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The Impact of Covid-19 on Microfinance Institutions in Somalia

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Abstract

This study aims to investigate how Covid-19 has affected the microfinance institutions in Somalia. This study employed a qualitative descriptive approach by conducting a case study in Mogadishu and Hargeisa. The data of the study was collected through a questionnaire distributed to microfinance institutions in Somalia in 2021. The paper found that the number of MFIs that have been negatively affected by the epidemic was higher than the number affected positively or naturally. It also found that most MFIs witnessed high credit risks, and more than half of them have reduced lending to less than half due to Covid-19.

Keywords: Islamic Microfinance, Covid-19, Microfinance Institutions, Somalia

Jel Codes: G21, O55, G01

Introduction

Microfinance refers to a program that provides insurance, savings, and loans to people in extreme poverty to improve their lives and alleviate poverty in society. Microfinance played a significant role in poverty alleviation, as the World Bank recognized it as a means of addressing income inequality and poverty. It also declared 2005 as the year of microfinance with the aim to expand its poverty alleviation campaign (Ali et al., 2013). The idea of microfinance was founded in Bangladesh in 1976 and has rapidly spread across the world, such as Asia, Eastern Europe, Africa, and Latin America (Abdul Rahman, 2007).

After the collapse of the central government in Somalia in the 1990s, the country's political and economic system collapsed due to the civil war (Musse et al., 2019). According to the World Bank (World Bank, 2020) , the Somali population estimated in 2007 at about 14 million, where 69% of the population under the poor, making the country one of the poorest countries in the world. Despite the civil war, the country's economy began to recover in 2011 as the country witnessed a continuous period of political and security progress, providing an opportunity to escape from dark periods. According to the World Bank (World Bank, 2020), a report on Somalia Economic Update highlighted the country's economy was improving before the Covid-19 pandemic, recovering from the 2016/17 drought. In 2019, the economy grew of the country at an estimated rate of 2.9%, on par with population growth, and was expected to rise by 3.2% in 2020.

The emergence of Covid-19 (coronavirus) pandemic has left a tremendous impact on the world's economy and health. Covid-19 also negatively affected Somalia's real Gross Domestic Product (GDP) growth in 2020 and hindered the country's economic recovery. During that time, the country’s economy is expected to contract by 2.5% due to the closure of airports and businesses, limiting exports because of Covid-19 (World Bank, 2020). A survey conducted in 2020 by Consultative Group to Assist the Poor (CGAP) revealed that the global microfinance sector faces a crisis due to the increase of default repayment of debt because of Covid-19 (CGAP, 2020).

Regarding many studies focusing on the role of microfinance in poverty alleviation in Somalia, it is rare to find studies focusing on the impact of Covid-19 on Islamic microfinance institutions (IMFIs). Thus, this study seeks to bridge this literary gap by investigating the impact of Covid-19 on IMFIs in Somalia by presenting a case study in Mogadishu and Hargeisa. In addition, this study is the first study that examines the MFIs in Somalia from the perspective of the institutions themselves, as previous research papers investigate the problem statement from the perspective of the customers.

The study also shed light on the financial institutions in the country, their types, and sizes. After the introduction section, it follows the literature review section that discusses the definition of the terms of microfinance (MF) and poverty and reviews the existing literature review. After that, we discuss the main difference between Islamic and conventional microfinance. This followed by another section focusing on financial institutions in Somalia, their types, and sizes. Then we present our research methodology and our result. Lastly, concludes the paper with a recommendation.

1. Literature Review

Otero (1999) defines microfinance as *"the provision of financial services to low-income, poor, and very poor self-employed people."* According to Ledgerwood (1999), microfinance is a financial service that provides savings, credit, insurance, and payment services to low-income people. Ledgerwood argues that the definition of microfinance does not cover all aspects of MF activities as some MFIs provide services such as project development services (skills training and marketing) and social services (literacy and healthcare training). Moreover, MFIs can be government banks, non-governmental organizations (NGOs), credit unions, saving and loan cooperatives, commercial banks, or non-bank financial institutions. On the other hand, Lashley (2004) defined microfinance as *"a term that appears to mean lending small amounts of money for enterprise development, with the ultimate aim of achieving a sustainable rise in incomes above the poverty line."* Khandelwal (2007) describes the word microfinance as "*a bank for the poor."* From the above definitions, we understand that microfinance is a financial service that helps poor people to enhance their lives and alleviate poverty in society.

In general, there is no generic definition of poverty, and it has been defined in various ways. Hagenaars (1986) defines poverty as *"a situation in which the welfare, derived from the command over resources of a household falls below a certain minimum welfare level, called poverty threshold."* While, Bellù et al (2005) defined it as *"the lack of, or the inability to achieve, a socially acceptable standard of living."* Merriam- Webster's Collegiate Dictionary (MCD) defines poverty as *"the state of one who lacks a usual or socially acceptable amount of money or material possession."* This definition encompasses two important ideas. (i) The definition of poverty varies from time to time and in different societies. For example, what is socially acceptable in Somalia may be different from Turkey. (ii) The ability to purchase goods and services (and thus, with money) or to own (material possessions). Khan (2010) and World Bank (2000) states poverty as *"poverty is pronounced deprivation in well-being."*

The World Bank (2020) report on poverty and shared prosperity highlighted that the emerging coronavirus (Covid-19) , armed conflict, and climate change are leading to an increase in global poverty in the future. The report estimated that by 2030 climate change would cause a fall of around 132 million people into poverty, many of whom dwell in countries affected by institutional fragility and armed conflict, where global poverty is significantly increasingly concentrated. The extreme poor rate in Syria and the Republic of Yemen from 2.3% in 2013 to 3.8% in 2015; in 2018, the rate has risen rapidly and reached around 7.2% with the outbreak of conflicts in these countries.

Abdul Rahman (2007) highlighted that Islamic finance (IF) plays a significant role in promoting the social and economic development of the poor and small (micro) entrepreneurs without imposing interest. Research conducted by Dahir (2015) Investigated the challenges that face MFIs in poverty eradication in Mogadishu. The result of the study revealed that MFIs have a positive effect in alleviating poverty among poor people. Both studies conducted by Nimsith et al (2019) in Sri Lanka and Rokhman (2013) in Indonesia titled *"The effect of Islamic microfinance on poverty alleviation"* revealed that microfinance has a significant role in poverty alleviation, and improving income level, education, business progress, and helps poor people to elevate their life in a sharia-compliant manner.

Research conducted by Rahman et al (2013) focused on challenges and solutions in Islamic microfinance. The study found that these challenges are weak market penetration, sustainability of MFIs due to lack of fund mobilization and high administrative costs, and the effectiveness of IMFIs in poverty alleviation. According to previous studies, they found that IMFIs in Somalia face challenges. Dahir (2015) investigating the challenges facing MFIs in Mogadishu. The findings revealed that insufficient support from the government, inadequate regulations, insufficient funding from donors, default risks inherited from borrowers, and limited capacity to manage microfinance are among the challenges facing MFIs. Another study added Xalane et al (2019) a low level of awareness among the locals regarding the availability of Islamic microfinance is another factor challenging Islamic microfinance in Somalia.

A comparative study of Islamic microfinance for Small and Medium Enterprises (SMEs) In Somalia and Nigeria conducted by Mohamed (2019) revealed that both countries have common challenges such as heavy collateral requirements, improper regulations, lack of credit access from MFIs, and lack of adequate support from the government, these challenges hinder the growth of economic development. The study found that 80% of respondents in Somalia did not use IMFIs products while 53.3% of respondents in Nigeria used the products.

According to the Common Market for Eastern and Southern Africa (COMESA) report on *"Economic impact of Covid-19 on micro, small and medium enterprises in Africa and policy options for mitigation"* by Zeidy (2020) revealed a lack of operational cash flow, business closures, and decreasing opportunities to meet new customers were among the challenges facing MFIs in Africa due to the Covid-19.

This paper covers the impact of Covid-19 on IMFIs in Somalia due to very limited studies in this area, there is only one paper titled; *"Economic Impacts of Covid-19 on Microfinance Institutions and Small Businesses: Empirical Survey from Somalia"* by Afrah et al (2021). The paper did a case study in Mogadishu, and the results reveal that Covid-19 has a negative influence on both microfinance institutions and small businesses. Thus, this study is the first study that examines the MFIs in Somalia from the perspective of the institutions themselves, as previous research papers investigate the problem statement from the perspective of the customers. Moreover, the paper will present a case study for both Mogadishu and Hargeisa.

2. The Main Difference Between Islamic and Conventional Microfinance

Islamic and conventional microfinance differ in their characteristics, fund mobilization, and social development. Islamic Microfinance refers to a financial institution that provides sharia-compliant products and services based on profit share and loss. This financial sector is free from interest rate as sharia-prohibited interest, and they gain profit through trading, leasing, or directing financing in profit loss sharing contracts (Abdelkader et al., 2013). On the other hand, traditional microfinance relies on an interest rate that transfers risk from lender to borrower, which means that some people earn a profit without the risk (Ahmad et al., 2020).

Mobilization of funds is another difference between these two systems, where convention microfinance is based on government subsidies, interest-based deposits, donations, and loans. Whereas Islamic microfinance mobilization funds instruments are broader than conventional ones and consist of external and internal resources. The internal resource of Islamic microfinance can be wadiah (safekeeping), qard al-hassan (benevolence loan), mudarabah (profit sharing), and musharakah (partnership). While external resources can be zakah (alms), donations, gifts, and waqf (Wajdi Dusuki, 2008). The last difference between them is social development, whereby Islamic Microfinance is based on religion (includes behaviour, ethics, and social development). While conventional microfinance relies on secularism (includes behaviour, ethics, and social development) (Mohamed, 2019).

Table 1: Islam vs Conventional Microfinance

Difference	Islamic microfinance	conventional microfinance
Characteristics	Based on risk-sharing Sharia compliance Gain profit by trading, leasing, or directing financing in Profit Loss Sharing contracts.	Based on interest rate Risk transfer Gain profit by lending
Fund mobilization	External resource (zakah, donations, gifts, and waqf) Internal resources (wadiah, qard al-hassan, mudarabah, and musharakah	Government subsidies Interest-based deposits Donations and loans
Social development	Based on religion (includes behaviour, ethics, and social)	Based on secularism, behaviour, ethics, and social

Source: Wajdi Dusuki 2008 and Mohamed 2019

3. The Financial Institutions in Somalia, Their Types, and Sizes

3.1. Before the Collapse of the Government

The Somali republic was established in 1960 after the former Italian Trusteeship merged with British Somaliland and its first president was Aden Abdullah Osman. This was followed by the second presidential assassination of the country and the military coup by General Siad Barre in 1969 and it was collapsed in 1991. Before the collapse of the Somali central government, the country's financial sector consisted of the Central Bank of Somalia, the Somali

Development Bank, the Commercial and Savings Bank, and the state insurance company (KPMG, 2004).

3.2. After the Collapse of the Government

The Central Bank of Somalia (CBS) collapsed in 1991 due to the civil war that led to the collapse of the country's economy and in 2011, the country's economy began to recover. At present, the country's formal financial sector is composed of central banks (including in Somaliland), commercial banks, money transfer businesses (MTB), mobile money operators (MNO), and microfinance institutions (MFI) (World Bank, 2019). Today there are 11 banks, and 10 MTBs authorized by CBS. Additionally, two banks are licensed but not yet operational (Central Bank of Somalia, 2021). According to the annual report of CBS, the total assets of the banking industry reached 414 million United States Dollar (US$) in December (Central Bank of Somalia, 2018).

According to the World Bank (World Bank, 2020), the microfinance sector in Somalia remains unregulated, and there are six MFI either affiliated as subsidiaries of commercial banks or registered as nongovernmental organizations (NGOs). This includes MicroDahab, IBS Microfinance, Premier Microfinance, Amal Microfinance, Kaaba Microfinance, and Kaah International Microfinance services (KIMS). MFI affiliated with the commercial banks generally work in the same regions as their parent institutions, while NGOs operate in urban areas such as Mogadishu, Hargeisa, Kismayo, and Garowe. The products that offer MFIs are based on sharia finance, and the most common financial instruments they use are qard al-hassan (benevolence loan), donations, and Murabaha (cost-plus). The asset size of MFIs players in the country ranges from US$0.3 million to US$3 million and their average loans stand around US$1,000 in 2019. Finally, MFIs lend both commercial and private purposes.

Based on the research we did from the Central Bank of Somalia and Somaliland, websites of the banks, past reports we found that currently there are eight MFIs in the country. These institutions are either affiliated as subsidiaries of commercial banks or registered as NGOs, and all of them are Islamic MFIs. Table 2 will provide background information about these institutions.

Table 2: Islamic Microfinance Institutions in Somalia

Institution Name	Foundation Year and Operation Area	Type	Number of Branches	Model of Finance	Focused Area	Total Client
MicroDahab	2014 All Somali	Affiliated Dahabshiil Bank International	16	Profit based model	Renewable energy Fishing Agriculture Livestock Youth and Women	12500
IBS Bank	2015 Mogadishu	Commercial bank	10	Group and individual model	NF	NF
Premier Bank	2014 Mogadishu & Hargeisa	Commercial bank	7	Charity model	NF	NF
Amal Bank	2016 All Somalia	Commercial bank	11	Charity model	NF	20,000
Kaaba Microfinance	2008 Somaliland	NGOs	NF	Profit based model	Female Youth	6129
Kaah International Microfinance Services	2015 All Somalia	NGOs	13	Profit based and charity model	Female Rural area Youth	13,700

Dara Salam Bank	2010 Hargeisa	Commercial bank	8	Profit based and charity model	Small business Rural area Agriculture Women	NF
Salam Somali bank	2009 Mogadishu	Commercial bank	23	Charity model	NF	10,000+

Source: Bank Websites and Questionnaire (Collected by the Authors from the Institutions)

NF indicates "not found."

4. Research Methodology

4.1. Study Design

This study relies on a qualitative methodology by conducting a case study in Mogadishu and Hargeisa to find out how the Covid-19 affects MFIs in Somalia. Qualitative research is research that focuses on specific individuals rather than the public to understand humans and the experience they have in the world. So this method is used to reveal behaviour and opinion to understand their experience in the world (Jackson et al., 2007). In this study, we conducted a descriptive survey research design. Descriptive research is a case study used to solve a problem or improve practice through analysis, observation, and description. This method mostly uses survey, which includes questionnaires, personal interviews, phone surveys, and normative surveys (Koh, 2000).

4.2. Scope of the Study

The study has restricted some MFIs in Somalia that are affiliated with commercial banks in the country. The researcher-selected institutions operate in Mogadishu and Hargeisa, as they are the main cities in the country. These institutions include MicroDahab, Salam Somali bank, Dara Salam Bank, Premier Bank, and Amal Bank. The sample size of the study was 5 MFIs, and NGO microfinance institutions not a part of this study.

4.3. Data Collection and Analysis

This study utilized primary and secondary data. The secondary data relies on the available data such as reports of the World Bank, annual reports of the Central Bank of Somalia, articles, research papers, reports of microfinance institutions, books, and the websites of the Somali banks. While the primary data were collected using a questionnaire distributed to MFIs in Somalia, particularly in Mogadishu and Hargeisa, as they are the main cities that MFIs work. This data was collected in 2021 by using social media. The questionnaire contains 13 questions divided into two parts. The first part focuses on the demographic data, such as the name of the institutions and establishment year, their work area, number of branches, the total customer they served since they start the MF program, and the kind of MF model they use. The second part probes the impact of Covid 19 on IMFIs in Somalia and consists of 8 questions.

The researcher asked institution how Covid-19 affects their institutions, if the default payment rises due to the Covid-19, and if the projects provide to the client decreased. In addition, to what extent do they reduce lend, and offer indulgence to their client. Lastly, asked if they faced a financial crisis, any kind of challenges they face after Covid-19, and how to overcome these challenges. These questions were designed as follow; 3 closed-ended question 3 dichotomous question and 2 open-ended questions. In this study, the collected data were analyzed using descriptive statistics with the help of the Stata program.

5. Results and Discussions

This section consists of two parts. The first part shows demographic information of the institutions and how Covid-19 affects MFIs, while the second part discusses the main challenges they faced after the pandemic and the opinions of the MFIs to solve these problems.

5.1. Demographic Information of the Institutions & How Covid-19 Impact MFIs

The table below presents the background information of the institutions that participated in this study. We found that the model of microfinance that uses MFIs in Somalia is either based on a charity model or a profit-based model.

Table 3: Demographic Information

Name of the Institutions & Date of Establishment	Institution Work Area	Number of Branches	Total Customer	Model of Microfinance
Salam Somali Bank, 2009	Mogadishu	23	10,000+	Charity model (qard hassan, waqf and zakah)
Microdahab, 2014	All Somali	16	12500	Profit based Model (mudarabah,murabah, and musharakah)
Amal Bank, 2016	All Somalia	11	20,000	Charity model
Dara Salam Bank	Hargeisa	8	-	Profit based model

Premier Bank, 2014	Mogadishu & Hargeisa	7	-	Charity model

Source: Authors

The result present in table 4, revealed that the number of MFIs negatively affected by the epidemic is higher than those affected positively or naturally. Where 60% of them were affected negatively, and 40% had a positive and natural effect. The result also shows that MFIs have suffered an increase in debt default due to the Covid-19 as it has reached 80% while 20% of them did not face any increase in credit risk. In addition, the result presented in Table 3 also showed that more than half of the MFIs did not face financial liquidity crisis during this period as only 40% of them faced it.

From the above result, we can conclude that the impact of Covid-19 on MFIs in Somalia varies from institution to institution, as some of them were affected negatively whilst others were affected either positively or naturally. Some MFIs influenced the Covid-19 in a positive manner due to increases demand loans because the income of the people declined due to closure of business and other restrictions to reduce the spread of the Covid-19. However, the number affected negatively is higher than the number affected positively or naturally. Moreover, less than half of MFIs faced financial liquidity crisis, but most of them faced a high level of credit risk during Covid-19 due to an increase of default of repayment.

Table 4: Impact of Covid-19 on MFIs in Somalia

Variable Name	Frequency	Percent %	Mean and Std.Dev
To what extent does Covid-19 affect your institution.			
Positive Natural Negative	1 1 3	20 20 60	0.6[0.89]
Did default of repayment debt during Covid-19 increased			
Yes No	4 1	80 20	0.8[0.44]
Did your institution face a liquidity crisis because of Covid-19?			

Yes No	2 3	40 60	0.4[0.54]

Source: Authors

Table 5 also shows how the Covid-19 virus has affected MFIs in Somalia. It shows that all MFIs in the country have seen a decrease in the number of projects they offer to their clients due to the coronavirus. The result also showed that 80% of MFIs reduced lend less than half whilst 20% have stopped lending completely. However, 60% of MFIs offered their customer indulgence at a moderate level while 40% offered it at a high level.

MFIs in Somalia weren't the only ones who reduced lending due to Covid-19, but a survey conducted in 2020 by the Global Pulse Survey of Microfinance Institution also revealed that 33% of MFIs reduced their lending in half while 10% totally stopped lending, and 57% reduced more than half (CGAP, 2020). The CGAP did not find the reason behind why the MFIs reduced lend, and think that lower demand from clients, hoarding of cash to meet an uncertain future and increased riskiness of clients can be the reasons.

Table 5: Impact of Covid-19 on MFIs in Somalia

Variable Name	Frequency	Percent %	Mean and Std.Dev
Does the project number offered by your institution decrease due to Covid-19?			
Yes No	5	100	1[0]
To what extent your institution reduces lending because of Covid-19?			
Reduced less than half Stopped lending	4 1	80 20	0.8[0.44]
To what extent your institution offering indulgence to customers			
High Medium	2 3	40 60	0.4[0.54]

Source: Authors

5.2. The Main Challenges Faced MFIs After the Pandemic and Their Opinions Regarding How to Address This Problem

The emergence of Covid-19 results in major challenges to the MFIs in Somalia, and here are some of the key challenges they faced after Covid-19.

- Increase default of loans because the restriction to reduce the pandemic results in colure of business activities, which decreased the income of the people.
- Decline profit and more withdrawal.
- Increase the non-performing assets (NPA) of the institutions due to the non-payment.

To overcome these challenges, they proposed the following solutions.

- Come up with good strategies and plans.
- Deep research on how Covid-19 affects microfinance institutions and the factors that cause it.
- Deal it positively.
- Create an opportunity for both young people and farmers to reduce the economic deficit of the country.

Conclusion and Recommendations

The study attempts to find out how Covid-19 affected MFIs institutions in Somalia. The study employed a qualitative descriptive approach conducting a case study in Mogadishu and Hargeisa. The results showed that MFIs negatively affected by Covid-19 were higher than those affected positively or naturally. It also indicated that most MFIs witnessed high credit risks. In the case of liquidity, less than half of them face a financial crisis. The results also show that more than half of MFIs have cut lending by less than half, and all of them declined the number of their projects due to the Covid-19. Additionally, the results also revealed that MFIs offering a high level of indulgence to their clients are relatively less than compared to those offering at medium level. However, increasing defaults, declining profits, and increasing NPA were among the main challenges facing MFIs in Somalia after Covid-19.

Every study has limitations, and the limitation of this study was the lack of sufficient studies on how Covid-19 affected MFIs in Somalia and the difficulty of distributing questionnaires due to the Covid-19. This study is recommended as follows. First, expand MFIs to contribute alleviation of poverty. Second, do further research about this field, particularly the impact of Covid-19 on MFIs in Somalia in the future. Lastly, disclosure of information to the public would help enhance the operating performance of institutions, so MFIs in Somalia would be better off disclosing their information to the public. So, if they disclose their information to the public by publishing annual reports of the institution, it will enhance their reputation and give opportunities to attract many investors.

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