islamic ideals put their money in a bank, which later lent to other landowners for agricultural development. However, at the time, borrowers were not penalized for late payments on their loans, which caused the bank to face a variety of issues, including a growth in the number of borrowers and difficulties for the bank's employees, who did not have autonomous control over the bank's operations. As a result, depositors expected to receive more benefits in exchange for the money they paid out at the time (Shahar et al., 2017).

As stated in Chachi, (2005) Mit Ghamar Islamic saving bank (MGISB), founded in Egypt in 1963 by El Naggar, was another early example of contemporary Islamic banking. The bank's goal was initially to act as an effective mediator between capital supply and demand. And to run an educational center for economic empowerment, saving education expenses, and the creation of banking system. Finally, to alleviate hoarding and capital formation issues by acting as a dynamic element in mobilizing idle capital for investment.

In the 1970s, several Islamic banks arose in the Middle East area. such as Dubai Islamic Bank (DIB) which was established in 1975, and it is consider the first worldwide Islamic financial institution, it was significant to establish Islamic banking and finance as a global phenomenon. It was crucial to its member nations' economic growth and development. Furthermore, the bank's mission was to decrease the gap between wealthy and impoverished member countries (Aqib Ali, 2015).

In 1977, Three Islamic banks came into existence such as, Faisal Islamic Bank of Egypt (FAIT), Faisal Islamic Bank of Sudan (FIBS), Kuwait Financing House (KFH), in addition to Bahrain Islamic Bank (BIB) in 1979. Moreover, during the 1980s, Several Islamic banks began to appear in several nations, including Pakistan, Iran, Sudan, Malaysia, and Bahrain (Shahar et al., 2017).

Several conventional banks established Islamic banking departments and windows throughout the followed decade, introducing Islamic banking products and services. Islamic finance's fast expansion, as well as the development of new and creative Shariah-compliant goods and services, enables it to compete on a worldwide scale with the competitive interest-based banking and financial system. Many international organizations, such as the Islamic Development Bank (IDB), the Islamic Finance Service Board (IFSB), the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), and the International Islamic Rating Agency, are assisting in the growth and development of Islamic finance around the world. Islamic banking is becoming a crucial and dynamic force in the global financial system. (Aqib Ali, 2015.)

## 3.3 PRINCIPLES OF ISLAMIC BANKING AND FINANCE

The main source of Islamic law is *Quran*, the *Sunnah*, *al-ijma*, and *al-qiyas*, which they are the main elements in Islamic finance industry (Alrifai, 2015).

The fundamental aims of Islamic contract law are to promote social justice and fairness. Fairness is treating others in a way that does not hurt them and fostering a fair atmosphere among individuals. while social justice is attaining equal rights and opportunity for all. These objectives are the ultimate goals of Islamic banking.

### 3.3.1 Main Prohibitions of Islamic Finance

The use of interest (riba) is the primary restriction in Islamic banking, which we can defined it as an charging of unreasonably high-interest rates. As a result, the concept of riba includes both credit riba and invalid sales because one of the two delays is a legal excess with no discernible monetary restitution (Paldi, 2014).

In Islam, exchanging money-for-money are prohibited, and there is no sense of money's to create worth out of the money alone. *Riba* comes in two varieties. The surplus over and above the loan is known as *Riba al-Fadl*. while *Riba al-nasia'ah* is interest on a debt that increases from late or postponed payments. Some scholars postulated the third sort of *riba* known as *Riba al-Jahiliya* or pre-Islamic *riba*, which is often signified by the lender asking the debtor whether he will clear the loan or raise it at the maturity date (Md Akther, 2015).

The prohibition of *Riba* is stated directly in four Surahs or chapters of the *Quran*. (*Al-Rum*, 30:39; *Al-Nisa* 4:161; Ali-Imran 3:130; *Al-Bakara* 2:275-9). The prophet (peace be upon him) condemned those who took Riba, paid it, documented it, and two witnesses, stating they were all identical.

LAWAL, (2016), mentioned that Interest (*riba*) is not allowed amongst all religions, including Hinduism, Judaism, Islam, and Christianity and there is no dispute about its rejection from a simply religious standpoint. It is forbidden in Islam since it hurts human society by increasing the proactivity of wealth accumulation in fewer hands. It results in an ever-increasing ratio of risk-free capital to risk-related capital, which leads to indebtedness, unemployment, and, eventually, gross income and wealth inequality. Furthermore, it is one of the primary sources of inflation. Because of the growing debts, it produces trauma and depression. It contradicts the concepts of brotherhood and sympathy and relies on greed, selfishness, and hardness of heart. It could be a sure gain with no possibility of loss, and finally, it establishes a monopoly in society (Ayub, 2007).

Uncertainty (*gharar)* is another fundamental constraint that serves as a primary basis for contract invalidity (Ashraful & Chowdhury, 2015). It is an externally forbidden attribute that renders the contracts null and void. It means "danger" or "hazard." *Gharar* refers to a disparity in negotiating power caused by ignorance or a lack of information of a contract's aspect, quality, subject matter, or characteristic. There are two types of uncertainty (*gharar).* Tolerable *gharar* (*gharar Yasir*) is uncertainty that may be endured and accepted by both parties without affecting the contract's core. The second type is the significant or excessive *gharar (gharar fahish*), which is prohibited. It is a high level of uncertainty that overwhelms a contract. (Mihajat Muhammad Iman Sastra, 2016). The reasoning for the banning the gharar sales or any transaction that has the element of uncertainty and danger during which the transaction will end in seizing someone else's property for vanity and injustice, which could be immorality and enmity.

Another prohibition in the Islamic finance is gambling (*Maysir*). Gambling can be described in Islamic finance. "Any arrangement formed by two parties to achieve ownership of a specific asset or service that results in benefits for one party and harm for others by associating a particular transaction with an act or occurrence" (Mihajat, 2016). Gambling, which includes betting, lotteries, and other types of gambling, is severely forbidden in Islam. There are *Quranic* verses, such as (2:219 and 5:90) that emphasize the ban on gambling and the wisdom behind it.

Gambling allows a person to win or lose only by chance. This condition enables a person to utilize other people's money unfairly and unlawfully, which contradicts core Islamic values like justice, equity, fairness, ethics, and morality (Yunus et al., 2018).

In terms of the economy, gambling prohibition assists in the redirection of funds toward genuine investment, removing the foundation for liquidity preference and lowering volatility in short-term investment.

Other rules must be respected by practitioners and supervisors for shariah compliance, in addition to the fundamental prohibitions of *riba, gharar, and gambling*. Islam forbidden participating in illegal acts such as dealing alcoholic beverages, dead animals, selling pork, and other prohibited elements.

## 3.4 MODES OF INVESTMENT IN ISLAMIC BANKS

The ban on paying interest *(riba*), coping with major uncertainty (*gharar),* and gambling (*maysir)* are principles that drive Islamic financial products (Siddiqui, 2008). There are four classifications of Islamic financial modes: 1) profit and product partnership, (2) commodities finance, (3) leasing, and (4) agency agreement (Al-Jarhi, 2019).

Profit-sharing (*Mudarabah),* cost plus profit financing (*Murabaha),* partnership financing (*Musharaka),* leasing *(Ijara*), forward sale *(Salam*), and construction financing *(istisna*) are the most well-known contracts utilized by Islamic banks (Khaldi & Hamdouni, 2011).

### 3.4.1 Profit Sharing *(Mudarabah*)

*Mudarabah* is one of the crucial contracts in Islamic banking and economics. According to AAOIFI, it is a contract between two parties, the first of which is the fund's owner (*Malik*) and the second of which is the fund's management (*Madarib*). The division of profit must be according to the contract agreement, and losses must be borne solely by the capital provider (Faisal et al., 2021).

### 3.4.2 Cost Plus Profit Financing (*Murabaha)*

The "*Murabaha"* contract is popular Islamic financial instrument utilized by Islamic institutions. It is a profit-making contract. The customer requests an Islamic bank to buy an asset in cash on its behalf. He then agrees to purchase this asset via deferred payment with a margin paid to the bank. Shariah dictates that the bank acquires the asset first and then resells it. It is also essential that the asset be tangible, that the client is knowledgeable that he has agreed to purchase at the new price (purchase price plus profit margin) (Dalel & Bessem, 2013) .

### 3.4.3 Partnership Financing *(Musharakah*)

The Arabic term for "sharing" is *musharakah*. It is also a contract signed by two or more people to carry out a specific business to share profits through joint investment (Arshad & Ismail, 2010). It is one of the forms of cooperation under gaining profits in the business. Therefore, it is encouraged in Islam. They will split the profit in line with their agreement, and each partner will face the loss in proportion to the ratio of his investment. Furthermore, *Musharakah* contract business operations must be *Shariah*-compliant and controlled in several areas. Trading, plantation, construction, investment, manufacturing, and services are just a few examples.

### 3.4.4 Leasing *(Ijara*)

*Ijara* is a reward derived from a rental agreement between two parties in which the lessor (owner of the asset) lends capital asset to the lessee (the user of the asset) (Gait & Worthington, 2007). It is leasing things out. Furthermore, the usage of Ijara was recognized before Islam, as shown by the *Quran* and the prophet's *Sunnah* (peace be upon him).

### 3.4.5 Forward Sale (*Salam)*

*Salam* is a contract in which money is made upfront at the time of contracting in return for the later delivery of purchased goods or services. Although the selling and purchase of nonexistent items are not allowed under Islamic financial transactions. Salam contract, on the other hand, is exceptional sale. The following is the evidence of the Hadith narrated on the authority of Ibn Abbas:

> *The messenger of Allah came to medina and found its inhabitants entering Salam contracts (With the price paid in advance) in fruits for one, two, and three years. He said whoever Enters into a salam contract let him specify a known volume or weight and a known term Of deferment.*

As a result, the following are the key legal requirements for the validity of a Salam contract: At the moment of contracting the purchased product must not be present. Payment should be given at the time of contract, and the amount and quality of the commodities, as well as the date and place of delivery, should be mentioned and known for both parties.

### 3.4.6 Construction Financing (*Istisna)*

*Istisna* is a relatively new technique in Islamic banking and finance, defined as a contract to purchase products now for a fixed price that will be created or developed hereafter in accordance with specified criteria (Zarqa, 1997) .The *Istisna* item is not available at the time of contract but will be produced later by the producer or contractor. For example, the entrepreneur may ask the bank to approve a production contract. Under certain conditions, the bank engages in an *Istisna* contract with a third party (the manufacturer) to build and deliver the desired goods. Muslim jurists accept the legality of *Istisna* through the analogy (*Qiyas*) of the Salam contract. Nevertheless, *Istisna* and Salam are different in several ways, such as the issues related to I*stisna* being, in general terms, a commodity indeed of production. Additionally, the payments in *Istisna* are in the form of a flat sum or installments, which have the possibility of being postponed, and the contracts in the delivery of *Istisna* are indefinite (Gait & Worthington, 2007).

**Table 3: Forms of Islamic Financial Contracts**

| **The contracts** | **Explanation** |
|---|---|
| Mudaraba | Form of partnership, the capital supplier is not permitted to meddle with management. However, they have access to information. |
| Murabaha | Profit-making contract. It is a contract in which the seller states his profit and cost. |
| Musharakah | Form of partnership in which both parties participate in the money and management of the firm. |
| Ijara | It is a rental agreement. It refers to the leasing property between two parties, the lessor and the lessee. |
| Salam | This contract refers to the purchase of a commodity for later delivery in exchange for an upfront payment. |
| Istisna | Agreement contract A customer agreed to sell something that did not exist at the time of the contract but would be manufactured later with the specified characteristics and delivered at a later date for a fixed fee. |

Origin: Author *This chart comprehensively explains six fundamental forms of Islamic financial contract*

## 3.5 DIFFERENCE BETWEEN CONVENTIONAL AND ISLAMIC BANKING

Shariah is the pillar upon which Islamic finance is formed. As a result, it does not offer to sponsor Shariah-prohibited activities such as wine, pork, and pornography. It does not lend money for interest. It meets needs by supplying vital assets or by sharing profits and losses.

Islamic banks are not as new in the business world. It has its way of doing business and engages in different activities. However, it is somewhat similar to conventional banks but not the fundamental principles. However, their differences lie in their role, working methods, applications, and functional instruments.

### 3.5.1. Deposits

Deposits are collected from savers by both Islamic and conventional systems (Hanif, 2014). Their distinction, though, is in their agreement on a reward. In the conventional system, the reward is fixed and predefined; however, in the Islamic system, deposits are accepted through Musharakah and Murabaha, with the return being changeable and fixed.

### 3.5.2. Financing and Investments

How financing arrangements are established distinguishes Islamic banks from Conventional banks. The key difference between the two is the issue of interest charges. Because Islamic institutions are prohibited from charging interest, they cannot provide loans with a fixed reward. Profit on investments can only be charged by Islamic institutions if they offer the needed asset to the client or participate in the ongoing project. Conventional banks on the other hand, provide loans for a predetermined reward in the form of short-term loans, overdrafts, and long-term loans.

### 3.5.3. Risk-sharing

The encouragement of risk-sharing is one of the most important features of Islamic banking. (M. Iqbal et al., 1998). Conventional finance holds that the entrepreneur bears all risks between the financier and the entrepreneur whether the project succeeds or not. The investor will receive his funds at a predetermined interest rate. In Islam, such unequal distribution is not tolerated. By contrast, under Islamic finance, both the investor and the entrepreneur share the project's profits according to their agreement, they divided the profit. The investor bears all the loss, whereas the entrepreneur suffers a labor loss.

### 3.5.4. Moral Dimension

Conventional banks do not place a higher value on the moral values of the activities they facilitate (M. Iqbal et al., 1998). Unlike Islamic banks, all economic activities adhere to Islamic moral values. As a result, Islamic finance cannot fund any projects which oppose Islamic moral values, such as financing a wine factory, a casino, a nightclub, or any project that can harm society and contradicts Islamic moral values.

### 3.5.5. Credit Worthiness

The priority in the conventional system is the borrower's creditworthiness because the bank's primary goal is to receive the loan and interest rate on time. (Molyneux & Iqbal 2006). In the

Islamic system, however, the bank is more concerned with the project's viability. So, the bank can earn a return if the project is successful and profitable. Therefore, the Islamic system facilitates the distribution of credit, as well as the stability of the system.

### 3.5.6. Stability

In Conventional banking practices, there is an asymmetry between the bank's cash flow and the enterprise's cash flow ( Molyneux & Iqbal 2006). In the case of a recession or project failure, the businessman must pay a specified interest rate to the bank that does not include the project's total cost. On the other hand, there is an imbalance between the bank's assets and liabilities because their liabilities are guaranteed, and their assets are variable. That is where insecurity arises. On the other hand, in unconventional banking practices, liability is based on *Mudarabah*. Therefore, if any insecurities occur, it affects both the asset and the liability because depositors receive no set of guaranteed rates of return. As a result, bank failure is less likely.

**Table 4 Summary of the difference between Islamic and conventional banking**

| **Islamic Bank (IB)** | **Conventional Bank (CB)** |
|---|---|
| **Riba** *(riba* is prohibited) | Not prohibited |
| **PLS** (based on profit-loss sharing) | Based on risk transfer |
| **Risk sharing** (both the investor and the entrepreneur share the project's profits based on the supply and demand of the fund) | the entrepreneur bears all risks between the financier and the entrepreneur whether the project succeeds or not |
| **Moral values** (do not fund any projects that oppose Islamic moral values, such as such as projecting a wine factory, a casino, a nightclub, or any project that can harm society) | Do not place a higher value on the moral ethics for the activities they facilitate. |
| **Creditworthiness** (primary goal is the soundness of the project, so the bank can earn a return if the project is successful and profitable) | The goal is the borrower's creditworthiness because the bank's primary goal is to receive the loan and interest rate on time |
| **Stability** (used asset-based contracts and risk is shared between the parties of the contract) | Mostly used debt-based contracts and risk is transferred between the contract parties |

Origin: Author

# 4. THE FINANCIAL INSTITUTIONS IN SOMALIA

## 4.1 INTRODUCTION

Financial system is a network of banks, insurance companies, and stock exchanges that facilitates the change of funds.

After two decades of conflict, Somalia's financial system had decimated. When the Somali state fell apart in January 1991, all of the country's financial institutions, including the central bank and banking systems disintegrated (Powell et al., 2008).

Somalia had several banks before the collapse, including the central bank of Somalia: Somalia commercial bank, saving bank, Somalia Development bank, and state insurance company (Hassan, 2017). Somalia has only a few banks in this period. However, the banking system has changed significantly since the pre-civil war period in 1991; Somalia has a long history of economic uncertainty. From 1970 and early 1980, The banking system's primary function was to fund government institutions. The commercial and savings banks were declared insolvent in 1989, and the Development Bank was unable to lend. The financial system has devolved into a state of deep crisis and corruption. As a result, the majority of banking operations moved into the shadows.

However, despite the disintegration of the financial system and the collapse of the government, the economic performance of Somalia improved during its period of statelessness. This economic development was attributed to the fall of the repressive government and the improper policies it was implementing. After the civil war and relative peace emerged economic development was identified in the pastoral sector, commercial business activities, and the overall living standards (Powell et al., 2008).

## 4.2 BRIEF HISTORY OF FINANCIAL INSTITUTIONS IN SOMALIA

Somali financial institutions date back to the colonial era, about 1920, with the formation of the Central Bank of Italy, the first bank in Southern Somalia. This bank expanded its branches from Mogadishu to Kismayo in 1925. Later on, in 1930, the British government founded a savings bank as part of an effort to encourage individuals to save their earnings. In the following year, 1932, the Cassa di Risparmio, a commercial bank, was established. Another commercial bank, the Banco di Roma, was established in Mogadishu in 1936. However, in 1941, the British administration liquidated all Italian banks, resulting in a significant change in Somalia's financial institutions (Hassan, 2018).

As a result, in 1943, the Barclays bank opened in Mogadishu. Nonetheless, in 1950, Italian commercial banks were permitted to reopen their branches. In the same year, 1950, the United Nations trusteeship administration established a new regulator of financial institutions, the "Cassa per la circolazione monetaria Somalia". This institution provided treasury services, bought and sold foreign currencies and gold, and issued circular cheques and current account cheques, among other things.

In 1960, the Somali National Bank was created as the Central Bank of Somalia, with permission to operate across the Somali Republic. In the years that followed (1961), an Egyptian Commercial Bank had established. While in 1968, the Somali Development Bank was established to promote medium and long-term lending. In the same year, the National and Grindlays banks opened branches in Mogadishu, Hargeisa, and Berbera. Finally, the Credito Somalo was closed down. Furthermore in 1975 the Somali National Bank took over all of its assets and liabilities, resulting in a structural overhaul of the Somali banking sector. The amalgamation of the two commercial banks results in the formation of the Commercial and Savings Bank of Somalia. Therefore, the Somali National service bank was renamed the central bank of Somalia. Somalia has had a Central Bank of Somalia, a Commercial and Savings Bank of Somalia, a Somali Development Bank, and a Somali Insurance Company since 1990.

## 4.3 CURENT FINANCIAL INSTITUTIONS IN SOMALIA AND ITS DEVELOPMENT

Many of the same informal institutions operated under the national government continue to provide financial services in Somalia today. While Somalis continue to have limited access to official banking and financial institutions, access to other financial services has increased since the state's breakdown in 1990. Since that period, Somalia has improved more than other African countries in many developments index indicators (Powell et al., 2008).

Approximately 15% of the Somali population has a bank account, but only 5% of those who have a bank account were active users (Mogadishu, 2020). However, according to unofficial statistics, the number of people that use commercial and local bank accounts has increased significantly, accounting for roughly 28 percent of the population. The financial sector in the nation is still in its infancy, with only a few commercial banks licensed (Mogadishu, 2020) .

The Somali Central Bank adopts the Financial Institutions Law No. 130/2012, which establishes common conditions for both the operation of Islamic and conventional financial institutions to regulate the activities and establishment of these banks. Even though all five commercial banks existed currently practice Islamic banking. However, the law allows the financial industry to adapt and open the conventional system such as *Riba*-based (interest-taking) banks and insurance corporations.

Somalia was without a central monetary authority for more than 15 years, beginning with the outbreak of the civil war in 1991. However, with the reformation of the Central Bank of Somalia in 2009, the Somali financial sector has gradually transitioned away from its informal working style and toward more established regulatory frameworks. Before the rise of commercial banks, which now play a vital role in Somalia's payment systems. The widespread use of private money transfer operators (MTOs), which served as payment systems in informal banking networks, has kept the country afloat and moving forward in recent decades.

Finally, Somalia's current financial system consists of the central bank, Islamic banks, micro finance institutions, NGOs, mobile money operators and Money transfer business. Central bank, which serves as the country's primary financial institution regulator. Under the Financial Institutions Law (FIL) of 2012, it is in charge of issuing licenses and supervising banks and money transfer services. The second category is commercial banks, and the Central Bank of Somalia (CBS) give licenses to eight CB as of January 2019. As a result, the microfinance industry is currently unregulated, with six major Microfinance Financial Institutions (MFIs) acting as commercial bank subsidiaries or non-governmental organizations (NGOs). Finally, mobile money operators are the primary transaction instrument used by both individuals and businesses in Somalia, accounting for 36 percent of GDP.

**Table 5: Summary of the Major Players in Somalia's Financial Industry**

| **Category** | **Description** | **Key Actors** |
|---|---|---|
| Central banks | The primary regulators of financial institutions are central banks. They license and control other financial institutions and advance supervision, but they do not yet help to assure local banks. | The central bank of Somalia<br>The central bank of Somaliland<br>The central bank of Puntland |
| Islamic banks | Profit sharing and the prohibition of interest are essential features of IBS. | Dahabshiil Bank International (DBI), Dar-salaam bank (DSB), Premier bank, international bank of Somalia (IBS Bank), Amana bank, Global Tech Bank, and Trust African Bank. Moreover, there are some other licensed banks but not operational yet. |
| Microfinance Institutions | MF is aimed toward individuals and little businesses that do not have access to traditional banking and related services. There is no official regulation in Somalia to support MF (Even though it is getting started in Somaliland). Some Somali banks are planning to accommodate the demand for microfinance as soon as the required rules are in place. | Kaaba microfinance institution (KMFI), Kaah International Microfinance Services (KIMS), MicroDahab (MFI), Shuraako, and Kaalo. |
| Money transfer business | Money transfer companies primarily handle international remittances, though some are partially widely varied with overlapping financial and non-financial sector interests. | Amal Express, Amaana Express, Dahabshiil, Hodan, Jubba, Kaah Express, Taaj, Tawakal, Iftin, Bakal Express, and Globalex. |

| | | |
|---|---|---|
| Mobile money operations | Mobile money services are available from all mobile network operators. Leading mobile network operators are part of many sectors and are forming alliances with money transfer companies to expedite international transactions. | Telesom is one of the major MNOs in Somaliland that uses the Zaad system for cash transfers and safety net payments. Dahabshil E-Dahab, Hormud-EVC, and Somtel are among the other companies. |

**Source**: (Calhoun Courtenay Cabot Venton Toscane Clarey Abdirisak Dalmar et al., 2020)

## 4.4 THE EMERGENCE OF ISLAMIC BANKS IN SOMALIA

Interest-free banking is considered profit and loss sharing banking in Somalia, according to the law. Banks that share profits or losses are those that conduct investment or commercial activities.

The Banks and Other Financial Institutions Decrees, enacted in the 1990s, marked the beginning of the emergence of modern interest-free banks. In Somalia, interest-free banking has a long and illustrious history. Non-interest banks have been designated as specialized banks under the banks and other financial institutions decrees provision since 1996.

Additionally, In the year of 2000s, investors were on the rise as they sought banking licenses to establish interest-free banks. However, due to the country's political turmoil and the Central Bank of Somalia's inability to function efficiently, these initiatives failed to materialize. Around the year 2009, interested investors advocated for the development of full-fledged interest-free banks in Somalia. After fulfilling the capital standards of the Central Bank, the Salaam Somali Bank was granted permission to create the brainchild of a group of Somalis (Hassan, 2017).

Currently, Somalia has 14 full-fledged Islamic banks, which they are: Salaam Somali Bank, Amal Bank, Premier Bank, Amana Bank, Som Bank LTD, Bushra Bank, Idman Community Bank, Agro African Bank, Dahabshiil Bank International, International Bank of Somalia, Daryeel Bank LTD, Galaxy International Bank and Dar- AsalamBank.

In 2022, Somalia declared that two foreign banks had obtained banking licenses in the country, opening the door to international investment for the first time in decades. The Egyptian bank Banque Misr and the Turkish bank Ziraat Katilim are the country's first foreign banks to be allowed to operate. These two robust organizations will add value to the development of Somalia's financial sector and assist the economy in flourishing (African news, 2022).

## 4.5 PRODUCT OFFER BY ISLAMIC BANKS IN SOMALIA

Somalia's Islamic banks provide Islamic savings and current accounts. Savings accounts allow for profit sharing, whereas current accounts are for day-to-day transactions (Hasan, 2018). Furthermore, larger projects, such as construction and renovation, are the focus of Islamic loans. Trade financing is also available to help with the importation of goods into the Somali market. In Somalia, Islamic banks can finance new real estate through Istisna, old real estate through Diminishing Musharakah, agricultural production through Salam contracts, various types of equipment through Murabaha purchase order financing, and Mudaraba financing such as running a restaurant, among other things.

Clients can fund secure fixed-return products, like Treasury Murabaha deposits, or by working with the bank (Musharaka), like Islamic finance operator Takaful, which are riskier but carry greater profit rates if successful. Among the goals of Islamic banks is to make Somalia more contemporary and safe cashless society.

## 4.6. OPPORTUNITIES OF ISLAMIC BANKS IN SOMALIA

Islamic banking and finance have a higher opportunity to contribute in the country. First, it encourages financial inclusion, particularly among a sizable needy Muslim population. Second, asset-backed lending and risk-sharing elements encouraged small and medium-sized enterprises (SMEs) and public-sector investment. Finally, the restriction on speculating and risk-sharing implies that Islamic financing is less dangerous than Conventional finance (Kammer, 2015).

In the modern Islamic banking of Somalia, these characteristics are more relevant and necessary. Working in a financial sector that hasn't been operational for a quarter-century will present numerous challenges for Somalia's Islamic banking sector. However, it can benefit the country's all-Muslim population, which necessitates powerful financial institutions.

Somalia's economy benefits from the expansion of Islamic banking and finance by offering better services to small and medium-sized enterprises. Generally, the growing population, rising young population, and return of the diaspora are all chances for Islamic banking and finance to increase their services.

Because of the Somalis people faith, Somalis prefer ethical and Islamic financing and transactions. If Somalia implements the Islamic banking system, it can utilize equity capital to address the inadequate workforce capital proportion for information industry farmworkers associated with agriculture and manufacturing industries.

If Somalia's Islamic banks successfully follow these methods, they may persuade our political leaders to replace grants and subsidies with equity funding, which aids in self-reliance through specialized financial institutions.

Finally, the establishment of Islamic banking would likely provide Somalia's government with diplomatic benefits in conducting financial transactions with Muslim-dominated states, notably in securing trillions of dollars in equity investment from the Gulf nations.(Hassan, 2017).

## 5. FINDINGS AND RESULTS

### 5.1 INTRODUCTION

This chapter describes the conclusions of research conducted to examine the difficulties and prospects for Islamic banks in Somalia. A total of 106 Somalian Islamic bank personnel answered the survey, representing Islamic banks in various towns around the country.

### 5.2 DESCRIPTIVE STATISTICS

Descriptive statistics provide for the explanation and description of fundamental data information such as an Islamic bank employee's educational status, years of experience, and their position.

**Fig 1: Educational Status**

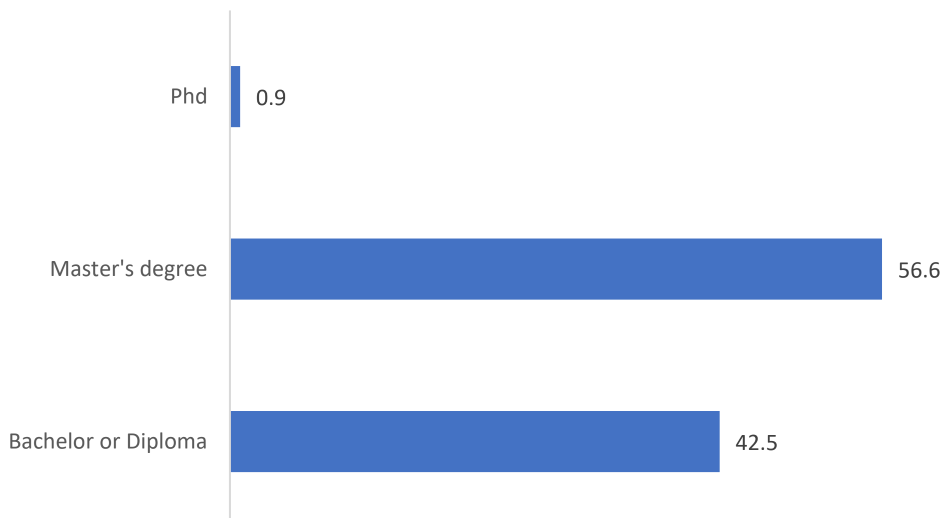
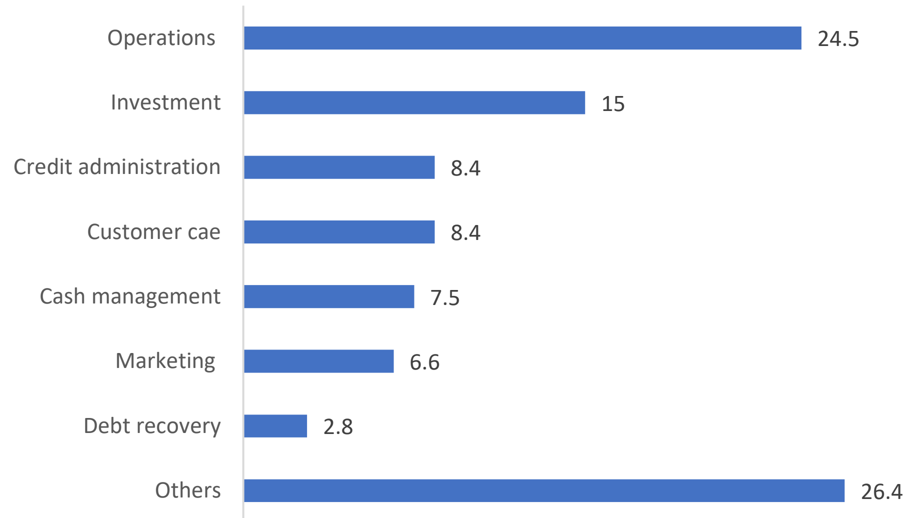


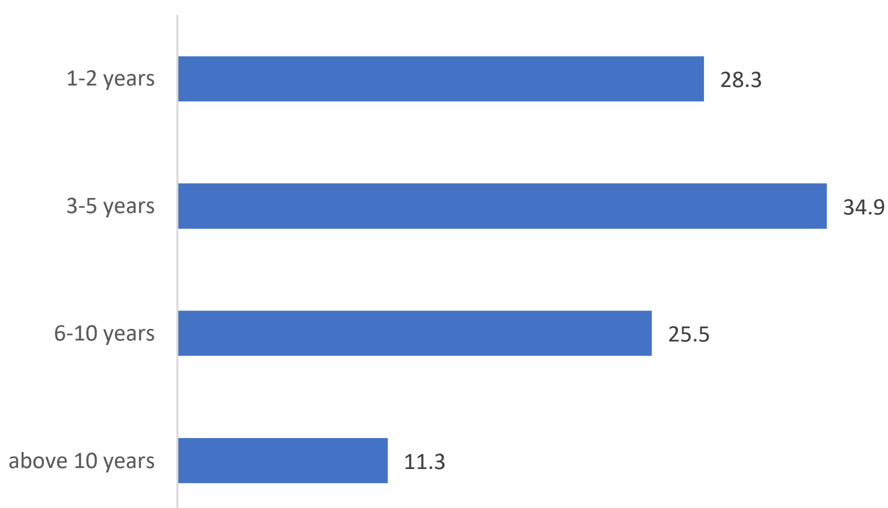

Fig. 1 illustrates the employee's educational status. The majority of Islamic bank employees in Somalia are Master degree holders. Among the 106 participants, 56.6 percent have a Master's degree, 42.5 percent have a Bachelor's degree, and only 0.9 percent have a Ph.D.

**Fig 2: Positions of the Employees**




With regard to the employee's position in the Bank 24.5 percent work in the Operations Department, 15.0 percent in the Investment Department, 8.4 percent in customer care department, 2.8 percent in the Dept recovery department (they make calls or visit debtors in order to collect the debt), 7.5 percent in the Cash Management department, 8.4 percent in the Credit Administration Department, 6.6 percent in the Marketing Department, and 26.4 percent in other Islamic bank departments.

**Fig 3: Experience of The Participants**



The above figure revealed some data regarding the years of experience of the employees of IBS. 34.9 percent of employees have 3-5 years of experience, 28.3 percent have 1-2 years of experience, 25.5 percent have 6-10 years of experience, and only 11.3 percent of the employee have 10 years and above experience in the Islamic banking industry.

## 5.3 CHALLENGES THAT ISLAMIC BANKS IN SOMALIA FACE

This section assesses survey results regarding the challenges and issues that Somalia's Islamic banks face.

**Table 6: Financing Small Projects**

| Variables (participants views) | Frequency | percentage | Mean/ Std. Dev |
|---|---|---|---|
| Do you agree that Somalia's Islamic Banks finance small projects? | | | |
| Strongly agree<br>Agree<br>Disagree<br>Strongly disagree | 43<br>55<br>5<br>3 | 40.6<br>51.9<br>4.7<br>2.8 | 1.58/ 0.71 |

Table 1 shows the results regarding financing small projects and asked to rate between strongly agree and strongly disagree. We found that 40.6 percent of participants strongly agree that Islamic banks in Somalia finance small projects. In contrast, 51.9 percent agree with the statement. The statement is strongly disagreed upon by 2.8 percent of the participants. 4.7 percent of them, on the other hand, disagreed with the statement.

**Table 7: The Main Challenges**

| Variables (participants views) | Frequency | percentage | Mean/ Std.Dev |
|---|---|---|---|
| The most significant difficulty confronting Islamic banks in Somalia? | | | |
| 1: Lack of seriousness of Islamic banks in financing development projects | 10 | 9.43 | 3.30 / 1.71 |
| 2: Shortage of cash capital | 28 | 26.42 | |
| 3: Lack of understanding of the significance of Islamic banking | 37 | 34.9 | |
| 4: Inadequate public desire for Islamic banking | 6 | 5.6 | |
| 5: The isolation of the Somali banking experience from the world | 13 | 12.26 | |
| 6: Others | 12 | 11.3 | |

Table 2 indicates to identify the most significant challenge confronting Islamic banks in Somalia. 26.4 percent reported a lack of cash capital, while 5.6 percent reported a lack of public desire. 34.9 percent of respondents indicated a lack of understanding of the significance of Islamic banking. 9.4 percent responded; lack of seriousness of Islamic banks in financing development projects, 12.3 percent responded; and isolation of Somali banking experience from the rest of the world. Finally, 11.3 percent of participants stated that there are additional issues.

**Table 8: Islamic Insurance and Islamic Fund**

| Variables (participants views) | Frequency | percentage | Mean/ Std.Dev |
|---|---|---|---|
| Do you agree there will be a challenge for Somalia's Islamic banks if there is no Islamic insurance or Islamic funds on the market? | | | |
| Strongly agree<br>Agree<br>Disagree<br>Strongly disagree | 23<br>65<br>15<br>3 | 21.7<br>61.3<br>14.2<br>2.8 | 1.58 / 0.83 |

Table 3 shows whether there will be a problem if Somalia does not have Islamic insurance or Islamic funds. and asked to rate their level of agreement between strongly agreeing and disagreeing. We found that 21.7 percent strongly agreed that there would be a significant challenge if Islamic banks in Somalia do not have Islamic insurance Islamic funds in the market, while 61.3 percent agreed, 2.8 percent strongly disagreed, and 14.2 percent disagreed.

**Fig 4: Legal and Regulatory challenge**

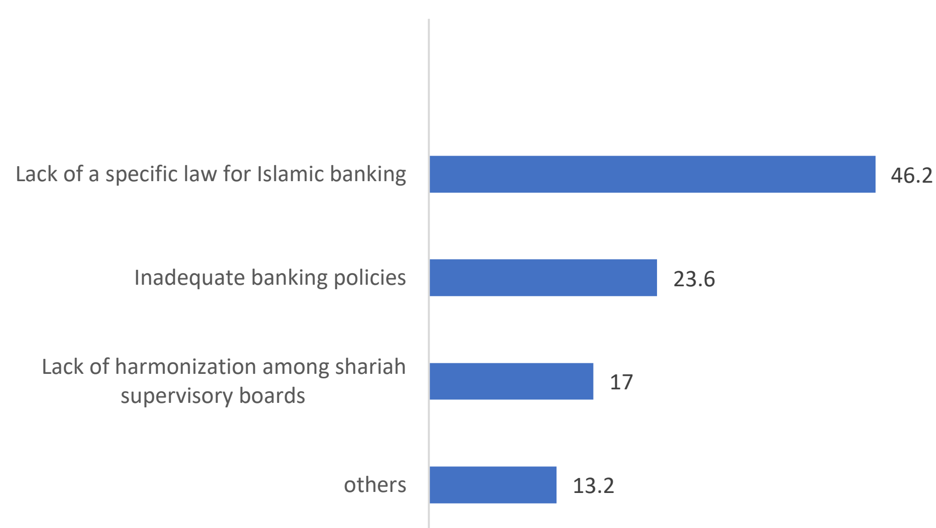
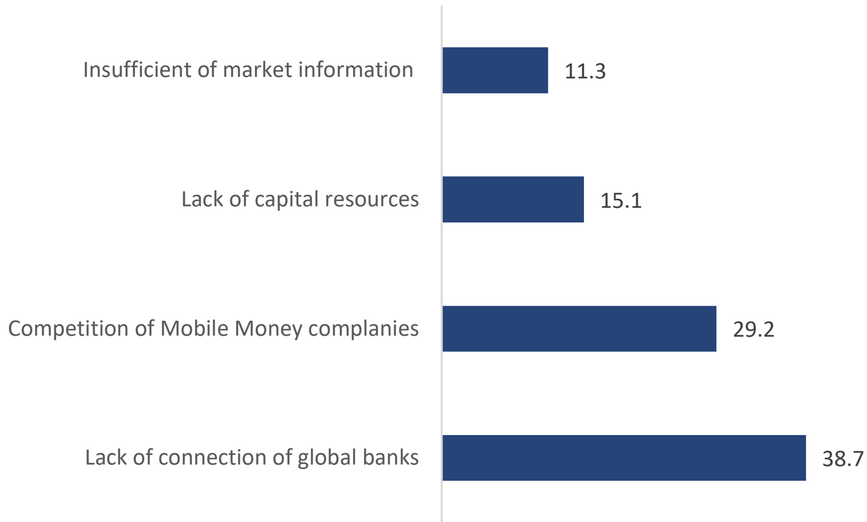


Fig 4 provide details of the legal and regulatory challenges that Islamic banks face in Somalia. The most significant issue regarding legal and regulatory challenges is identified by 23.6 percent as inadequate banking policies, 17 percent as a lack of harmonization among *Shariah supervisory boards,* and 46.2 percent as a lack of specific law for Islamic banks. Finally, 13.2 percent said there are others.

**Fig 5: Management Issues**


A lack of expertise and skilled employees is one of the most critical obstacles for Somalia's Islamic banks, cited by 48.1 percent. While 24.5 percent cited a lack of risk management. 6.6 percent said there was a lack of accounting and auditing standards. while 20.1 percent of respondents mentioned other issues.

**Fig 6: Financial Expansion Issues**




For this statement, 29.2 percent of participants responded to competition from mobile banking operators which intersected in sending and receiving remittances, we found that 11.3 percent responded to insufficient market information which based on not having enough ideas about customer feedback, and 15.1 percent responded to a lack of sufficient capital resources which causes insufficient funds to cover expenses, finance growth potential, and provide a new product or service to market. While 38.7 percent, which was the majority of participants, responded with a lack of connection with global banks. Finally, 5.7 percent said others.

**Table 9: Limitation of Market Share and Products**

| Variables (participants views) | Frequency | percentage | Mean/ Std.Dev |
|---|---|---|---|
| 1: Issues that limit market share in Somalia's Islamic banks are? | | | |
| 1: Lack of Islamic insurance<br>2: High pricing of Finance<br>3: Illiteracy of Islamic financial transactions and affairs<br>4: Others | 24<br>32<br>28<br>22 | 22.64<br>30.19<br>26.42<br>20.75 | 3.07 / 2.13 |
| 2: The issues that restrict the goods supplied by Somalian Islamic banks? | | | |
| 1: Law of return of investment<br>2: Inadequate expertise<br>3: Lack of R&D (research and development)<br>4: Lack of interest of customers<br>5: Others | 22<br>10<br>53<br>10<br>11 | 20.75<br>9.43<br>50<br>9.43<br>10.38 | 3 / 1.64 |

According to the findings, 26.4 percent of participants reported illiteracy in Islamic financial transactions and affairs. Generally, the Somali community understands Islamic financial transactions, which is a type of financing activity that must adhere to Shariah law. However, lack sufficient knowledge of how financial transactions operate? 30.2 percent reported high pricing of financing which discourage consumer purchases, which was the majority response of the participants. while 22.6 percent said they did not have Islamic insurance. 20.8 percent of participants responded that there are other challenges.

Statement 2 discusses the limitations of products offered by Somalian Islamic banks. According to the survey results, 50 percent of participants reported a lack of R&D (research and development), 20.8 percent responded with a low rate of return, 9.4 percent responded with a lack of customer interest, and 9.4 percent reported inadequate expertise, and 10.4 percent responded Inadequate expertise.

**Table 10: Risk Issues**

| **Variables (participants views)** | **Frequency** | **percentage** | **Mean/ Std.Dev** |
|---|---|---|---|
| Which of the following is one of the most significant risks to Somalian Islamic banks? | | | |
| 1: Funding risk | 5 | 4.72 | 3.89 /1.62 |
| 2: Foreign exchange risk | 10 | 9.43 | |
| 3: Credit risk in debt-based financial instruments | 43 | 40.6 | |
| 4: Collateral risk | 11 | 10.38 | |
| 5: Rate of return risk | 16 | 15.09 | |
| 6: Liquidity risk | 15 | 14.15 | |
| 7: Others | 3 | 2.83 | |
| 8: Reputation risk | 3 | 2.83 | |

This statement lists the most significant risks that Islamic banks in Somalia face. According to the findings, 40.6 percent responded to credit risk debt-based financial products, 14.2 percent to liquidity risk, 4.7 percent to funding risk, and 15.1 percent to rate of return risk. Only 2.8 percent mentioned reputation risk, 10.4 percent said collateral risk, 9.4 percent said foreign exchange risk, and only 2.8 percent said other risks.

## 5.4 OPPORTUNITIES OF ISLAMIC BANKS IN SOMALIA

This section assesses survey data related to the prospects accessible to Islamic banks in Somalia. The results for the responder are shown in the tables below.

**Table 11: Development of Islamic Banks in Somalia**

| Variables (participants views) | Frequency | percentage | Mean/ Std.Dev |
|---|---|---|---|
| Do you think the growth of Islamic banks in Somalia leads people to save and invest? | | | |
| 1: Agree<br>2: Strongly agree<br>3: Disagree<br>4: Strongly disagree | 38<br>59<br>7<br>2 | 35.85<br>55.6<br>6.6<br>1.89 | 1.74 / 0.6 |

According to Table 6, 55.7 percent of participants strongly agreed that the development of Islamic banks in Somalia encourages people to save and invest, and nearly 35.8 percent agreed. Similarly, 6.6% disagreed that they encourage people to invest and save. While only 1.9 percent of respondents strongly oppose the ideas.

**Table 12: Accomplishment of Islamic Banks in Somalia**

| Variables (participants views) | Frequency | percentage | Mean/ Std.Dev |
|---|---|---|---|
| Which of the following do you think Islamic banks in Somalia accomplished? | | | |
| 1: Profit maximization<br>2: Promoting sustainable development projects<br>3: increase job opportunities<br>4: Assist in eliminating poverty<br>5: Improving the Quality of Products and Services<br>6: Minimizing the cost of operations<br>7: Others | 33.02<br>11.32<br>17.92<br>14.15<br>17.92<br>3.77 | 35<br>12<br>19<br>15<br>19<br>4 | 2.91 / 1.71 |

| | | | |
|---|---|---|---|
| | 1.89 | 2 | |

According to this table, employee of IBS asked achievements and performance of their banks. Majority of the participants which were 33.11% responded that; profit maximization and 14.2% answered elimination of poverty. 11.3 percent of the participants answered promotion of sustainable development projects, 17.9% of the participants responded that job availability is one of the IBS's performance indicators, 3.8% responded cost operations minimization is another achievement, and 17.9% answered product and service quality improvement. Lastly, 1.9 percent of the participants responded that there are other accomplishments that IBS of Somalia achieved.

**Table 13: Social Acceptability**

| **Variables (participants views)** | **Frequency** | **percentage** | **Mean/ Std.Dev** |
|---|---|---|---|
| Do you agree that Islamic banking and finance have a higher societal acceptance in the country than traditional banks? | | | |
| 1: Agree<br>2: Strongly agree<br>3: Disagree<br>4: Strongly disagree | 26<br>50<br>19<br>11 | 24.3<br>47.17<br>17.92<br>10.38 | 2.14 / 0.9 |

In this question, the societal acceptance of Islamic banking and Conventional banking is compared. According to the data, 47.2 percent of interviewees thought that Islamic banks had greater societal acceptance than conventional banks., 24.5 percent agreed, and 17.9 percent disagreed. In comparison, 10.4 percent of participants strongly disagreed.

**Table 14: Availability of Successful Financing Projects**

| Variables (participants views) | Frequency | percentage | Mean/ Std.Dev |
|---|---|---|---|
| Do you agree that Islamic banks in Somalia will thrive on the availability of successful infrastructure, agriculture, and trade finance projects? | | | |
| 1: Agree<br>2: Strongly agree<br>3: Disagree<br>4: Strongly disagree | 50.94<br>39.62<br>6.60<br>2.83 | 54<br>42<br>7<br>3 | 11 / 0.73 |

Based on this table, 39.6 percent of respondents strongly agreed that the existence of effective infrastructure, agriculture, and commerce projects is critical for Somalia's Islamic banks. And almost 50.9% agreed with the same idea. Correspondingly, 2.8% of those who filled the questionnaire strongly disagreed that Islamic banks in Somalia will prosper the accessibility of successful projects, such as infrastructure, agriculture, and trade projects. 6.6% of the participants disagreed with the idea.

**Table 15: Efficiency and Performance of Islamic Banks**

| Variables (participants views) | Frequency | percentage | Mean/ Std.Dev |
|---|---|---|---|
| How would you rank Somalia's Islamic banks' effectiveness and profitability over the last decade? | | | |
| 1: Good<br>2: Very good<br>3: Excellent<br>4: Bad | 46<br>47<br>12<br>1 | 43.40<br>44.34<br>11.32<br>0.94 | 1.69 / 0.7 |

Participants were asked to score and appraise the efficiency and effectiveness of Somalia's Islamic banks during the previous 10 years. 11.3 percent of participants rated their performance as excellent, while 44.3 percent rated it as very good. 43.3 percent rated their performance as good. 0.9 percent of participants scored poorly, with none scoring unsuccessfully. As a result, this demonstrates the progress made by Islamic banks in Somalia over the last decade

**Table 16 Summary of Issues and Opportunities of SIB**

| Main Issues | Main Opportunities |
|---|---|
| Lack of seriousness of Islamic banks in financing development projects | Encourage people to save & invest |
| Shortage of cash capital | High efficiency & performance |
| Lack of understanding of the significance of Islamic banking | Eliminating poverty |
| Inadequate public desire for Islamic banking | Promoting sustainable development project |
| Isolation of global connection | Offering more job opportunities in the market |
| Lack of a specific law of Islamic banks | Improving quality of products & services |
| Inadequate banking policies | Higher societal acceptability |
| Lack of harmonization among shariah supervisory boards | |
| Lack of expertise | |
| Lack of risk management | |
| Lack of accounting auditing standards | |
| Insufficient of market information | |
| Lack of capital resources | |
| Competition from Mobile money banking | |
| Lack of Islamic insurance | |
| High pricing of Finance | |
| Illiteracy of Islamic financial transactions and affairs | |
| Law of return of investment | |
| Lack of R&D (research and development) | |

| | |
|---|---|
| Lack of interest of customers | |

Origin: Author

## 5.5 THE CHALLENGES AND STEPS FORWARD

### 5.5.1 Shortage of Expertise and Skilled Personal

Shortages of competence are a global concern for the Islamic finance industry, not just in Somalia. Karbhari et al., (2004) examined the problems and concerns affecting western Islamic banks: the instance of the United Kingdom. Their findings indicated that one of the main challenges is a lack of expertise. Hailu & Bushera, (2020) indicated one of the most serious issues that Ethiopian interest-free banks confront is a shortage of Islamic finance professionals.

Employees of Islamic banks must recognize the importance of evaluating Islamic banking products. Employees should be the first to thoroughly understand their products and have a positive attitude in order for the items to be acceptable to buyers. It has the potential to make a substantial contribution to the overall growth of Islamic banks, particularly in Somalia. Employees and professionals at Islamic banks should be better aware of the items they market to their consumers. Furthermore, bank managers should establish institutions to teach bank staff in technology and business project management. They should also be educated on the ethics and religion of their economic investments.

### 5.5.2. Lack of Awareness Among Society of Islamic Banking

The phrase "knowledge" of Islamic banking goods and services means being aware and accepting of existing tradable items, product content, and functions (Buchari et al., 2015). These are learned by interacting with the products or hearing about them from other sources. Aside from the growing development of Islamic banks in Somalia over the last decade, societal awareness of Islamic banking is extremely poor. Somalia's Islamic banking faces insufficient client understanding due to a lack of information regarding the country's Islamic banks' aims, principles, and benefits. To create awareness in the community as the Somali -community speaks one language. This awareness will be how Islamic banks work and what is different from the conventional. Disseminate this awareness on social media sites, such as radio, TV, journals, and other social media.

### 5.5.3. Regulative Challenges

Somalia did not previously have financial laws other than law number 130. However, recently the federal parliament of Somalia has started approving and implementing commercial laws such as bank registration law, mobile banking registration, general financial management law, and other laws. That might be a step in the right direction, paving the way for laws and regulatory boards to oversee and guide the country's financial sector. Recently, the Somali government established a National Economic Commission. Thus, it is accountable for banks and financial institutions in Somalia’s banking system to become more effective and efficient. This is vital to have more regulations that will simplify the work of banks and encourage customers to deal with banks. Moreover, having different supervisory boards such as banking, remittance and microfinance can help overcome this challenge. And This will take time as Somalia is recovering from civil wars.

### 5.5.4. Lack of Harmonization Among Shariah Supervisory Boards

Like any other Islamic bank around the globe, Islamic banks in Somalia face a lack of shariah supervisory board harmonization. Every Islamic bank in the country has a Shariah board of directors, and that may confuse clients. It might happen that different shariah supervisory boards may issue fatwas for the same commodity. Therefore, Islamic banks in Somalia must form unified *Shariah supervisory boards*. It can establish if the Islamic banks in Somalia agree to follow or accept a common discipline. Furthermore, a centralized Shariah board can reduce the differences and tools of Islamic finance, resulting in an Islamic financial market.

### 5.5.5. High Pricing of Finance

Although it is forbidden in Islam to determine a price as prophet Muhammed said prices are fixed by Allah when people came and asked him to fix the price of the market. Islamic banks in Somalia face the challenge of higher pricing. As a result, Islamic banks must reduce their high pricing through risk-sharing mechanisms. Risk-sharing eliminates the need for either banks or consumers to bear risk alone. When they share risk, they both stand to lose (either in effort or capital), so higher pricing is unnecessary.

### 5.5.6. Lack of Islamic Insurance

Another issue confronting the Somalian Islamic banking industry is a scarcity of Islamic insurance. Islamic insurance, also known as *Takaful*, is an idea of collaborative efforts that ensures the participants' mutual protection. The Fiqh Academy declared in 1985 that insurance based on partnership principles, Shariah compliance, and charitable contributions are permitted (Lim et al., 2010).

In Somalia, Islamic banks must develop Islamic insurance, which is independent of and accountable for the supervision and monitoring of the Takaful industry, as well as persuade their consumers of the benefits of Islamic insurance. Islamic banks should educate their customers that Islamic Insurance is all about risk sharing rather than risk transfer, it is about the participants' sincerity and willingness to help one another. It is about participant cooperation, commitment, and brotherhood.

### 5.5.7. Law Rate of Return

Islamic law, which rejects the concept of interest, allows for an undetermined rate of return based on profit. However, unlike conventional banks, Islamic banks incur more financial risks since the rate of return on investments is unpredictable. Due to shariah compliance, Islamic banks do not have fixed-income securities on their balance sheets, nor do they have a pre-determined return on deposits, putting them at risk (Zainol & Kassim, 2010).

The solution is to ensure that large amounts of money are transferred to those investments that should have a lower risk. It is a viable solution because it ensures that banks achieve high rates of return, allowing them to prosper. These advantages will help not only banks but also lenders since the supply of loans have a positive connection with rates of return, with higher rates of return boosting the supply of loans (Makiyan, 2003).

### 5.5.8. Lack of Research and Development department (R&D)

One of the most significant issues confronting Somalia's Islamic banks is the absence of an R&D department. According to Fatima et al., (2018) R&D activity initiates and encourages new production, increases knowledge levels, and introduces new technological applications and processes. Furthermore, it is critical to any business's success, achievements, and profitability. As a result, Islamic banks in Somalia must adopt and establish R&D to catch up and develop techniques that increase efficiency and effectiveness in the bank's operations and service disbursement to society and clients.

R&D is in charge of digital modernization in today's digitalized world, which simplifies the bank's work through the development of applications. QR codes and many other digitalized platforms make it easy for customers and banks. To achieve sustainable development and be on par with developed international banks, Somali Islamic banks must prioritize R&D.

### 5.5.9. The Competition from Mobile Banking

In its most basic form, competition occurs when two or more organizations or companies that provide similar products and services with similar goals compete to outperform one another. Islam does not oppose competition when it comes to development and providing benefits to society. However, it composes when it turns into a negative one as stated by (Ogunbado, 2013). Competitiveness should be self-assured and healthy, fostering improved production and service quality.

Another significant challenge that Somalia's Islamic banks face is competition from mobile money operators who began before Islamic banks. They were only interested in the sending and receiving of remittances. In my opinion, Islamic Banks in Somalia should strength their competitiveness in a way that encourages them to innovate and produce high-quality products.

### 5.5.10. Inadequate Market Information

It is enough to have a quality product to enhance and improve the banking industry; market information is also necessary. According to the survey findings, the lack of market information is a significant challenge for Islamic banks in Somalia. For my point of view, market information plays a vital role in enhancing financial institutions because it allows them to have new ideas and implement predictions based on customer feedback, which further explains what their needs or interests are? Therefore, to make tangible progress, Somalia's Islamic banks must overcome this issue. They must process and manage market information, besides supervising market research activities.

### 5.5.11. Lack of Connection with Global Banks

Another issue is a lack of connectivity with global banks oversees. Therefore, it is believed that if Islamic banks in Somalia become more legitimate in their services and behavior, they will have the potential to gain the attention of international banks. Moreover, this would benefit Somalian Islamic banks because worldwide interbank transactions would become easy and enable them to benefit from knowledge, technology, and new ideas.

## 5.6 RISKS

### 5.6.1. Credit Risk in Debt-Based Financial Products

Risk arises in many aspects of commercial operations; nonetheless, credit risk is a critical component that banks must manage and financial institutions, particularly Islamic banks in Somalia. Credit risk is the probability that a creditor or counterparty may fail to make payments in accordance with the conditions agreed upon (Masood. Omer et al., 2012). As a result, it occurs of the bank's dealings with or lending to individuals, as well as other banks or financial institutions.

Credit risk is another issue that Islamic banks in Somalia confront. Islamic banks in Somalia must form a committee of specialists to assess credit risk. To mitigate risk, Islamic banks should employ five risk metrics. Character, Capital, Capacity, Collateral, and the Counterparty's economic situation. Moreover, Islamic banks in Somalia should set up a clear credit policy, such as checking the customer's credit record.

### 5.6.2. Liquidity Risk

Another major risk confronting Islamic banks in Somalia is liquidity risk.  It is when a bank will lack the ability to encounter its obligations on time and at a reasonable cost (Arif & Anees, 2012) Liquidity risk affects not only the performance of the bank but also its public image; if depositors do not get their funds on time, a bank may lose its trust. To avoid this issue, Islamic banks in Somalia must thoroughly understand liquidity risk. Develop the mechanisms required for proper risk measurement and management, maintain constant awareness of the shutdowns of their various funding sources, and enhance their cash reserves to reduce liquidity risk.

### 5.6.3. Rate of Return Risk

One of the hazards that Islamic banks in Somalia confront is the rate of return risk. The rate of return risk is a total balance sheet vulnerability that occurs when assets and balances from different entertainment providers differ. An increase in benchmark rates may lead to high return expectations among investment account holders (IAH or *Sahib ul mal*). As a result, the bank will be under pressure to pay a larger rate of return than achieved and has opted to relinquish its rights to entertainment providers because it is their obligation to manage sahib al-mal expectations and assets to current account holders (Febianto, 2012).  As a result, in my opinion, the bank should adopt a strategy and structure for protecting their shareholders' assets. They should also determine the magnitude of the spread between rivals' rates and the fund provider's predicted rate.

### 5.6.4. Collateral Risk

Another issue that Somalian Islamic banks face is a collateral risk. It is one of the foremost significant defenses against credit loss and financing, and also it is critical to the bank's liquidity insurance activity's performance. In Somalia, Islamic banks must develop policies regarding collateral risk, such as hiring relevant experts, eligibility (what collateral the bank will lend against), and valuation (how much the collateral is worth), all of which are critical in protecting the bank from loss in the event of a borrower default.

### 5.6.5. Foreign Exchange Risk

Foreign exchange risk emerges when a bank's revenue and liabilities are dominated by foreign currencies (Rhanoui & Belkhoutout, 2019). Islamic banks in Somalia do not receive payment in their own currency (Somali shillings).

In my view, to avoid this risk, Islamic banks in Somalia must be aware of risk mitigation techniques and follow the central bank's instructions. Finally, establishing a group of committee members who are knowledgeable about foreign exchange risk management techniques would help.

# CONCLUSION

This chapter concludes the whole study. It consists of four different sections. First, it focuses on the study's results and analysis. Second, it introduces several policy recommendations for the study, and third, it presents and discusses the limitation of the study. Last, it offers some suggestions for further research.

Islamic banking is a zero-interest-rate, equity-based system. The three fundamental prohibitions of Islamic finance are the prohibition of interest *(riba*), the prohibition of uncertainty (*gharar*), and the prohibition of gambling (*maysir*). The most well-known contracts used by Islamic finance are *Mudaraba*, *Murabaha*, *Musharakah*, *Ijara*, *Salam*, and *Istisna*.

Historically, the Islamic financial system arose throughout the time of the prophet Muhammed (peace be upon him). Transactions are carried out by using *Mudaraba*, with one party contributing capital and the other contributing effort and experience. Profits are distributed under the terms agreed upon by both parties. When it comes to losing, the capital supplier bears the loss, while the other party would suffer a loss of effort and time.

From the years 661 to 850, the system also developed under the control of Muawiya and the Abbasid caliphates. Subsequently, it was ruled by Islamic rulers, including Andalusia (Spain) in 1031, Granada until 1942, the Malacca Sultanate until 1511, and the Ottoman Empire (Turkey) until 1918 (Alamgir M et al., 2017).

Several studies claimed Malaysia was the site of the earliest Islamic Banking (IB) trials in the mid-1940s.  Pakistan in the late 1950s, and Egypt in 1963 (Alamgir M et al., 2017; Perry & Rehman, 2011). Furthermore, several Islamic banks, including Faisal Islamic Bank of Egypt, Faisal Islamic Bank of Sudan, and Kuwait Financing House, were set in place in 1977. Bahrain Islamic Bank came into existence in 1979, and in 1980 countries such as Pakistan, Iran, Sudan, Malaysia, and Bahrain have demonstrated Islamic banking (Aqib Ali, 2015).

It discovered the banking system of Somalia during the colonial era in 1920. Before the collapse of the Somali government in 1960, Somalia had several banks, including the central bank of Somalia, the Somali commercial bank, the commercial and saving bank, the Somali development bank, and the state insurance company. Furthermore, the current financial system of

Somalia consists of the central bank, Islamic banks, microfinance institutions, mobile money operators, and money transfer businesses.

The results for Somalian Islamic banks showed that the growth of Islamic banking and finance in Somalia is anticipated to benefit the economy of small and medium-sized enterprises. Furthermore, the vast infrastructure and rehabilitation in Somalia provide a chance for Islamic banks to participate. However, Somalia's Islamic banks encounter a number of difficulties.

One of the study's main findings reveals that the most challenge of Somalia's Islamic industry could be a lack of awareness and understanding of Islamic banking. The second major issue is a lack of expertise. The third major challenge is the regulatory challenge.

Other challenges include a lack of coordination among shariah supervisory boards, high financing costs, a lack of Islamic insurance, a lack of R&D, competition from mobile banking, insufficient market information, a lack of connection with global banking, credit risk in debt-based financial products, liquidity risk, rate of return risk, collateral risk, and foreign risk. These difficulties progressed to the next level.

The least ranked challenges were lack of public desire for Islamic banking, lack of seriousness of Islamic banks in financing development projects, lack of accounting and auditing standards, illiteracy of Islamic financial transactions, lack of interest from customers, funding risk, and reputation risk.

**POLICY RECOMMENDATION**

Because Somalia's population is entirely Muslim, it provides promise and positive attributes to the IBS. The country's Islamic banking future appears bright. However, Islamic banks in Somalia must take several steps forward, summarized below, to ensure their continued success.

Because Islamic banking is a new concept in Somalia, particularly among bankers, there is a need to start educating both the general public and policymakers on Islamic banking principles. As a result, the society must have access to the information about Islamic banking products, benefits, services, and features. Furthermore, Islam promotes fairness, justice, and transparency, Islamic banking in Somalia must adhere to these principles in the latter. So far, Somalia's public education campaign on Islamic financial concepts has been ineffective.

Somalia should collaborate with Muslim countries, specifically those pioneers in this concept of Islamic banking, such as Malaysia, Dubai, Bahrain, and others, to exchange ideas and knowledge and address other issues impeding its development in this area.

Islamic banking supervision is critical. One of the current weaknesses of Somalia's Islamic banks is a lack of effective regulation. As a result, Somalia's Shariah supervisory boards must accept this responsibility and create a fruitful supervision framework to manage all of Somalia's financial institutions.

Somalia should use R&D techniques to promote new products and improve existing ones for successful adoption. Additionally, this will increase and enhance the bank's efficiency and effectiveness and make significant progress in expanding the country's banks.

Another issue is the lack of Islamic insurance. Islamic banks in Somalia should establish Islamic insurance companies to protect their investments from unforeseen risks and help the industry grow.

Efficiency risk management capability is crucial for any Islamic banking industry, especially Islamic banks in Somalia. Every risk is unique, and its management depends on the type of the risk. Islam emphasizes the necessity of effectively managing and limiting risk. Islamic banks in Somalia should develop a proper mechanism for risk management and hire qualified staff for it

**LIMITATION OF THE STUDY**

Like any other social science research, this study has potential limitations that may have an impact on the study's conception, such as a lack of resources and references, as well as non-cooperation in accessing data during the data collection stage. Some of the limitation faced were as follows;

One of the significant limitations was a lack of relevant resources on the subject matter, since Islamic banks is new in Somalia, following the decline of the Somali government in 1960, making it difficult to access quality information about the country's financial system.

Another limitation of the study arouses from non-cooperation in data access. It was another challenge to locate monthly or annual reports on the bank's website so that you could keep track of them.

Furthermore, there were difficulties in getting the staff to respond appropriately to the questions while conducting the survey. Making the information collected partially or inadequate in conducting full-scale research on this area.

**SUGGESTIONS FOR FURTHER STUDIES**

This study investigates the difficulties and possibilities confronting Somalian Islamic banks. This study suggests that further research in terms of semi-structured interviews and survey should be done in order to minimize and address these problems faced by Somalian Islamic banks.

Secondly, a further study is needed to identify the factors influencing Somalia's immature banking system up to the latest years to be able to be a competitive Islamic bank aligned with the other leading Islamic banking countries such as Malaysia, Kuwait, Qatar, Saudi Arabia, and others.

Thirdly, further study is important for this research area of interest to enable the policy maker and the government to enact the policies for the Somalian financial system. Besides that, it is vital for the practitioners and academicians to access the information easily.

Finally, more research is needed to investigate risk management approaches. This helps to reduce the incidence of hazards and contributes to the expansion of the Somali Islamic banking sector through an effective risk management strategy.

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# APPENDIX I

## ETTHIC APPROVAL DOCUMENT

# APPENDIX II

**SURVEY SAMPLES**

**ISSUES, PRACTICAL SOLUTIONS and OPPORTUNITIES of SOMALIAN ISLAMIC BANKS (2022) (ENGLISH)**

My name is Adna Ibrahim Farah, a Master's student at the Islamic economics and finance department at Ankara Social Science University (ASBU). This survey aims to point out the challenges that hinder the development of Islamic banks in Somalia. Moreover, it identifies the Opportunity of Islamic banks in Somalia.

The survey consists of three different parts:

1) Demographic profile of Islamic banking employees
2) Challenges faced by Somalian Islamic banking
3) Opportunities of Somalian Islamic banking

The ASBU Ethics Committee is in charge of this study. The study "**Issues, Practical Solutions and Opportunities of Somalian Islamic Banks**" is supervised by Assist. Professor. Dr Tawfik Azrak.

The participation of the survey is entirely voluntary. The answers will not be disclosed to third parties. Your responses will be used in the master's thesis only, and it will be critical for both solving Islamic banking issues and future research in Somalia.

You can send an email to Adnafarah12@gmail.com with your comments, suggestions, and solutions. I appreciate your help.

## Survey Questions

## Part one: Demographic profiles

**1:** Level of Educational of Qualification

A. Bachelor or Diploma
B. Master's degree
C. PhD

**2:** In which department you are working?

A. Operational department
B. Investment department
C. Customer care department
D. Dept-recovery department
E. Cash management department
F. Credit administration department
G. Marketing department

**3**: Years of Experience

A. 1-2 years
B. 3-5 years
C. 6-10 years
D. Above 10 years

## Part two: Challenges face Islamic banks in Somalia

1: Do you agree that Somalia's Islamic banks finance small projects?

A. Strongly disagree
B. Disagree
C. Agree
D. Strongly agree

2: The main and the most important challenge facing Islamic banks in Somalia is:

A. Shortage of cash capital
B. Lack of public desire for Islamic banking
C. Lack of awareness of the importance of Islamic banking
D. Lack of seriousness of Islamic banks in financing development projects
E. The isolation of the Somali banking experience from the world
F. Others

3: Do you agree there will be a challenge for Somalia's Islamic banks if there is no Islamic insurance or Islamic funds on the market?

A. Strongly disagree
B. Disagree
C. Agree

4: Legal and regulatory challenges in Somalian Islamic Banks are:

A. Inadequate banking policies
B. Lack of harmonization among shariah supervisory boards
C. Lack of a specific law for Islamic banking
D. others

5: Management issues in Somalian Islamic Banking are:

A. Shortage of expertise and skilled personnel
B. Lack of risk management
C. Lack of accounting and auditing standards
D. Others

6: Financial expansion issues in Somalian Islamic banks are:

A. Competition from mobile banking operators
B. Inadequate market information
C. Lack of enough capital resources
D. Lack of connection with global banks
E. Others

7: Issues that limit market share in Somalia’s Islamic banks are:

A. Illiteracy of Islamic financial transactions and affairs
B. High pricing of financing
C. Lack of Islamic insurance
D. Others

8: Issues that limit the products offered by Somalian Islamic banks are:

A. Lack of R&D (research and development) department in Islamic banks?
B. Law rate of return
C. Lack of interest of customers
D. Inadequate expertise
E. Others

9: One of the most significant risks faced by Somalian Islamic banks is?

A. Credit risk in debt-based financial products
B. Liquidity risk
C. Funding risk
D. Rate of return risk
E. Reputation risk
F. Collateral risk
G. Foreign exchange risk
H. others

## Part three: Opportunity of Islamic banks in Somalia

1: Do you agree that the development of Islamic banks in Somalia encourages people to save and invest?

a) Strongly disagree
b) disagree
c) Strongly agree
d) agree

2: Which of the following do you think Islamic banks in Somalia accomplished?

a) Profit maximization
b) Assist in eliminating poverty
c) Promoting sustainable development projects
d) Making available job possibilities
e) Minimizing the cost of operations
f) Improving the Quality of Products and Services
g) others

3: Do you agree that the country's societal acceptability of Islamic banking and finance is higher than conventional banks?

a) Strongly disagree
b) Disagree
c) Strongly agree
d) Agree

4: Do you agree that Islamic banks in Somalia will thrive on the availability of successful infrastructure, agriculture, and trade finance projects?

a) Strongly disagree
b) Disagree
c) Strongly agree
d) Disagree

5: How would you rate the efficiency and performance of Somalia's Islamic banks over the last decade?

A. Excellent
B. Very good
C. Good
D. Bad
E. Very bad

6: In your opinion, what do you think can improve and enhance Islamic banks in Somalia?

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**End of the Survey**

**Thank you very much**

# APENDIX III

## ISSUES, PRACTICAL SOLUTIONS and OPPORTUNITIES of SOMALIAN ISLAMIC BANKS (2022) (SOMALI)

Salamu Aleykum Warahmatullah Wabarakatuh

Magacaygu waa Adna Ibrahim Farah, ardayad Master-ka ka dhigata qaybta dhaqaalaha iyo maaliyadda Islaamka ee Jaamacadda Ankara Social Science University (ASBU). Sahankan ayaa ujeedadiisu tahay in lagu tilmaamo caqabadaha hortaagan horumarinta bangiyada Islaamiga ah ee Soomaaliya. Waxaa intaa dheer, waxay tilmaamaysaa Fursadaha bangiyada Islaamiga ah ee Soomaaliya.

Sahanku wuxuu ka kooban yahay saddex qaybood oo kala duwan:

1) Tirakoobka shaqaalaha bangiyada Islaamiga ah

2) Caqabadaha soo wajaha Bangiyada Islaamiga ah ee Soomaaliya

3) Fursadaha Bangiyada Islaamiga ah ee Soomaaliya

Guddiga Anshaxa ee ASBU ayaa mas'uul ka ah daraasaddan. Daraasadda "Arimaha, Xalka Waxtarka leh iyo Fursadaha Bangiyada Islaamiga ah ee Soomaaliya" waxaa kormeeraya Caawiye. Professor. Dr Tawfik Azrak.

Ka qaybqaadashada sahanku gabi ahaanba waa ikhtiyaari. Jawaabaha looma shaacin doono qolo saddexaad Jawaabahaaga waxaa loo adeegsan doonaa culuumta Master-ka oo keliya, waxayna muhiim u noqon doontaa labadaba xallinta arrimaha bangiyada Islaamka iyo cilmi-baarista mustaqbalka ee Soomaaliya.

Waxaad iimayl ugu soo diri kartaa Adnafarah12@gmail.com oo ay la socdaan faallooyinkaaga iyo talooyinkaaga. Waan ka mahadcelinayaa.

**Su’aalaha Sahanka**

**Qatbta Koowaad: Macluumad ku saabsan shaqaalaha bangiyada islamiga ah ee Somalia**

1: Heerka Waxbarashada Shahaadada

A. Bachelor ama Diploma

B. Shahaadada Masterka

C. PhD

2: Waaxdee ayaad ka shaqaynaysaa?

A. Waaxda shaqada

B. Waaxda maalgashiga

C. Waaxda daryeelka macaamiisha

D. Waaxda soo kabashada

E. Waaxda maamulka lacagta

F. Waaxda maamulka amaahda

G. Waaxda Suuqgeynta

3: Sanado Khibrad ah

A. 1-2 sano

B. 3-5 sano

C. 6-10 sano

D. In ka badan 10 sano

**Qaybta labaad: Caqabadaha haysta bangiyada Islaamiga ah ee Soomaaliya**

1: Ma ku raacsan tahay in bangiyada islaamiga ah ee Soomaaliya ay maalgeliyaan mashaariicda yaryar?

A. Aad baan u khilaafsanahay

B wan. khilaafsanahay

C.  wan ku raacsanahay

D. Aad ban ugu raacsanahay

2: Caqabadda ugu weyn uguna muhiimsan ee hortaala bangiyada Islaamiga ah ee Soomaaliya waa.

A. Raasamaal lacageed yaraan ah

B. Rabitaanka dadweynaha ee bangiyada Islaamka

C. Wacyigelin la'aan ku saabsan muhiimada bangiyada islaamiga ah

D. Mashruucyada horumarineed oo aan si dhab ah loo fulin bangiyada islaamiga ah

E. Ka go'doominta khibradda bangiyada Soomaaliyeed ee adduunka

F. Kuwo kale

3: Ma ku raacsan tahay in ay caqabad ku imaan doonto bangiyada islaamiga ah ee Soomaaliya haddii aysan jirin caymis Islaami ah ama dhaqaale islaami ah oo suuqa soo gala?

A. Aad baan u khilaafsanahay

B. khilaafsan

C. Ogolaansho

4: Caqabadaha sharci iyo sharci ee ka jira  bangiyada Islaamiga ah ee Soomaaliya waa.

A. Siyaasadaha bangiyada oo aan ku filnayn

B. Iswaafajin la'aanta guddiyada kormeerka shareecada

C. La’aanta sharci u gaar ah bangiyada Islaamka

D. kuwa kale

5: Arrimaha maamulka ee bangiyada Islaamiga ah ee Soomaaliya waa.

A. Xirfad yaraan iyo shaqaale xirfad leh

B. Maareynta khatarta ah

C. Heerarka xisaabinta iyo hanti dhawrka oo la’aanta

D. Kuwo kale

6: Arrimaha balaadhinta maaliyadeed ee bangiyada Islaamiga ah ee Soomaaliya waa.

A. Tartan ka socda hawlwadeenada bangiyada mobilada

B. Macluumaadka suuqa oo aan ku filnayn

C. La'aanta kheyraad ku filan raasumaalka

D. Xidhiidh la'aanta bangiyada caalamiga ah

E. Kuwo kale

7: Arrimaha xaddidaya saamiga suuqa ee bangiyada Islaamiga ah ee Soomaaliya waxaa ka mid ah.

A. Wax-akhris la’aanta dhaqdhaqaaqa maaliyadeed ee Islaamka iyo arrimaha

B. Qiimaha sare ee maalgelinta

C. C. Caymis la’aanta Islaamka

D. Kuwo kale

8: Arrimaha xaddidaya badeecadaha ay bixiyaan bangiyada Islaamiga ah ee Soomaaliya waxaa ka mid ah.

A. La'aanta waaxda R&D (Cilmi-baarista iyo horumarinta) ee bangiyada Islaamka?

B. Heerka soo celinta sharciga

C. Dan la'aanta macaamiisha

D. Khibrad aan ku filnayn

E. Kuwo kale

9: Mid ka mid ah khataraha ugu waaweyn ee soo wajaha bangiyada Islaamiga ah ee Soomaaliya?

A. Khatarta credit ee alaabta maaliyadeed ee ku salaysan deynta

B. Khatarta dareeraha

C. Khatarta maalgelinta

D. Heerka khatarta soo noqoshada

E. Khatarta sumcadda

F. Khatar damiin ah

G. Khatarta sarifka lacagaha qalaad

H. kuwa kale

**Qaybta saddexaad: Fursadaha bangiyada Islaamiga ah ee Soomaaliya**

1: Ma ku raacsan tahay in horumarinta bangiyada Islaamiga ah ee Soomaaliya ay dadka ku dhiiri galiyaan in ay wax kaydsadaan oo ay maalgashadaan?

a) Aad u khilaafsan

b) khilaafsan

c) Aad ban ugu raacsanahay

d) wan ku raacsanahay

2: Kuwee ayaad u malaynaysaa in Bangiyada Islaamiga ah ee Soomaaliya ay qabteen?

a) Kordhinta faa'iidada

b) Kaalmaynta ciribtirka faqriga

c) Horumarinta mashaariicda horumarineed ee waara

d) Samaynta fursadaha shaqo ee diyaarsan

e) Yaraynta kharashka hawlaha

f) Horumarinta tayada badeecadaha iyo adeegyada

g) kuwa kale

3: Ma ku raacsan tahay in aqbalka bulshada dalka ee bangiyada islaamiga ah iyo maaliyadda ay ka sarreeyaan bangiyada caadiga ah?

a) Aad u khilaafsan

b) khilaafsan

c) Aad u heshiiyaan

d) Ogow

4: Ma ku raacsan tahay in bangiyada islaamiga ah ee Soomaaliya ay ku horumaraan helitaanka mashaariicda kaabayaasha dhaqaalaha, beeraha, iyo ganacsiga ee guulaysta?

a) Aad ban u khilaafsan

b) Waan khilaafsanaahy

c) Aad ban ugu raacsanahay

d) waan ku raacsanahay

5: Sideed u qiimeyn lahayd waxtarka iyo waxqabadka bangiyada Islaamiga ah ee Soomaaliya tobankii sano ee u dambeeyay?

A. Aad u fiican

B. Aad u wanaagsan

C. Wanaagsan

D. Xun

E. Aad u xun

6: Aragtidaada maxaad u malaynaysaa inay hagaajin karaan oo kor u qaadi karaan bangiyada Islaamiga ah ee Soomaaliya?

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Dhamaadka Sahanka

Mahadsanid