

**THE ROLE OF CENTRAL BANK MONETARY POLICY ON  
DEVELOPMENT OF FINANCIAL SECTOR IN SOMALIA**

**Sa'ed Gelle Jama'**  
Finance Specialist  
Lecture of Green Hope University  
Email: Geelle000@gmail.com  
Tell: +252615914491  
Mogadishu, Somalia

**A RESEARCH PROJECT SUBMITTED TO DEPARTMENT OF BUSINESS AND  
ECONOMICS IN THE COLLEGE OF BUSINESS DEVELOPMENT IN PARTIAL  
FULFILLMENT OF REQUIREMENT FOR THE AWARD OF MASTER DEGREE IN  
BUSINESS ADMINISTRATION (FINANCE) AT JOMO KENYATTA UNIVERSITY OF  
AGRICULTURE AND TECHNOLOGY**

**JUNE, 2017**

**DECLARATION**

This research proposal is my original work and has not been presented for a degree in any other University.

Signature: ..... Date: .....

SA'ED GELLE JAMA'  
HD333-C005-6173/2014

This research proposal has been submitted for the examination with my approval as the University Supervisor.

Signature: ..... Date: .....

AARON L. MUKHONGO

**DEDICATION**

This piece of work is dedicated to my dear parents, for all that they have sacrificed to raise me up and direct me in the right path of life.



### **ACKNOWLEDGEMENT**

All praises be to Allah and peace be upon to his prophet .after that I would like to thank my parents, brothers and sisters who helped me to achieve this great goal. I also would like to send many thanks to my lecturer and supervisor AARON L. MUKHONGOwithout him I would not complete this proposal. Finally thanks to everyone who helped me morally to complete this proposal.



## TABLE OF CONTENTS

<b>DECLARATION.....</b>	<b>II</b>
<b>DEDICATION.....</b>	<b>III</b>
<b>ACKNOWLEDGEMENT.....</b>	<b>IV</b>
<b>LIST FIGURES.....</b>	<b>VII</b>
<b>LIST OF TABLES.....</b>	<b>VIII</b>
<b>LIST OF ACRONYMS.....</b>	<b>IX</b>
<b>DEFINITION OF TERMS.....</b>	<b>X</b>
<b>ABSTRACT.....</b>	<b>XI</b>
<b>CHAPTER ONE.....</b>	<b>1</b>
<b>INTRODUCTION.....</b>	<b>1</b>
<b>CHAPTER FOUR.....</b>	<b>29</b>
<b>RESEARCH FINDINGS AND DISCUSSION.....</b>	<b>29</b>
<b>4.1 Introduction.....</b>	<b>29</b>
<b>4.2 Response Rate.....</b>	<b>29</b>
<b>4.3 Reliability and Validity.....</b>	<b>30</b>
<b>4.3.1 Reliability analysis.....</b>	<b>30</b>
<b>4.3.2 Validity.....</b>	<b>31</b>
<b>4.4 Descriptive Statistics.....</b>	<b>32</b>
<b>4.4.1 Demographic data.....</b>	<b>32</b>
<b>4.4.2 Response of Gender distribution.....</b>	<b>33</b>
<b>4.4.3 Response of age group.....</b>	<b>33</b>
<b>4.4.4 Response of level of education.....</b>	<b>33</b>
<b>4.4.5 Years of experience.....</b>	<b>34</b>
<b>4.5 Study variables Findings.....</b>	<b>35</b>
<b>4.5.1 Bank rate.....</b>	<b>35</b>

4.5.2 Selective credit control and financial sector development.....	36
4.5.3 Reserve requirement .....	36
4.5.4 Moral Persuasion .....	37
4.6 Multiple Regression Analysis .....	38
4.6.1 Model Summary .....	39
4.6.2 Analysis of Variance.....	39
4.6.3 Regression Coefficients .....	40
4.6.5 Correlation Analysis.....	41
CHAPTER FIVE .....	44
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS .....	44
5.1 Introduction .....	44
5.2 Summary of Findings.....	44
5.2.1 Bank rate .....	44
5.2.2 Selective credit controls.....	45
5.2.3 Reserve requirement .....	45
5.2.4 Moral persuasion .....	46
5.3 Conclusions .....	46
5.4 Recommendations .....	47
5.5 Areas for further research.....	47
5.6 Limitation.....	48
REFERENCES.....	49
APPENDIX.....	52
APPENDIX I: QUESTIONNAIRE.....	52

**LIST FIGURES**

Figure 1.1 Conceptual Framework.....13Figure  
1.1 Sampling Frame .....24



**LIST OF TABLES**

Table 3.1	Target Population.....	26
Table 3.2	Sample size determination.....	27
Table 4.1	Target Population.....	26
Table 3.2	Sample size determination.....	27
Table 3.1	Target Population.....	26
Table 3.2	Sample size determination.....	27
Table 3.1	Target Population.....	26
Table 3.2	Sample size determination.....	27
Table 3.1	Target Population.....	26
Table 3.2	Sample size determination.....	27



**LIST OF ABBREVIATIONS**

**CBS** Central Bank of Somalia

**MP** Monetary policy

**GDP** Gross Domestic Product

**GNP** Gross National Product

**MS** Money Supply

**OMO** Open Market Operations

**ALM** Asset Liability Management

**LM T** Liability Management Theory

**ST** Shift-ability Theory



## DEFINITION OF TERMS

### **Monetary policy**

Monetary policy is the process by which the monetary authority of a country controls the supply of money, often targeting an inflation rate or interest rate to ensure price stability and general trust in the currency (John, 2011)

### **Reserve requirements**

Reserve requirements are the amount of funds that a depository institution must hold in reserve against specified deposit liabilities. Within limits specified by law (CBS, 2012)

### **Bank rate**

A bank rate is the interest rate at which a nation's central bank lends money to domestic banks, often in the form of very short-term loans. Managing the bank rate is method by which central banks affect economic activity (Farragher, 2001)

### **Moral suasion**

is a persuasion tactic used by an authority (i.e. Federal Reserve Board) to influence and pressure, but not force, banks into adhering to policy. Tactics used are closed-door meetings with bank directors, increased severity of inspections, appeals to community spirit, or vague threats (Raul, 2013)

### **Selective credit controls**

The qualitative or the selective methods are directed towards the diversion of credit into particular uses or channels in the economy. Their objective is mainly to control and regulate the flow of credit into particular industries or businesses (Fredrick, 2014)

## ABSTRACT

The general objective of this study is to investigate the role of central bank monetary policy on financial sector development. Specifically, the study investigated the role of Reserve requirement, Bank rate, moral suasion and selective credit controls on financial sector development in Somalia. The monetary policies play a significant role in development financial sector to any country. Central banks use the monetary policy as tool to control the financial body. This study will be conducted through a descriptive study. In addition the study employed a survey research design in data collection. The sampling procedure of this study is used non-probability sampling procedure particularly stratified sampling. This research employed quantitative data collection method whereby data is gathered by the use of closed ended questionnaires which are self-administered. The data collected will be analyzed using the software called Statistical Package for the Social Sciences (SPSS) version 20 and results shown in terms of frequency distribution and percentages. A regression model will be applied to determine the relationship between Reserve requirement, Bank rate, moral suasion and selective credit controls as the independent variables and financial sector development as the dependent variable.

## CHAPTER ONE

### INTRODUCTION

#### 1.1 Background of the study

Historically, the role of the central bank has been growing, some may argue, since the establishment of the Bank of England in 1694. It is, however, generally agreed upon that the concept of the modern central bank did not appear until the 20th century as problems developed in the commercial banking system. Thus, the central bank's modern function emerged in response to an already present commercial banking structure.

Monetary policy is one of the key financial stabilization weapons which involve actions designed to regulate or control the size, cost, availability and direction of money and credit in an economy to achieve some specific macro-economic policy objective. It is a deliberate attempt by the monetary authority (Central Bank) to control the money supply and credit condition for the purpose of achieving certain broad economic objective (Onouorah et al., 2011). Okpara (2010) defined monetary policy as a measure designed to influence the availability, volume and direction of money and credits to achieve the desired economic objectives.

By manipulating monetary policy instruments such as credit and exchange rate, central banks affect the rate of growth of the money supply, the level of interest rate, security prices, credit availability and liquidity creation from the hand of commercial bank. These factors, in turn can exert monetary imbalances or shocks on the economy by influencing the level of investment, consumption, imports, exports, government spending, total output, income and price level in the economy (Mishra and Pradhan, 2008).

According to Wikipedia(2016) Central banks around the world play similar functions some of which may include- implementing monetary policies, determining Interest rates, controlling the nation's entire money supply, the Government's banker and the bankers' bank ("lender of last resort"), regulating and supervising the banking industry, setting the official interest rate – used to manage both inflation and the country's exchange rate – and ensuring that this rate takes effect via a variety of policy mechanisms and managing the country's foreign exchange and gold reserves and the Government's stock register.

The central bank of any country is responsible for the financial developments, regulations and setting plans and strategies for the financial system of the country , the central banks are also responsible for issuing notes, coins and denominations of the country, there is no other part or organizations which have legal authority to produce, create or print currency of the country .these are not only the responsibilities of the central banks but they play the vital role for monitoring ,regulating and sometimes deregulating the financial institutions .

As Dafe and volz (2015).Suggested :”central banks have begun over the past decade to place renewed emphasis on the promotion of economic development and structural transformation, looking beyond narrow mandates for macroeconomic stability. Developmental central bank policies have included policies directed at financial sector development, the promotion of financial inclusion and aligning the financial system with sustainable development.”(p.1).

These functions are common to most central banks in the world; each country’s central bank has its own way of regulating the financial system of its country. The central bank of Somalia is one the most important institutions which is damaged by the civil war, and reestablished in 2004 by the federal government and it will be discussed the following .

### 1.1.1 Financial sector development in Somalia

The Somali national bank which is renamed later as the central bank of Somalia (CBS) was established immediately after the independence in 1960 under decree No.3 of 30 June, 1960 and converted to the law No.2 of 13 January, 1961. But unfortunately the bank was collapsed in civil war 1991; the central bank of Somalia restarted its operations in 2004, the bank drafted the several rules concerning the financial sectors in Somalia; the central bank of Somalia is like any other bank in the world which is responsible for overall financial system of the country, and carry out the banking activities, these include the fiscal policy, monetary policy, open market operations (OMO), lender as last resort, banker of banks, and issuing nations' currency. The recent reforms of central bank of Somalia emphasizes the transparency, anti-moneylaundering, anti-terrorist financing; and the regulating the financial organizations such as remittances', commercial banks, takaful companies in Somalia.

After the collapse of the financial system of Somalia in the civil war 1991, some Somali traders started to establish the HAWALA system, which facilitates the money transfer from the abroad to domestic people, and to carry out the commercial activities or transactions. This system becomes well accepted by the people since there were no alternatives (commercial banks or even central bank) to carry out these transactions. The financial sector of Somalia encountered numerous challenges after 11/9 events, the United States of America has frozen the accounts of some Somali remittances, especially the Barak Bank, which was suspected the financing terrorist, because of there were no central bank to monitor the activities of those informal financial institutions. These made the role of central bank of Somalia very important to build trust and create rules and regulations to develop the financial sector.

The efficient flow of capital in the financial sector serves as a stimulant for economic growth; this is because financial institutions which are the intermediaries in the financial sector serve the main purpose of mobilizing capital from the savings or surplus sector to the borrowing or deficit sector (Solomon, 2012). This tends to moderate the volume of money in circulation or liquidity in the economy.

According to Ajayi and Atanda (2012), a solid and stable financial sector is essential to make a well functioning national economy and to ensure balance liquidity within the economy. Appropriate liquidity management is essential to foster economic growth. Though, to achieve economic stability proper the uses of fiscal and monetary policies are required. Despite establishing regulatory agencies and monetary policy committees, the financial institutions of Somalia have actually been deterred in creating adequate liquidity and additional credit for the sustenance of the entire economy.

## **1.2 Statement of problem**

The role and importance of central bank of Somalia become very important in development of financial sectors in Somalia, despite the central bank of Somalia and its activities are limited to some government expenditure policies.

Currently the financial sector of Somalia or in other words informal financial institutions are straggling and encounter many challenges, which effect their operations and sometimes stop and frozen their accounts .The united states of America were frozen the accounts of some Somali remittances due to suspicion of channel of financing terrorism, many Somalis lose their money in these informal financial institutions. These challenges include the lack of clear regulations by the

central bank .this enforced the financial sector of Somalia to operate under rules and regulations by another countries which they are going to deal with.

In November 2001, Al-barakaat , formally Somali biggest remittance company , had its assets frozen and its united states operations closed down based on allegations that was susceptible to being used to fund terrorism .since then several Somali remittance companies have been put under pressure (European commission ,2004).

Another problem in the financial sector of Somalia, there is no system that facilitates the exchanges of checks between the banks and money between them, which we call in finance language clearinghouse department, which is a part of central banks functions.

The consequences of these problems may damage or even stop the emerging financial institutions, if the problem is not overcome or solved.

Evidence also showed that monetary policy changes on loan supply of less liquid banks, deposit base and induce banks' ability to perform their expected roles within the financial system. The situation of Somalia has witnessed several form of banking distress in the last 30 years despite the consistent use of monetary policy and guidelines which thus raise the question of how effective monetary policy has been in regulating the banking industry.

In this regard, an appropriate analysis of monetary shock transmission mechanisms is of crucial importance for central banks. This is to determine the process through which monetary policy influence the entire economy within the financial system framework.



This study is going to emphasize and investigate the various roles that central bank monetary policy plays in order to develop and enhance the financial system of Somalia.

### **1.3 Research Objectives**

The general objective of this study is to investigate the role of central bank monetary policy in financial sector development in Somalia .

Specific objectives

- 1- To investigate the role of reserve requirement policy on financial sector development in Somalia
- 2- To determine the role of moral persuasion policy in financial sector in Somalia
- 3- To assess the role of bank rate policy on financial sector development
- 4- To examine the role of selective credit controls policy on financial sector development in Somalia

### **1.4 Research questions**

The following research questions have been constructed to guide the study and enhance proper assessment of the work.

1. What are the role of sreserve requirement policy have ondevelopment of financial sector ?
2. What are the roles of central bank rate policy on financial sector ?
3. Howselective controls policyparticipate the development of financial setor in somalia?
4. How the moral persuasion policy is important in financial sector performance ?

### 1.5 Scope of the study

This study emphasizes on policies and regulations of central bank of Somalia, and its critical role in financial sector development in Somalia. The study is also discussed the various functions of central bank and trends of central banks after the civil war, the time scope and data reviewed is limited to years between 2004 and 2015.

### 1.6 Justification of the study

Numerous studies have been conducted the areas of relationship between monetary policy and the development of financial sector, but there is no acceptable or justified study about the role of central bank monetary policy in financial sector. In Somalia there is an emerging financial institutions, these include commercial banks, Hawalas and insurance companies. These institutions participate the follow of capital and growth of financial sector in Somalia. All these institutions need to regulated supervised and monitored by somewhere. The central bank of Somalia is the only entity which have authority to do these jobs. In order to demonstrate these things it has to be conducted the research. And this is why we are going to conduct this research and explain these phenomena.

## CHAPTER THREE

### LITERATURE REVIEW

#### 2.1 Introduction

This chapter is aimed to review the previous theories, researches done by other scholars, and the overall concepts related the role of central banks in developments of financial sector. It contains the theoretical review, empirical review, conceptual review, research gap, conceptual frame work and the summary of the chapter.

#### 2.2 Theoretical review

Different scholars wrote various books in the concept of monetary policy and it's important to the development of financial sectors in any country. As Monahty *et al* (2014) suggested that the central banks in Africa participated the overall development of economy of the continent and specially the financial sector. The primary function of central bank is , to manage short term interest rates, particularly in lending rates of banks, and therefore influence the demand for loans, money creation and sometimes called monetary policy , and it also regulates unstable financial system (Faure ,2013) .According the bank of England (2006), there are five functions that the central banks undertake, monetary policy (setting the exchange rates and interest rates), financial sector stability (banking supervision); government debt management; the wholesale payment system (acting as banker to banks) , these functions

### 2.2.1 The Keynesian Theory of Monetary Policy

The Keynesian Economists think of monetary policy as working primarily through interest rate. In Keynesian transmission mechanism, an increase in the money supply leads to a fall in interest rate to include the public to hold additional money balances.

Consequently, a fall in interest rate may stimulate investment. The increased investments also increase the level of income or output through the multiplier, which may stimulate economic activities. Thus, monetary policy affects economic activity indirectly through their impact on interest rates and investment. Therefore, the Keynesian transmission mechanism is characterized by a highly detailed sector building up of aggregate demand and a detailed specification of portfolio adjustment process that attaches central role to interest as an indirect link between monetary policy and fiscal demand. In simple terms, the monetary mechanism of Keynesians emphasizes the role of money, but involves an indirect linkage of money with aggregate demand via the interest rate as symbolically shown below.

On a more analytical note, if the economy is initially at equilibrium and there is open market purchase of government securities by the Central Bank of Somalia (CBS), this open Market Operation (OMO) will increase the commercial banks reserve (R) and raise the bank reserves. The bank then operates to restore their desired ratio by extending new loans or by expanding bank credit in other ways. Such new loans create new demand deposits, thus increasing the money supply (MS). A rising money supply causes the general level of interest rate (r) to fall. The falling interest rates affects commercial bank performance and in turn stimulate investment given businessmen expected profit. The induced investment expenditure causes successive rounds of final demand spending by GNP to rise by a multiple of the initial change in investment. On the other hand, a fall in money supply causes the general level of interest rate (R) to rise or increase thereby increasing the commercial banks profitability Jhingan(2005)

### 2.2.2 The Monetarist Theory

The Monetarist Economist recognize that money is not just a close substitute for a small class of financial assets but rather a substitute for large spectrum of financial and real asset. Given an equilibrium position, an increase in money supply raises the actual proportion of money relative to the desired proportion. Symbolically, the monetarist conception of money transmission mechanism can be summarized below:

The monetarist argument centers on the old quantity theory of money. If velocity of money in circulation is constant, variation in money supply will directly affect prices and output or income (GNP), (M. L. Jhingan, Monetary Economics 6th Edition (2005)

### 2.2.3 The anticipated income theory

This theory states that banks should involves themselves in a broad range of lending which may include long-term loans to business, consumer installment loans and amortized real estate mortgage loans considering the fact that the likelihood of loan repayment which generates a cash flow that supplement bank liquidity depends on the anticipated income of the borrower and not the use made of the funds per se. This implies that a high excess reserve increases profitability of banks by increasing the availability of loanable investment funds Parker (2010).

According to Malik (2015), this theory, regardless of the nature and character of a borrower's business, the bank plans the liquidation of the loan from the anticipated income of the borrower. This theory opines that a bank should make long-term and non-business loans since even a "real bill" is repaid out of the future earnings of the borrower; i.e out of anticipated income. At the time of granting a loan, the banks take into consideration not only the security, but the anticipated earnings of the borrower. Thus a loan by the bank gets repaid out of the future

income of the borrower in installments, instead of in lump sum at the maturity of the loan (Faure, 2013).

#### **2.2.4 Liability Management Theory**

The theory holds that banks could satisfy any liquidity need and short-run profit opportunity by issuing money market liabilities such as certificate of deposit (CD). Another version of the theory states that money market bank liabilities should be used along with bank assets to meet liquidity needs, which will lead to commercial banks profitability (Zhuang *et al* 2009).

A theory that focuses in banks issuing liabilities to meet liquidity needs. Liquidity and liability management are closely related. One aspect of liquidity risk control is the buildup of a prudential level of liquid assets. Another aspect is the management of the Deposit institution's (DI) liability structure to reduce the need for large amounts of liquid assets to meet liability withdrawals. However, excessive use of purchased funds in the liability structure can result in a liquidity crisis if investors lose confidence in the DI and refuse to roll over such (Encyclopedia of Finance, 2006). Asset Liability Management (ALM) can be defined as a mechanism to address the risk faced by a bank due to a mismatch between assets and liabilities either due to liquidity or changes in interest rates. Liquidity is an institution's ability to meet its liabilities either by borrowing or converting assets. Apart from liquidity, a bank may also have a mismatch due to changes in interest rates as banks typically (Christopher, 2014)

#### **2.2.5 Shift- ability Theory**

The central thesis of this theory holds that the liquidity of a bank depends on its ability to shift its assets to someone else at a predictable price. Better still; the theory of shift-ability exposes the banks vulnerability to government security for liquidity. Whether or not a bank can quickly realize liquidity through this means depends on the marketability of the securities and their relative prices. The theory tries to broaden

the list of assets demand legitimate for ownership and hence redirected the attention of bankers and the banking authorities from loan to investment as source of bank liquidity Jeffrey (2010).

It is hypothesized that an increase in capital investment will lead to commercial banks profitability. However, increase in profits may also motivate further increase in capital investment, which in turn expands the scope of banking operations for increased profitability.

As a Ricardo (2013), suggested that adequate capital investment provides for a bank to perform the intermediation function and provide related financial services. It also provides protection in conditions of near economic collapse against unanticipated adversity leading to loss in excess of normal expectations and permits banks to continue operations in periods of difficulty until a normal level of earning is restored. This theory was proposed by H.G. Moulton who insisted that if the commercial banks continue a substantial amount of assets that can be moved to other banks for cash without any loss of material (Mohanty, 2014). In case of requirement, there is no need to depend on maturities. This theory states that, for an asset to be perfectly shift-able, it must be directly transferable without any loss of capital loss when there is a need for liquidity. This is specifically used for short term market investments, like treasury bills and bills of exchange which can be directly sold whenever there is a need to raise funds by banks.

But in general circumstances when all banks require liquidity, the shift-ability theory need all banks to acquire such assets which can be shifted on to the central bank which is the lender of the last resort.

### 2.3 Conceptual frame work

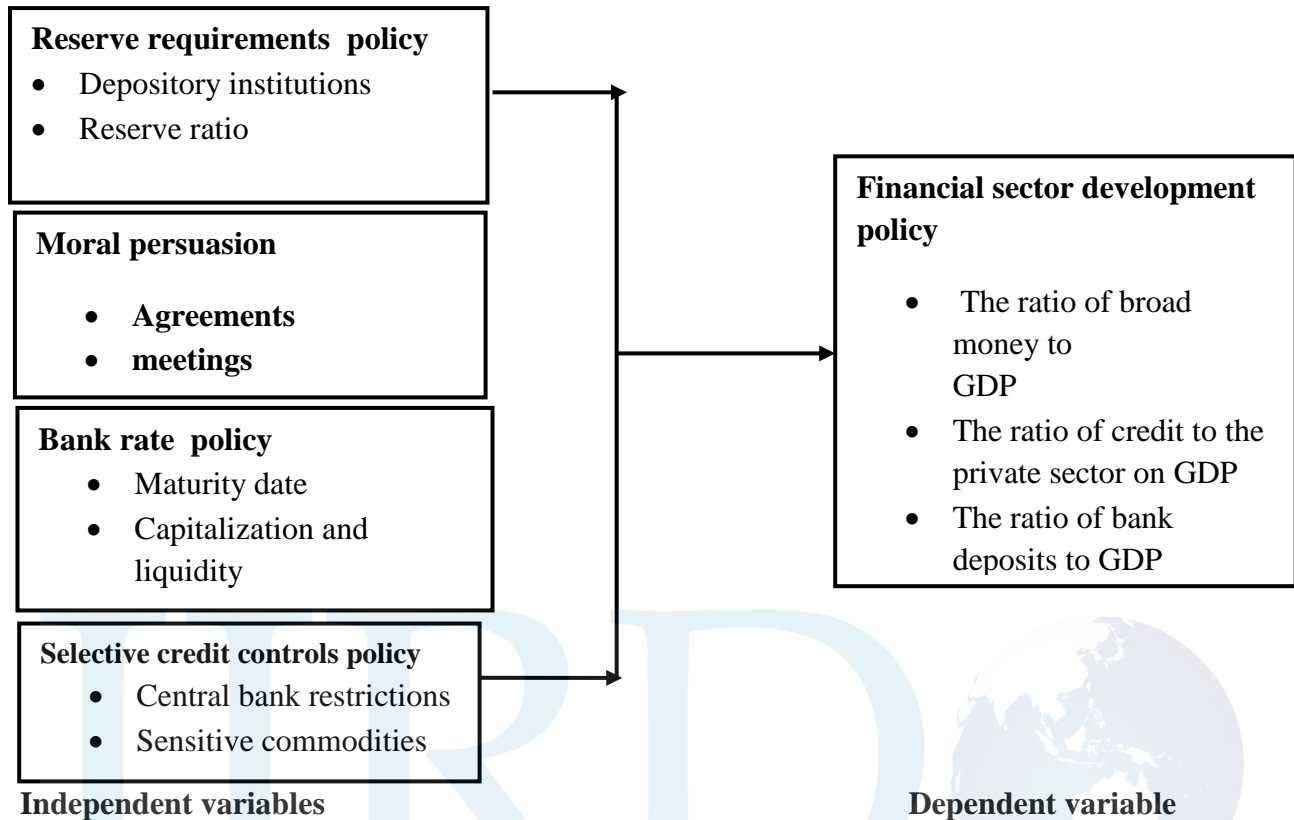


Figure 1.1 conceptual frame works

#### 2.4.1 Reserve requirements policy

Reserve requirements are the amount of funds that a depository institution must hold in reserve against specified deposit liabilities. Within limits specified by law, the Board of Governors has sole authority over changes in reserve requirements (. Depository institutions must hold reserves in the form of vault cash or deposits with Federal Reserve Banks (Calvo, 2011).

The dollar amount of a depository institution's reserve requirement is determined by applying the reserve ratios specified in the Federal Reserve Board's Regulation to an institution's resolvable liabilities. Reservable liabilities consist of net transaction accounts, non-personal time deposits (Adrian, 2014).



As Central Bank of Somalia (2011) indicated, Reserve requirements must be satisfied by holding vault cash and, if vault cash is insufficient, also by a deposit maintained with a central Bank. An institution may hold that deposit directly with a Central Bank or with another institution in a pass-through relationship. Reserve requirements are imposed on "depository institutions," defined as commercial banks, savings banks, savings and loan associations, credit unions, and agencies of foreign banks, Edge corporations, and agreement corporations (IMF, 2013).

#### **2.4.2 Moral persuasion policy**

Non-official' tool of monetary policy which governments employ to persuade (instead of coerce through law making power) financial institutions in following suggested guidelines on the availability and cost of credit. Moral suasion is used typically by making policy announcements to induce the desired response, before resorting to mandatory compliance through statutory regulations, central bank of Somalia (2012).

Romans (1966) describe that there is little evidence that the moral suasion is being used as wholly as a substitute of other instruments for financial policy. Other authors like Thelaw (2016), suggested that the moral persuasion is a monetary policy governmental guidance as a tool to persuade financial institutions to follow suggested guidelines on the availability and cost of credit, instead of lawmaking power to mandate. Before mandatory compliance through statutory regulations, moral suasion plays through policy announcements to induce a desired response (john,2015).In attempting to influence the moral views of others, activists sometimes employ pictures as tools of moral persuasion. In such cases, a viewer is confronted with an actual instance of the practice whose morality is at issue and invited to draw a general moral conclusion in response (Sarah, 2014).

### 2.4.3 Bank rate policy

A bank rate is the interest rate at which a nation's central bank lends money to domestic banks. Often these loans are very short in duration. Managing the bank rate is a preferred method by which central banks can regulate the level of economic activity. Lower bank rates can help to expand the economy, when unemployment is high, by lowering the cost of funds for borrowers. Conversely, higher bank rates help to reign in the economy, when inflation is higher than desired. The bank rate can also refer to the interest rate which banks charge customers on loans central bank of Somalia (2012). An analysis of bank interest rate setting behavior during the crisis has also been largely absent from the existing literature. The majority of studies focus on the response of credit aggregates and output (the existence of a credit crunch), but pay limited attention to the effects on prices. One relevant exception is Santos (2011); however, that paper analyzes the market for syndicated corporate loans, which is a quite specific segment of the credit market, highly dominated by large firms. The scant evidence on the effects of the crisis on the cost of credit in retail banking is mainly due to the lack of micro data at the bank-firm level. As far as we are aware, data on loan interest rates at the bank-firm level are available with a comprehensive degree of detail only from the credit registers of a few countries. Along these lines, Santos (2011) finds that firms that obtained a syndicated loan after the onset of the crisis paid an additional spread over Libor compared to similar loans they took out from the same bank prior to the crisis.

#### **2.4.4 Selective credit controls policy**

Selective credit control is a tool in the hands of central bank of Somalia to restrict bank finance against sensitive commodities (Carvalho and Azevedo, 2008). All these commodities, as would be observed, are of mass consumption and Government makes all efforts to ensure adequate supply of these commodities in the free market. The policy, therefore, is to discourage advances against these commodities as far as possible and the purpose is achieved through 'Selective Credit Control' (Moreno, 2011).

Leonardo and Gambacorta (2014) indicated that the Central Bank has enough justification for taking the latest measure as an anti-inflationary one. The directives to banks under "Selective Credit Control" policy appear to have been carried out by them in letter to some extent but violated in spirit. Scheduled bank advances against food articles, industrial raw materials and plantation products in advances against agricultural commodities in the corresponding period (Broner, Erce, Martin, and Ventura, 2014; Drechsler, Drechsel, Marquez-Ibanez, and Schnabl, 2015). To this extent the Selective Credit Control directives have been carried out by banks. Government price control programs in Somalia began over decades ago central bank of Somalia (2011). More recently, credit controls, which are a special case of price controls, entered the arsenal of policy instruments. Related studies for other countries include Vargas et al. (2010), Cerda and Larrain (2005) and Grosz et al. (2008). Credit control programs involve regulation of either the price of credit-interest rates or the quantity of credit extended for various purposes. Credit controls can be S&W or general. Selective controls affect the price or quantity of specific types of credit, whereas general controls are designed to affect the aggregate amount of credit used.

### 2.4.5 Financial sector development

Somalia's financial sector has done surprisingly well, as it is not only surviving, but growing in conditions of a free market supported by steady remittance flows (Maimbo, 2006). Even so, there are pitfalls to a conflict economy without a state, the most important being failure to provide public goods and failure to correct negative externalities. Although it is true that the private sector and the NGOs picked up provision of key services after the "exit" of the state from this arena, this provision has been extremely narrow in scope (World Bank, 2013). While remittances play an important role in the Somali economy, they cannot become a source of long-term sustainable growth. In the medium term, if there is an improvement in the political and security situation, it is expected that part of former remittance will turn into domestically-sourced investment as Somalis start returning home Adam at el (2013). In the longer term, regulations need to be put in place to promote investment, which is a crucial precondition for long-term growth (Tania, 2014). Financial sector is a term used to describe the commercial banks, finance companies, stock markets, Hawals, mutual funds or any other institution that involve the supply and demand of funds. In this variable we are going to analyse the financial sector development indicators such as the soundness of financial sector, the % of private sector of the total GDP and other indicators.

### 2.5 Empirical Review

In this section we are going to review the previous evidence, researches and findings of other researchers. Many studies have been conducted and several researchers found results in different periods of time, like Solomon (2013), found that the central banks play a vital role in financial sector development, and this depends on the soundness of central bank and its independence

from intervention of governments. According to the central bank of Somalia (2011), the central bank, or reserve or monetary authority is institution owned by government to manage the supply and of money and the circulation; it's also responsible to the issue of money and supervision of commercial banks.

According to the central bank of South Africa (2014), the financial sector development is important for succeeding and achieving pro-poor growth, through mobilization of savings and flow of capital investment and remittances from abroad. The central banks are responsible for clearing and settlements without it the connection and coordination between financial institutions becomes hard and difficult to deal each other.

Major theoretical literature on financial development and economic growth process postulate four distinguishable, but not mutually exclusive, effects of financial activity and development on overall economic performance. The first is the provision of an inexpensive and reliable means of payment. The second is the volume and allocation effect, in which financial activity increases resources that could be channelled into investment while improving the allocation of resources (Odeniran and Udejaja, 2010).

Recent papers provide cross-sectional evidence of the risk-taking channel, in which monetary policy affects not just the quantity but the quality of credit. The risk taking effects depend importantly on the amount of bank capital, where higher levels of capital mitigate incentives to reduce the quality of credit. Jiménez et al (2012) use detailed credit register data in Spain to show that lower rates leads to greater risk taking, more credit to riskier firms, and this effect is greater at banks with lower capital. Dell'Ariscia, Laeven, and Suarez (2013) look at this channel in the US, and find a relationship between ex ante riskiness of loans and bank capital.

Paligorova and Santos (2012) evaluate loan spreads on syndicated loans in the US and find that required spreads for more risky to less risky borrowers is lower in periods of looser monetary policy, and is stronger for banks with greater risk appetite. Maddaloni and Peydro (2011) find that low rates lead to softer lending standards in both the US and Euro area, which is greater if rates have been low for an extended period, supervision is weaker, and securitization activity is greater. Altunabas, Gambacorta, and Marques-Ibanez (2010) show unusually low rates for an extended period led to a sharper rise in expected default probabilities for banks, consistent with greater risk taking.

Monetary policy also affects the leverage of financial institutions. Drechsler, Savov, and Schnabl (2014) model the effects of monetary policy by affecting the external finance spread that banks pay to leverage. Easing of monetary policy leads to lower leverage costs for banks, which increases risk taking and lowers risk premia. They document that an external finance spread for banks (the funds rate – Tbill rate) moves closely with the fed funds rate. Adrian and Shin (2010, 2014) document that broker dealer leverage is endogenous and highly procyclical, owing to the way in which risk management is conducted. Adrian and Shin (2011a and 2009a) link the procyclical leverage to monetary policy, showing that tighter monetary policy tends to lower risk taking of broker dealers, leading to an increase in the pricing of risk, with associated contractionary macro consequences. In addition, Adrian, Moench and Shin (2009, 2010) link leverage management to aggregate economic activity, and show that shocks to dealer leverage impact macro activity through the pricing of risk. Adrian and Boyarchenko (2012) and Nuño and Thomas (2014) provide theories that rationalize these facts within dynamic stochastic general equilibrium (DSGE) models. In Adrian and Boyarchenko (2012), higher leverage is further associated with an increase in financial vulnerability in the form of systemic risk.

Today, most countries have an interest rate or exchange rate target to which the monetary base adjusts endogenously. Under such a framework the effects of reserve requirement increases on inflation are therefore less clear from a theoretical perspective. Nonetheless, market observers perceive that some countries, for example China, use reserve requirement policy as a substitute for interest rate policy to contain inflationary pressures. The implied argument is that reserve requirement increases may be able to cool down the economy and thereby also lower prices. But also the opposite argument is made: a loosening of reserve requirements in response to capital outflows may be a way to stimulate the economy without creating inflation (see for example Montoro and Moreno, 2011). Again, an empirical evaluation Regarding previous work, there is a large literature that uses structural VARs to identify monetary policy shocks and analyzes their effect on macroeconomic variables (see Christiano et al. 2000 for an overview and Mallick and Sousa, 2011, Cato and Pagan, 2011, Luporini, 2008 and Kamal, 2010 for applications to Brazil). Despite the fact that a number of emerging countries' central banks use reserve requirements as an additional policy instrument, the methods have so far not been applied to analyze the consequences of reserve requirement shocks

## 2.6 Critiques of existing literature

A lot of studies are conducted in the field of central bank and its effects to financial sector developments many of them attempt to propose solutions to the problem. Most of them are conducted researchers in Europe and Asian and few of them are conducted by Africans and none of them are conducted in the context of Somalia. Their conclusions and solutions cannot be applicable to the financial sector of Somalia and the central bank of Somalia because the systems are different in terms of nature and socio-cultural differences for example Dafe and volz (2015) , Solomon (2016) ,Bank of England (2016) and other authors found their conclusions based on

conventional banking practices since Somali financial sectors do not operate in the context of some conventions in those practices instead of using Islamic banking principles. On other hand most of these researches failed to follow the proper guideline of research methodology.

## 2.7 Research gap

The gap exists when current situation and desired outcome is different, this is sometimes called the problem. No previous studies are conducted in this field of study particularly in the context of Somalia, no thesis or dissertations and written in the role of central bank of Somalia in financial sector development( Solomon ,2012) .this gives me an opportunity as a researcher to question how central bank of Somalia affects the financial sector development? To get reasonable answer for this and other related questions I have compelled to do this study targeting the financial sector such as commercial banks,HAWALAS, and insurance companies in Mogadishu, it also covers the central bank of Somalia itself to find reliable answers for questions and solutions to the current problem( Ismail,2014).

## 2.8 Summery

The literatures above indicate the effects of monetary policy on financial sector development; the studies show that the central banks have significant influence in financial sector development .the central banks use tools to in order to influence the overall financial sector in the country these tools are also referred to functions of central bank .the most important functions that the central bank does include ;issuing the national currency ,control the supply and demand of money ,lender as last resort , link between the local financial system to the external banks and other financial institutions such as International Monetary fund (IMF) and World Bank .central banks also act as government financial advisor , banker



of commercial banks , responsible fiscal policy and government expenditure and the payment and management of national debt (government borrowings from internal and external).the central also responsible for drawing rules and regulations toward the financial sector in order to ensure the soundness and health of financial system in the country , to protect the people's confidence and prevent the exploitation of these institutions from their customers .the regulatory frame work also ensures the lending procedures , enforce the banks and other financial institutions to publish their financial statements to avoid the misleading of the customers .



## CHAPTER THREE

### RESEARCH METHODOLOGY

#### 3.1 Introduction

This chapter presents the methodology that the researcher is going to carry out the research.

It covers the introduction, research design, target population, sampling techniques and sample size. Additionally this section also covers the research instruments used, measures, data collection and analysis procedures and pilot test

#### 3.2 Research Design

The research design means what kind of research are you going to conduct? , there are different types of research designs and each design is appropriate for particular field of the study. Fluidsurveys (2016), and Wikipedia (2016) the exploratory research is conducted when the problem has not been clearly defined, and it is mainly depends on the review of previous theories .it should draw a definite conclusions to the problem at hand .this research is exploratory research why? Because there is no previous empirical evidence conducted this area particularly in the context of Somalia and in Mogadishu, this gives me as a researcher an opportunity to explore the problems exist in this area and propose the necessary solutions.

#### 3.3 Target population

The target population for this study is 16 financial institutions in Mogadishu; they include the 9 remittances (HAWALAS) and 6 commercial banks , central bank and ministry of finance .all these institutions are licensed by central bank the total number of people is 50.

**Table 3.1**

<b>ORGANIZATIONS</b>	<b>TARGET POPULATION</b>	<b>PERCENTAGE</b>
Hawalas	5	10
Commercial banks	10	20
Central bank	30	60
Ministry of finance	5	10
<b>TOTAL</b>	<b>50</b>	<b>100</b>

### 3.4 Sampling frame

the sampling of this study contains the 9 haw alas and 5 banks .the sampling frame also contains the names of all these banks and HAWALAS which are licensed by central bank of Somalia in addition to the central bank of Somalia the total number is 37 persons .

### 3.5 Sample and sampling technique

Sampling is the process of selecting units (e.g., people, organizations) from a population of interest so that by studying the sample we may fairly generalize our results back to the population from which they were chosen.

In this study we choose the stratified sampling technique, it is probability sampling technique where the population under study has the same chance to be included in the sample. Stratified technique classifies the population into sub groups .each group is selected randomly .we have

classified our population into sub groups such as commercial banks sector, HAWALAS, insurance companies and central bank

$$n = N / (1 + (N * e^2))$$

N=target population 50

n=sample size

e=is the confidence level at 0.05

$$n = 50 / (1 + (50 * 0.005^2)) = 37$$

### 3.6 Data Collection Instruments

Research instruments are testing devices used for measuring a given phenomena designed to obtain data on a topic of interest from research subject (Maina, 2012). Structured questionnaires will be used as a primary data collection instrument in collecting general information on financial sector that had not been captured in annual financial reports. Alongside the questionnaire the secondary data that was collected from financial journals written financial sector of Somalia such as remittance companies, commercial banks and Central bank of Somali website. Structured questionnaires had some control or guidance given for answers. It is basically short and of closed form requiring the respondent to provide a „yes“ or „no“ response, or to tick an appropriate response based on likert continuum scale of the range of 1 to 5; where 1 was strongly agree, 2 agree, 3 neither agree nor disagree, 4 disagree and 5 strongly disagree.

### 3.7 Data Collection Procedure

The secondary was collected using search engines such as Google and Yahoo, and other printed books, journals. The researcher then reviewed all necessary data required by literature review section; the researcher cited every information captured by these sources. Other hand the researcher is going to employ such data collection methods; these include the structured interview and structured quationiaer. The data reviewed also include international journals and series such IMF series and World Bank about African financial institutions and the financial system of Somalia.

### 3.8 pilot test

In order to test the validity and reliability of primary data collection methods, the researcher tested the methods. According to Connelly (2008), extant literature suggests that a pilot study sample should be 10% of the sample projected for the larger parent study. However, Hertzog (2008) cautions that this is not a simple or straight forward issue to resolve because these types of studies are influenced by many factors. Nevertheless, Isaac and Michael (1995) suggested 10 – 30 participants; Hill (1998) suggested 10 to 30 participants for pilots in survey research; Julious (2005) in the medical field, and van Belle (2002) suggested 12; Treece (1982) suggested 10% of the project sample size. As mentioned above the researcher employed the structured interview and structured quationiaere. The researcher randomly chosen 1 bank which is equivalent 10% of the sample and the method is seen as valid and reliable for following main research project.

### **3.9 Data processing and analysis**

The data processing and analysis means how the primary data collected will be coded, arranged, filtered and cleaned in order to make sure that the data is appropriate for decision making. The two main statistical analyses are made inferential and descriptive analysis.

#### **3.8.1 Descriptive analysis**

Descriptive statistics are used to describe the basic features of the data in a study. They provide simple summaries about the sample and the measures. Together with simple graphics analysis, they form the basis of virtually every quantitative analysis of data. Descriptive Statistics are used to present quantitative descriptions in a manageable form. In a research study we may have lots of measures. Or we may measure a large number of people on any measure. Descriptive statistics help us to simplify large amounts of data in a sensible way. Each descriptive statistic reduces lots of data into a simpler summary (William, 2006).

#### **3.8.1 Inferential analysis**

With inferential statistics, you are trying to reach conclusions that extend beyond the immediate data alone. For instance, we use inferential statistics to try to infer from the sample data what the population might think. Or, we use inferential statistics to make judgments of the probability that an observed difference between groups is a dependable one or one that might have happened by chance in this study. Thus, we use inferential statistics to make inferences from our data to more general conditions; we use descriptive statistics simply to describe what's going on in our data. The SPSS data analysis will be used particularly version 20.0, its one of the latest versions of SPSS and it has sophisticated tools and user friendly, which may ease for the researcher to use and analyze data.

### 3.9 Model Summery

A regression model will be applied to determine the relationship between Bank rate, Selective credit controls, Reserve requirements, Moral persuasion as the independent variables and financial sector development as dependent variable. Pearson's product moment correlation analysis is also used and it's a powerful technique for determine the relationship among variables. Correlation coefficient was used to analyze the strength of the relations between variables. Correlation coefficients are calculated to observe the strength of the association. A series of multiple regression analysis are used because they provide estimates of net effects and explanatory power. Analysis of variance (ANOVA) will be used to test the significance of the model.  $R^2$  will be used in this research to measure the extent of goodness of fit of the regression model. The regression model is indicated as shown as follows:  $Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon$

Where:-

$Y$  = represents the dependent variable, Financial sector development

$\beta_0 \dots \beta_4$  are the Regression Coefficient

$X_1$  = Bank rate

$X_2$  = Selective credit controls

$X_3$  = Reserve requirement

$X_4$  = Moral Persuasion

$\epsilon$  = Error term

## CHAPTER FOUR

### RESEARCH FINDINGS AND DISCUSSION

#### 4.1 Introduction

In this chapter, raw data from the questionnaires was analyzed and interpreted. Various tests were used to test the relationship between variables, level of significance, reliability and random distribution of data. Specifically, we used Cronbach's alpha test, descriptive statistics test, Pearson Bivariate correlation and Multiple Regression analysis (standard and stepwise). The independent variables of the study were Bank rate, Selective credit controls, Reserve requirements, and Moral persuasion and how they affected the dependent variable which was financial sector development.

#### 4.2 Response Rate

From the data collected, out of the 37 questionnaires administered, 34 were filled and returned, which represent approximately 92% response rate. This response rate is considered satisfactory to make conclusions for the study. Mugenda(2003) observed that a 50% response rate is adequate, 60% is good, while 70% rated very good. This implies that based on this assertion, the response rate in this case of 92% is therefore very good. The recorded high response rate can be attributed to the data collection procedures for instance, the researcher pre-notified the potential participants for the survey, the researcher administered the questionnaire with the help of research assistants through drop and pick method and follow up calls were also made to clarify queries as well as to prompt the respondents to fill the questionnaire. These methods facilitated the whole process of data collection hence the high response rate.



**Table 4.1 Response Rate**

<b>Response</b>	<b>Total</b>	<b>Percent</b>
Non Responses	03	8
Responses	3492	
<b>Total</b>	<b>37</b>	<b>100</b>

### 4.3 Reliability and Validity

Prior to exploring and describing the relationship between Bank rate, selective credit controls, Reserve requirement, Moral persuasion and Financial sector development Somalia, the measures were examined and assessed to gauge reliability and validity.

#### 4.3.1 Reliability analysis

Cronbach's alpha was used to determine the internal reliability of the questionnaire used in this study. Values range between 0 and 1.0; while 1.0 indicates perfect reliability, the value 0.70 is deemed to be the lower level of acceptability (Hair, Black, Barry, Anderson, & Tatham, 2006). The reliability statistic for each of the identified factors is presented in Table 4.1. It is evident from Table 4.1 that Cronbach's alpha for each of the identified factors is well above the lower limit of acceptability of 0.70. The findings indicated that Bank rate had a coefficient of 0.702, Selective credit controls had a coefficient of 0.755, Reserve requirement had a coefficient of 0.770, Moral persuasion had a coefficient of 0.711 and Financial sector development obtained a coefficient of 0.734. The results indicate that the questionnaire used in this study had a high level of reliability. These tables indicate that each of the items relates to the identified factor and that the coefficient alpha value of the identified factor will not increase if some of the items are left

out. Basically, reliability coefficients of 0.7 or more are considered adequate for studies (Hair, Black, Barry, Anderson, & Tatham, 2006; Malhotra, 2002).

**Table 4.2: Reliability Statistics**

Variables	Cronbach's Alpha	Comments
Bank rate	0.702	Accepted
Selective credit controls	0.755	Accepted
Reserve requirement	0.770	Accepted
Moral persuasion	0.711	Accepted

#### 4.3.2 Validity

Factor analysis was used to check validity of the constructs. Kaiser-Meyer-Olkin measures of sampling adequacy (KMO) & Bartlett's Test of Sphericity is a measure of sampling adequacy that is recommended to check the case to variable ratio for the analysis being conducted. In most academic and business studies, KMO & Bartlett's test play an important role for accepting the sample adequacy. While the KMO ranges from 0 to 1, the world-over accepted index is over 0.5. Also, the Bartlett's Test of Sphericity relates to the significance of the study and thereby shows the validity and suitability of the responses collected to the problem being addressed through the study. For Factor Analysis to be recommended suitable, the Bartlett's Test of Sphericity must be less than 0.05.

The study applied the KMO measures of sampling adequacy and Bartlett's test of sphericity to test whether the relationship among the variables has been significant or not as shown in below in table 4.2. Factor 1 was based on five items that represented bank rate; Factor 2 was based on five items that represented selective credit controls, Factor 3 was based on five items that

represented reserve requirement, Factor 4 with five items represented moral persuasion, and Factor 5 with five items represented financial sector development. The Kaiser-Meyer-Olkin measures of sampling adequacy shows the value of test statistic as .743, which is greater than 0.5 hence an acceptable index. While Bartlett's test of sphericity shows the value of test statistic as 0.000 which is less than 0.05 acceptable indexes. This result indicates a highly significant relationship among variables.

**Table 4.3: Factor analysis -KMO and Bart**

<b>KMO and Bartlett's Test</b>	
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.	.743
Approx. Chi-Square	46.184
Bartlett's Test of Sphericitydf	4
Sig.	.000

#### 4.4 Descriptive Statistics

This section outlines the demographic data, gender, years of existence and key players in the industry.

##### 4.4.1 Demographic data

The study required to establish the demographic data of the respondents. The researcher begun by a general analysis on the demographic data obtained from the respondents which included; the gender, duration of existence and the key players in the industry. This research targeted 37 participants in regard to establishing the determinants of financial sector development and 34 questionnaires were generated.

#### 4.4.2 Response of Gender distribution

The descriptive statistics of the study indicated that 25 (73.6%) of the respondents were men while the remaining 9(26.4) were women, this clearly shows that the industry is male dominated as indicated in table 4.4.

**Table 4.4 Gender of respondents**

Gender	Frequency	Percent
Male	25	73.6
Female	9	26.4
<b>Total</b>	<b>34</b>	<b>100.0</b>

#### 4.4.3 Response of age group

From the table 4.4, shows that 10 (29.4%) of financial institutions in Mogadishu have been in existence for at least 20-30 years, 15 (44.11%) have been in existence for 30-40 years and 4(11.7%) have been in existence for 40-50 years, 3(8.8%) have been in existence for 50-60 years, 2(5.8%) have been in existence for 60-70 years

**Table 4.5 Response of age group**

Age	Frequency	Percentage
20-30	10	29.4
30-40	15	44.11
40-50	4	11.7
50-60	3	8.8
60-70	2	5.8
<b>Total</b>	<b>34</b>	<b>100.0</b>

#### 4.4.4 Response of level of education

The descriptive statistics of the study Table 4.5indicated that there is numerous level of education in the financial institutions.Most of the respondents 13(38.6%) highlighted the

Bachelorlevel, 8 (23.4%) indicated Diploma level, 5(14.7%) indicated Maters level, 5(14.7%) of Secondary level and 3(8.8%) indicated PHD level. These results show respondents' opinion and the level of education

**Table 4.6 level of education**

<b>level</b>	<b>Frequency</b>	<b>Percentage</b>
Secondary	5	14.7
Diploma	8	23.5
Bachelor	13	38.2
Master	5	14.7
PHD	3	8.8
<b>Total</b>	<b>34</b>	<b>100.0</b>

#### 4.4.5 Years of experience

From the Table 4.6, shows that 15 (32.3%) have been in experience for at least 1-5 years, 10(29.4%) have been in experience for 5-10 years, 5 (14.7%) have been experience for 10-15years and 4 (11.7%) have been experience for above 15 years. The findings imply that the respondents had worked enough periods in enhance accurate responses.

**Table 4.7 working experience**

<b>Years</b>	<b>Frequency</b>	<b>Percentage</b>
1-5	15	32.3
5-10	10	29.4
10-15	5	14.7
Above 15	4	11.7
<b>Total</b>	<b>45</b>	<b>100.0</b>

#### 4.5 Study variables Findings

The following presents the findings on the various study variables.

##### 4.5.1 Bank rate

The study required to investigate the effects of Bank rate on financial sector development. Table 4.8 summarizes respondents' level of agreement on how Bank rate affects the financial sector development. Most of the respondents agreed to the fact that the Bank rate significantly affects the financial sector development, reporting a mean of 2.56. During the inflation the central bank increase lending rate to domestic banks in order maintain the economic stability, while central bank decreases the lending rate to domestic banks during economic downtown Ali and Barguthi (2008) suggest that there is a difference between Islamic banks and conventional banks in terms of interest rate and the type of financing to the projects .commercial banks in Somalia such as Salam Somali bank and Dahabshil use Islamic finance principles ,they don't charge any interest rate instead they apply the murabaha principles IMF(2016).

**Table 4.8 Bank rate and financial sector development**

Statement	N	Mean	S.D
The bank rate plays an important role in financial sector development	34	2.80	1.408
The central bank of Somalia uses a bank rate policy to increase or decrease the volume of credit in the country	34	2.47	1.290
The central bank uses the bank rate policy to control the demand and supply of money	34	2.98	1.438

#### 4.5.2 Selective credit control and financial sector development

The study shown to establish the effects of selective credit controls on financial sector development. From the results indicated in table 4.9 the average of respondents agreed that the selective credit control policies do affect the financial sector development in Mogadishu with a mean of 2.42 being obtained. The results also conquer with the findings on the question that was asked whether the Credit control may participate the credit balance and have relationship to the financial stability .The findings on this question obtained a mean of 2.47. the second question about the selective credit controls which is Restrictions of harmful products may have positive effects to the overall economy of the country the respondents have shown that this is good averaging mean of 2.51. this confirms the previous researches made by Mogondho (2009) and Cithara (2015) the results shown that the monetary policy is great tool to increase or decrease the supply of money including selective credit controls.

**Table 4.9 Selective credit control and financial sector development**

Statement	N	Mean	S.D
Credit control may participate the credit balance and have direct relationship to the financial stability	34	2.47	1.321
Reducing the cost of capital of certain commodities may encourage the demand of many people	34	2.51	1.372
Restrictions of harmful products may have positive effects to the overall economy of the country	34	2.51	1.290

#### 4.5.3 Reserve requirement

The study sought to establish of reserve requirement on financial sector development. Respondents agreed that the reserve requirement plays an important role in financial sector development in Somalia if any as represented by a mean of 2.38, most of the respondents agreed

that The central bank of Somalia has not ability currently to set the reserve requirement rate by a mean of 2.53 and a mean 2.73 were obtained on the question whether the reserve requirement is powerful tool to prevent the bank runs and stabilize the banking system. The findings of these studies confirms, with the relationship between reserve requirement and financial sector development is found to be significantly positive (Jamal et al, 2003). This reasoning suggests a positive relationship between financial sector development and reserve requirement,

**Table 4.10 Reserve requirement and financial sector development**

Statement	n	Mean	S.D
The reserve requirement plays an important role in financial sector development in Somalia	34	2.53	1.471
The central bank of Somalia has ability to set the reserve requirement rate	34	2.82	1.482
The reserve requirement is powerful tool to prevent the bank runs and stabilize the banking system	34	2.82	1.386

#### 4.5.4 Moral Persuasion

A number of questions were asked to determine how the central bank uses moral persuasion and its effects on financial sector development since moral persuasion is qualitative policy .the respondents were asked whether Moral suasion plays an important role in financial sector development in Somalia. Respondents agreed that obtaining a mean of 2.89. The respondent agreed that the Central bank uses the moral suasion as effective policy to influence the commercial banks obtaining a mean of 2.82 and similarly a mean of 2.78. These findings are in agreement with the literature review findings that indicate that the During the meeting, the central bank will explain the economic and financial state of the country and ask the commercial banks to take



certain steps to overcome any financial and economic problems faced. For example, during an economic downturn, commercial banks will take into account the borrowers financial state before forcing him to re-pay his loan(Munzarina, 2010)..

**Table 4.11Moral persuasion and financial sector development**

Statement	N	Mean	S. D
Moral suasion plays an important role in financial sector development	34	2.82	1.35
Central bank uses the moral suasion as effective policy to influence the commercial banks	34	3.22	1.29
Moral suasion encourages to the commercial banks that theydon't give loans to unproductive purpose	34	3.40	1.35

#### 4.6 Multiple Regression Analysis

Multiple regression analysis was performed to evaluate the relationship between the dependent variable (financial sector development) and the independent variables (Bank rate, selective credit controls, reserve requirement and moral persuasion) and to test the research on the role of central bank monetary policy on financial sector development in Mogadishu, Somalia. While stepwise multiple regression analysis was conducted in order to establish the best combination of independent (predictor) variables would be to predict the dependent (predicted) variable and to establish the best model of the study (Cooper & Schindler, 2013). In this study, a multiple regression analysis was conducted to test the role of central bank monetary policy in financial sector development in Mogadishu, Somalia. The research used statistical package for social sciences (SPSS V 20) to code, enter and compute the measurements of the multiple regressions.

#### 4.6.1 Model Summary

Model summary is a summary that describes how far the independent variables explain the dependent variables that mean the greater R value has the great number the greater independent variables explain with dependent variable. In order to test the research, a standard multiple regression analysis was conducted using financial sector development as the dependent variable, and the four monetary policy tools: Bank rate, selective credit controls, reserve requirement and moral persuasion as the predicting variables. Tables 4.13, 4.14 and 4.15 present the regression results. From the model summary in table 4.12, it is clear that the adjusted R<sup>2</sup> was 0.361 indicating that a combination of bank rate, selective credit controls, reserve requirement and moral persuasion explained 36.1% of the variation in financial sector development in Mogadishu, Somalia.

**Table 4.12 Model Summary**

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.662 <sup>a</sup>	.439	.361	.34509

a. predictors: (constant), morale persuasion, the bank rate , reserve requirement, selective credit controls

#### 4.6.2 Analysis of Variance

Analysis of Variance (ANOVA), as the name implies, is a statistical technique that is intended to analyze variability in data in order to infer the inequality among population means. This may sound illogical, but there is more to this idea than just what the name implies. The ANOVA technique extends what an independent-samples t test can do to multiple means. The null

hypothesis examined by the independent samples t test is that two population means are equal. If more than two means are compared, repeated use of the independent-samples t test will lead to a higher Type I error rate (the experiment-wise  $\alpha$  level) than the  $\alpha$  level set for each t test.

**Table 4.13 Analysis of Variance**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.701	4	.675	5.670	.002 <sup>b</sup>
	Residual	3.454	29	.119		
	Total	6.154	33			

a. dependent variable: financial sector development

b. predictors: (constant), morale persuasion, the bank rate, reserve requirement, selective credit controls

From the ANOVA table 4.12, it is clear that the overall standard multiple regression model (the model involving constant, bank rate, selective credit controls, reserve requirement and moral persuasion) is significant in predicting how bank rate, selective credit controls, reserve requirement and moral persuasion determine financial sector development in Mogadishu, Somalia. The regression model achieves a high degree of fit as reflected by an  $R^2$  of .0436 ( $F = 5.670$ ;  $P = 0.02 < 0.05$ ).

#### 4.6.3 Regression Coefficients

Table 4.13 presents the regression results on how company size, degree of risk and capital intensity determine capital budgeting decision for merchandise companies in Mogadishu, Somalia. The multiple regression equation was that:  $Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \varepsilon$  and the multiple regression equation became:  $Y = 1.071 + .185X_1 + 0.832X_2 + .227X_4$  As depicted in table 4.13, there was positive and significant effects of Bank rate on Financial sector

development ( $\beta = .185$ ;  $t = 1.308$ ;  $p > 0.05$ ). There was positive and significant effects of Selective credit controls on financial sector development ( $\beta = 0.832$ ;  $t = 4.535$ ;  $p < 0.05$ ). However, there was positive and significant effects of Reserve requirement on Financial sector development ( $\beta = .257$ ;  $t = 1.599$ ;  $p > 0.05$ ), and also there was positive and significant effects of Moral persuasion on Financial sector development ( $\beta = .227$ ;  $t = -1.069$ ;  $p > 0.05$ ).

**Table 4.14 Regression Coefficients**

Model		Coefficients			T	Sig.
		Unstandardized Coefficients	Standardized Coefficients			
		B	Std. Error	Beta		
1	(Constant)	1.071	.500		2.143	.041
	BANK RATE	.053	.040	.185	1.308	.201
	SELECTIVE CREDIT CONTROLS	.819	.181	.832	4.535	.000
	RESERVE REQUIREMENT	-.226	.141	-.257	-1.599	.121
	MORALE PERSUASION	-.290	.209	-.227	-1.383	.177

a. Dependent Variable: FINANCILAL SECTOR DEVELOPMENT

#### 4.6.5 Correlation Analysis

Pearson Bivariate correlation coefficient was used to compute the correlation between the dependent variable (Financial sector development) and the independent variables (Bank rate, selective credit controls, Reserve requirement and Moral persuasion). According to Sekaran (2008), this relationship is assumed to be linear and the correlation coefficient ranges from -1.0 (perfect negative correlation) to +1.0 (perfect positive relationship). The correlation coefficient was calculated to determine the strength of the relationship between dependent and independent variables (Kothari, 2013). From table 4.14, the results generally indicate that independent

variables (Bank rate, selective credit controls, Reserve requirement and Moral persuasion) were found to have positive significant correlations on financial sector development at 5% level of significance. There was a weak positive and significant correlation between Bank rate and financial sector development ( $r = .119$ ,  $P > 0.05$ ). There was a strong positive and highly significant correlation between selective credit controls and financial sector development ( $r = .563$ ,  $P < 0.05$ ). There was a strong positive and highly significant correlation between Reserve requirement and financial sector development ( $r = .067$ ,  $P < 0.01$ ). There was a weak positive and highly significant correlation between Moral persuasion and financial sector development ( $r = .151$ ,  $P < 0.01$ ).



Table 4.15 Correlation

		Correlations				
		THE BANK RATE	SELE CTIVE CREDI T CONT ROLS	RESECE REQUIREMEN T	MORALE PERSUASI ON	FINANCILAL SECTOR DEVELOPMENT
The bank rate	Pearson	1	-.137	-.171	-.017	.119
	Correlation					
	Sig. (2-tailed)		.439	.334	.924	.503
SELECTIVE CREDIT CONTROLS	N	34	34	34	34	34
	Pearson	-.137	1	.486**	.524**	.563**
	Correlation					
RESERVE REQUIREMENT	Sig. (2-tailed)	.439		.004	.001	.001
	N	34	34	34	34	34
	Pearson	-.171	.486**	1	.216	.067
MORALE PERSUASION	Correlation	.334	.004		.221	.705
	Sig. (2-tailed)	.924	.001	.221		.393
	N	34	34	34	34	34
FINANCILAL SECTOR DEVELOPMENT	Pearson	-.017	.524**	.216	1	.151
	Correlation	.439	.004		.001	.705
	Sig. (2-tailed)	.503	.001	.705	.393	
	N	34	34	34	34	34
	Pearson	.119	.563**	.067	.151	1
	Correlation					
	Sig. (2-tailed)	.503	.001	.705	.393	
	N	34	34	34	34	34

\*\* . Correlation is significant at the 0.05 level (2-tailed).

## CHAPTER FIVE

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

#### 5.1 Introduction

This chapter accordingly summarizes the findings in line with the objectives, draws conclusions and makes the necessary recommendations. Areas of further study that may enrich the study area are also suggested.

#### 5.2 Summary of Findings

The general objective of this study was to investigate the role of central bank monetary policy on financial sector development in Mogadishu, Somalia. Specifically; this study investigated the effects of bank rate, selective credit controls, reserve requirement and moral persuasion on financial sector development in Mogadishu, Somalia. The study employed a survey research design in data collection. This research employed quantitative data collection method whereby data was gathered by the use of closed ended questionnaires which were self-administered. Factor analysis was used to assess the validity and Cronbach alpha to assess reliability of the questionnaire. Multiple regression analysis was performed to assess the relationship between the dependent variable (financial sector development ) and the independent variables (bank rate ,selective credit controls ,reserve requirement and moral persuasion) and to test the research on the role central bank monetary policy in financial sector development with specific focus on the commercial banks and non-bank financial institutions in Mogadishu, Somalia.

##### 5.2.1 Bank rate

Bank is defined as the rate charged by the central bank for lending funds to commercial banks. John and Githari (2006) Bank rates influence lending rates of commercial banks. Higher bank

rate will translate to higher lending rates by the banks. In order to curb liquidity, the central bank can resort to raising the bank rate and vice versa. A bank rate is the interest rate at which a nation's central bank lends money to domestic banks, often in the form of very short-term loans. Managing the bank rate is method by which central banks affect economic activity. Lower bank rates can help to expand the economy by lowering the cost of funds for borrowers, and higher bank rates help to reign in the economy when inflation is higher than (Muganbi,2001), it was clearly indicated that bank rate less correlated with the development of financial sector development .

### **5.2.2 Selective credit controls**

Selective credit control is a tool in the hands of the central Banksto restrict bank finance against sensitive commodities (Drake, 2010).. These sensitive commodities include Food grains i.e., cereals and pulses Cotton textiles, which include cotton yarn. Others defined Jamila (2010) and Joseph (2008) suggested that Selective methods of credit control are a comparatively recent development in monetary management by the central bank. The measures of selective control are sharply distinguishable from the general instruments of credit control in that they are directed towards particular uses of credit and towards total volume of credit (Hassan eta al, 2011).

In fact, selective instruments are designed to influence specific sectors of the economy, which are most vulnerable to fluctuations and require to be controlled, without affecting the economy as a whole. It is because of this specific particularised application that they are called “selective” controls.

### **5.2.3 Reserve requirement**

Banks loan funds out to customers based on a fraction of the cash they actually have on hand. The government makes one requirement of them in exchange for this ability: keep a certain



amount of deposits on hand to cover possible withdrawals. This amount is called the reserve requirement, and it is the rate that banks must keep in the reserve. The Federal Reserve's Board of Governors sets the requirement as well as the interest rate banks get paid on excess reserves (Roosevelt at *el*, 2013)

#### **5.2.4Moral persuasion**

Often termed simply 'suasion', it has been used to persuade banks and other financial institutions to keep to official guidelines. The 'moral' aspect comes from the pressure for 'moral responsibility' to operate in a way that is consistent with furthering the good of the economy. In Australia, the Reserve Bank has shown preference for this type of policy control. In Japan, it is known as 'window guidance' and in the U.S., it is known as 'jawboning' - exercising the persuasive power of talk rather than legislation.(Ali ,2014)

#### **5.3 Conclusions**

Financial sector development has a strong positive and significant correlation on selective credit controls, having correlation coefficient of .563. While other variable also have positive relationship with bank rate, reserve requirement, moral persuasion but the correlation is very weak .this is due to the functions of central bank of Somalia are not properly executed and the central bank did not control all financial activities in the country unless giving licenses for financial institutions, the central did not set the reserve requirements to the financial institutions ,the study also shows that the central bank : the R square shows that the 43.6% of financial sector development( dependent variable ) are explained by monetary policies of central bank such monetary policies bank rate , selective credit controls, reserve requirement and moral persuasion(independent variables) .the correlation is positive but not strong the remaining proportion which is 77.4% is explained by other unknown factors .

#### 5.4 Recommendations

Based on the major findings of this study, the following recommendations were made:

- 1) The central bank of Somalia should start the implementing the monetary policies in order to enhance the financial stability
- 2) The central should draft the commercial bank regulations in Somalia and pass the parliament in order to restart its strangeness.
- 3) The central bank of Somalia should print the new currency, because the monetary policy is all about the money demand and supply .the Somali shillings cannot be trusted anymore because there is no legal tender and it's not controlled by central bank of Somalia.
- 4) The general use of monetary policy such as reserve requirement and bank rate is central body of financial sector in Somalia. With these the financial institutions become chaotic and results local financial crises.

#### 5.5 Areas for further research

The general objective of this study was to investigate the role of central bank monetary policy in financial sector development in Mogadishu, Somalia. Specifically; this study investigated the effects of bank rate, selective credit controls, reserve rate requirement and moral persuasion on financial sector development in Mogadishu, Somalia.

The further studies need to be carried out to identify industry based challenges that these financial institutions face and how best these challenges can be deal with to enhance growth and performance of financial sector such as commercial banks, financial companies, insurance companies and any other institution in the sector.

## 5.6 Limitation

It is essential to note a number of limitations of this study. The possible limitation of this research is the trustworthiness of the data found. Inaccurate results could be a result of the investigation respondents misunderstanding the questions or terminology. This is so because people have got different tastes and feelings hence, resulting in them acting differently. The limitation of this study also include the research only considers the financial institutions in Mogadishu, not other cities such as Hargaisa. The main limitation of this study getting the relevant respondents such government officials or central bank officials for security reasons.

In order to solve these problems and to make ensure the success and reach the final goal of this work the researcherflowed the following procedures:

Through communication with the staff of the important information about the financial sectors ,such as the managers and head offices of the commercial banks , ministry of finance and central bank ,they allowed the researcher to ask questions relevant the issues at hand.the researcher also explained the terminologies that some misunderstandings arose .some people fear from privacy issues in order to solve this the researcher promised for respondents that these informed will be kept as privacy.

**REFERENCES**

- Pétursson, T.(2002). Wage and Price Formation in a Small Open Economy: Evidence from Iceland. Central Bank of Iceland Working Paper 16.
- Faure, A.(2008)). Monetary Policy: Transmision.Cape Town: Quoin Institute
- Kaleem, A. (2000). Modeling monetary stability under dual banking system: the case of Malaysia.International Journal of Islamic Financial Services.
- Sims, C. (1986). Are forecasting models usable for policy analysis? Quarterly Review,Federal Reserve Bank of Minneapolis. Winter: 2-16.
- Hanning, A. and Jansen, S. (2010). Financial Inclusion and Financial Stability: Current Policy Issues. Asian Development Bank, Working Paper Series, No. 259.
- Mavrotas, G. and Son, S. (2004).Financial Sector Development & Growth: Re-examining the Nexus.
- Sunde, T. (2012).Financial Sector Development and Economic Growth Nexus in South Africa.International Journal of Monetary Economics and Finance. Vol. 5(1), 64-75.
- Zhuang, J.et al. (2009).Financial Sector Development, Economic Growth and Poverty Reduction: Literature Review. Asian Development Bank, Working Paper Series, No.173.
- Koivu, T. (2002).Does Financial Sector Development Affect Economic Growth in Transition Countries? For presentation at the ... (BOFIT) Seminar.
- Liang, H. and Reichert, A.K. (2012).Policy-Related Factors on the Relationship Between Financial Sector Development and Economic Growth: Evidence From Advanced Countries. Journal of Business & Economic Studies, Vol. 18, No. 1.
- Sunde, T. (2011).Financial sector development and economic growth in Namibia.Journal of Emerging Trends in Economics and Management Sciences (JEETEMS), 1(2), p. 76-80.
- Fujiwara, I. (2005). Is the Central Bank's Publication of Economic Forecasts Influential? Economics Letters, 89(3): 255–61.

- Kothari, C.R (2013). *Research Methodology-Methods and Techniques* (3rd ed.). New Delhi : New Age International Publishers Ltd.
- Kumar, R. .. (2005). *Research methodology* (2nd Edition) ed.). Sage Publications, London.
- Mugenda, A., & Mugenda, O. (2003). *Research methods; qualitative and quantitative approaches*. Nairobi, Kenya : African Center for Technology Studies,(ACTS).
- Goodhart, C.(2001). *Monetary policy transmission lags and the formulation of the policy decision on interest rates*. Federal Reserve Bank of St. Louis
- Sekaran, U. (2010) *Research methods for business: A skill building approach* (5th ed)USA: John Willey & Sons' publisher.
- Pétursson, T.(2002). *Wage and Price Formation in a Small Open Economy: Evidence from Iceland*. Central Bank of Iceland Working Paper 16.
- Faure, A.(2008)). *Monetary Policy: Transmision*.Cape Town: Qouin Institute
- Kaleem, A. (2000). *Modeling monetary stability under dual banking system: the case of Malaysia*.International Journal of Islamic Financial Services.
- Sims, C. (1986). *Are forecasting models usable for policy analysis?* Quarterly Review,Federal Reserve Bank of Minneapolis. Winter: 2-16.
- Hanning, A. and Jansen, S. (2010). *Financial Inclusion and Financial Stability: Current Policy Issues*. Asian Development Bank, Working Paper Series, No. 259.
- Mavrotas, G. and Son, S. (2004).*Financial Sector Development & Growth: Re-examining the Nexus*.
- Sunde, T. (2012).*Financial Sector Development and Economic Growth Nexus in South Africa*.International Journal of Monetary Economics and Finance. Vol. 5(1), 64-75.
- Zhuang, J.et al. (2009).*Financial Sector Development, Economic Growth and Poverty Reduction: Literature Review*. Asian Development Bank, Working Paper Series, No.173.

- Koivu, T. (2002). Does Financial Sector Development Affect Economic Growth in Transition Countries? For presentation at the ... (BOFIT) Seminar.
- Liang, H. and Reichert, A.K. (2012). Policy-Related Factors on the Relationship Between Financial Sector Development and Economic Growth: Evidence From Advanced Countries. *Journal of Business & Economic Studies*, Vol. 18, No. 1.
- Sunde, T. (2011). Financial sector development and economic growth in Namibia. *Journal of Emerging Trends in Economics and Management Sciences (JEETEMS)*, 1(2), p. 76-80.
- Hall, J. H. (2000). Investigating Aspects of the Capital Budgeting Process Used in the Evaluation of Investment Projects. *South African Journal of Economic and Management Sciences*.
- Fujiwara, I. (2005). Is the Central Bank's Publication of Economic Forecasts Influential? *Economics Letters*, 89(3): 255-61.
- Kothari, C.R (2013). *Research Methodology-Methods and Techniques* (3rd ed.). New Delhi : New Age International Publishers Ltd.
- Kumar, R. .. (2005). *Research methodology* (2nd Edition) ed.). Sage Publications, London.
- Mugenda, A., & Mugenda, O. (2003). *Research methods; qualitative and quantitative approaches*. Nairobi, Kenya : African Center for Technology Studies,(ACTS).
- Goodhart, C.(2001). Monetary policy transmission lags and the formulation of the policy decision on interest rates. Federal Reserve Bank of St. Louis
- Sekaran, U. (2010) *Research methods for business: A skill building approach* (5th ed)USA: John Willey & Sons' publisher.

**APPENDIX****APPENDIX I: QUESTIONNAIRE**

This questionnaire is a designed to the study the role central bank monetary policy in financial sector development .please help us to get the right answer. Your information will be kept strictly confidential. Thank you very much for your time and cooperation. We greatly appreciate the help of your organization and yourself in furthering this research endeavor.

Please tick in the blanks provided as your response.

**1.Gender:**Male ( )Female ( )

**2.Age:**20– 30 ( ) 30 – 40( )

40 – 50( ) 50 and above ( )

**3. Education :** Secondary( ) Diploma ( )

Bachelor ( )Master( )

**4. Title of respondent:**Accountants ( ) Finance mangers ( ) Investors( )

**5. Experience**

1-5 yrs( ) 5-10 yrs( )

10-15 yrs( ) Above 15 yrs( )

**Section (B):**

Please write your rating on the space before each option which corresponds to your best choice.

Kindly use the scoring system below:

Response Mode	Rating	Description	Legend
Strongly Agree	(1)	Very high	SA
Agree	(2)	High	A
Neutral	(3)		N
Disagree	(4)	Low	DA
Strongly Disagree	(5)	Very low	SD

	SA	A	N	D	SD
<b>SECTION C: RESERVE REQUIREMENT</b>					
The reserve requirement plays an important role in financial sector development					
The central bank of Somalia has ability to set the reserve requirement rate					
The reserve requirement is powerful tool to prevent the bank runs and stabilize the banking system					
<b>SECTION D: BANK RATE</b>					
The bank rate plays an important role in financial sector development					
The central bank of Somalia uses a bank rate policy to increase or decrease the volume of credit in the country					
The central bank uses the bank rate policy to control the demand and supply of money					
<b>SECTION E: MORAL SUASION</b>					
Moral suasion plays an important role in financial sector development					
Central bank uses the moral suasion as effective policy to influence the commercial banks					
Moral suasion encourages to the commercial banks that they					



don't give loans to unproductive purpose					
Moral suasion may participate in decreasing the inflation					
<b>SECTION F: SELECTIVE CREDIT CONTROLS</b>					
Credit control may participate the credit balance and have direct relationship to the financial stability					
Reducing the cost of capital of certain commodities may encourage the demand of many people .					
Restrictions of harmful products may have positive effects to the overall economy of the country					

