

WILL FOREIGN LICENSED BANKS CHANGE SOMALIA'S BANKING SECTOR?

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In the last decade, Somalia has witnessed unprecedented expansion in the banking sector, leading to the opening of numerous commercial banks. According to the 2021 report of the Central Bank of Somalia, 13 new commercial banks have been licensed, most with close ties to international banks as a gateway into the international financial market. There are also cases where money transfer operators have successfully upgraded their status into financial institutions in their own right. These banks, which claim that they adhere to Shariah principles, provide a number of services ranging from retail banking to project investment and startup business.

In July 2022, the Central Bank of Somalia issued a statement that two foreign commercial banks, the Egyptian Banque Misr and the Turkish Ziraat Katli Bank have been licensed to operate in Somalia. These two banks will be the first foreign banks permitted to operate in the country since the nationalization of the foreign commercial banks under Barre's regime in 1972. This news has caused mixed reactions from the public. Local finance experts had not foreseen the imminent entry of international banks into the Somali banking sector. Most local banks are not prepared for competition with foreign banks which have international presence and operate in stronger economies. On the other hand, others see this move as an opportunity to improve Somalia's international reputation as a destination for foreign direct investment.

The question is whether the newly licensed foreign commercial banks will indeed improve the landscape of Somalia's banking sector. Prior to the licensing of these two foreign banks, the competition was limited to the local banks which were offering basic retail and investment services to the Somali public. Given that Banque Misr and Ziraat Katli Bank have more experience and resources than the local banks, the bar has certainly been moved up and takes the competition to an international level, bringing new services and new types of banking operations to Somalia. This in turn might force the local banks to make structural changes in their banking operations, either by merging with one another or increasing their own international presence.

There are three likely focus areas in this new competition between the foreign banks and the national banks in Somalia. The first expected change is the shift in investment services provided by the banks in Somalia. As mentioned earlier, the investment or the financing opportunities

provided by the local banks to the public are basic financial services. However, the foreign banks might offer a wider and more sophisticated level of services, for example, providing mutual fund and tailoring their investment funds to specific sectors such as agriculture. The latter investment category is certainly needed in Somalia.

The second expected change is the scope of money transfer activities. Somalis have difficulty in sending and receiving money internationally due to security issues and the close monitoring of its financial sector. When there were no international banking services available, the local banks devised a variety of methods to perform international money transfers through correspondence banks and unregulated money transfer agencies. This means that the newly licensed foreign banks will offer a viable alternative through their operating networks in their home countries and international subsidiaries. However, this also gives them the competitive advantage over the local banks.

The third and most important change is the shift of UN, NGOs, and other international agencies to the new foreign banks to conduct their retail banking services and project financing. This means that their substantial deposits will be made to either Banque Misr or Ziraat Katli Bank and no longer to the local banks. The same will be the case of Somali expatriates who will use their services to transfer private and business funds. More importantly, Turkish companies like Albarak which manages the Mogadishu seaport and Favori which operates the Aden Adde International Airport are expected to rely heavily on Ziraat Katli Bank. In this case, the local banks will be hard-pressed to make sufficient deposits and might even be forced out of the market.

In summary, the changes to Somalia's banking sector are inevitable and are the direct result of permitting foreign banks to operate in the country. Therefore, I recommend that these local banks undertake structural reforms, especially in the type and quality of their banking services, to improve their service delivery and maintain a good market share in the sector. Finally, the local banks have to advocate for new regulations that can protect them against the heavyweight competition from international banks.