

Investigating the Effect of Islamic Banking on Poverty Reduction: Empirical Evidence From Mogadishu, Somalia

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Abstract

This study investigates to test and analyze the influence of Islamic banking on poverty reduction. The study mainly looked at the influence of Islamic Banking on poverty reduction and relationship between Islamic Banking and poverty reduction. The researcher used descriptive research design with quantitative methods with sample size of 45, Premier bank manager 17 and 34 Employees. Simple random sampling used to select the sample, and they included staff, operational, secretaries and departmental officers. Using simple random sampling respondents were chosen from the different departments selected and questionnaires distributed to the selected respondents from the four departments in the bank. Primary data used during collection of data. Data collected by use of questioner method and analyzed in form of tables. The Findings shows that Islamic banking influences poverty reduction and has moderate relationship which indicated by R-value ($r=2.71$) and p-value ($p=1.00$). The result identifies that role Murabaha is the major predictors of Islamic banking which influenced positively in poverty reduction. Islamic banking is more important for poverty reduction, researcher recommended giving them high effort, and Management of Premier is encouraged to promote that activity. Also, study indicated that there is moderate relationship between Islamic banking and poverty reduction, so management of the bank should develop and make strong that relationship by providing and facilitating Islamic banking products such Murabaha and Mudarabah. This research makes significant theoretical and practical implications to enrich the existing literature on Islamic banking and contribute to poverty reduction help existing policy makers and Islamic banking institutions to reduce poverty by introducing low-income people to Mubaraha.

Keywords: Islamic Banking, Poverty Reduction, Muaraba, Mudalaba

Introduction

Poverty alleviation in all its forms remains one of humanity's most challenging problems. Poverty has been a constant issue for a long time. Poverty affects people from all over the world whether they are from developed, developing, or underdeveloped countries. This is

why the United Nations Development Program (UNDP) has placed poverty at the top of its priority list for the Sustainable Development Goals (SDGs) program, which is set to be achieved by 2030. Based on data released by UNDP in the Sustainable Development Goals Report, the global population living in extreme poverty or earning less than US\$1.9 per day has been declining since the SDGs were implemented in 2015 until 2019, but at a sluggish rate. Meanwhile, the worldwide extreme poverty percentage fell from 10% in 2015 to 8.2% in 2019. However, a terrible event occurred in 2020, when the COVID-19 triggered a rise in global poverty for the first time in decades, with the extreme poverty rate rising to 8.8% and more than 71 million people being driven into poverty due to this COVID-19.

Islamic banking systems such as Murabaha, Mudalaba, Musharaka, Qarda-Hassan can contribute to reduce poverty and its adverse effects on social development (Jamadar et al., 2024). A bank's primary function is to work as a financial intermediary, collecting money from individuals who have a financial surplus and transferring it to others who have a financial deficit for a variety of purposes. Banks' capacity to channel money is mostly determined by their ability to gather funds from the general public and channel it to productive economic sectors. Poverty has been a major development problem of Indonesia. According to the Indonesian Statistics Bureau, around 29 million people live in poor conditions (Hajad et al., 2023). Poor people do not only have low income but also lack access to the basic needs such as education, health care, clean drinking water and proper sanitation. The most important constraint that poor people face to come out of poverty is the lack of access to credit to run their own businesses due to several reasons. First, formal financial institutions require collateral. Second, they prefer high-income clients with large loans. Third, the bureaucratic processes and procedures in providing loans are complex. Finally, the loan for the poor is not attractive and profitable. So, microfinance became a solution for these problems.

The assets accumulated Islamic banks have ability to overcome the problem of poverty. Through strong Islamic bank assets, a number of industrial sectors will move to boost the economy and also generate opportunities of developing new industrial sectors. It will result in positive effects in which employment increases and everyone's income is sufficient. However, the level of poverty in Indonesia of 18.36% in the last one year is worrying and able to reverse the situation. The high level of poverty generates a question whether Islamic bank has helped much in the poverty alleviation. The lack of breakthrough in the utilization of Islamic bank assets is very likely to trigger the emergence of the poverty problem. Poverty will get strong if the assets of Islamic banks are weak and poverty will get weak if Islamic products are strong.

Several other studies have investigated the role of the of Islamic banking sector in poverty reduction (Saputri & Zamrudi, 2023). The study found that Islamic bank financing has a negative and significant effect on poverty, indicating that when Islamic banks distribute huge quantities of financing, poverty rates would decrease. Poverty reduction and economic growth are significantly influenced by Islamic bank-specific and macroeconomic variables, meaning that the Islamic Banking Industry (IBI) has the potential to contribute to the achievement of the SDGs and hence supports its promotion. Combining Islamic banking with zakat, ushr, waqf, and micro-investments might be a more effective and meaningful strategy for reducing poverty. Islamic banking has shown to be an effective way for poverty reduction. A prior study also discovered a link between banking services and poverty reduction, as well

as the fact that the link occurred through savings rather than credit. The instrumental variable technique, especially fixed-effects two-stage least squares, on a panel of 71 developing nations from 2002 to 2011.

In Somalia, Somalia has in place the Ninth National Development Plan (NDP-9), which envisages a five year (2020-2024) pathway towards economic emancipation and reduction of poverty in the country, hence serves as an Interim Poverty Reduction Strategy Paper (IPRSP) within the framework of the Highly Indebted Poor Country (HIPC) initiative. Satisfactory implementation of the poverty reduction strategy will trigger the completion point of debt relief for Somalia. Quality data and statistics are key for monitoring and evaluating the NDP-9, sectoral plans, and the attainment of Sustainable Development Goals (SDGs) and measure the progress towards the completion point of debt relief. This Poverty Analysis Report relies on the SIHBS—2022 data, whose report the SNBS published and disseminated on February 20, 2023, to analyze and measure current poverty levels and inequalities within Somalia by presenting valuable insights into the dimensions and distribution of poverty across regions and demographic groups as the primary indicator of welfare, as opposed to income. Evidence has shown consumption is not solely pegged on short-term fluctuations in income. Rather, it exhibits smoother and less variable patterns compared to income. The food poverty line (FPL) was first estimated using individual energy requirement by gender and age. Energy requirement by gender and age is multiplied by the population shares by the gender and age distribution obtained from SIHBS-2022. The resultant mean energy requirement for Somalia is 2,200 kcal/person/ day, which is used as the minimum energy requirement for the food poverty line. A non-food allowance is then also calculated and combined with the food poverty line to produce the overall poverty line. According to this poverty analysis generated from the SIHBS—2022, 54.4 percent of Somali population live below the poverty line, as they consume less than \$2.06 per day. This aggregate measure encompasses expenditure on two main components: food and non-food consumption. Non-food consumption by households was collected in separate sections of the SIHBS 2022 questionnaire with recall periods of 7 days, one month, six months or one year depending on the item

Problem Statement

Islamic banking play's critical role in economic growth and economic development in many countries around the global. As indicated, the above discussion, it is clear that Somalia is one of poorest country in the world as according to this poverty analysis generated from the SIHBS—2022, 54.4 percent of Somali population live below the poverty line, as they consume less than \$2.06 per day. This poverty led to the country to remain tremendous economic challenges and negatively affect the standard living in the country. To solve these obstacles several other studies have investigated the role of the of Islamic banking sector in poverty reduction.

Although many studies related to the problem under investigation have been conducted in many parts of the world, yet there is a literature gap in the study area, therefore, this study is aimed to bridge this literature gap and find out the effect of Islamic banking on poverty reduction in Mogadishu, Somalia.

Limitations

- 1) Due to restrictions of time and sample responsiveness, the sample size was restricted
- 2) As the questionnaire was narrowed, some factors could not be studied in depth

- 3) Since population was too much sample has been taken from the population since some of good respondents has been left.
- 4) The time was allocated this paper was only two months

Literature Review

Assets of Islamic banking

The ability of total assets of Islamic financial institutions in handling the poverty issues has been explained by experts in various ways. The effectiveness of poverty alleviation cannot be directly felt through total assets but by allocating part of it in CSR activities. Some research in several countries has proven that microfinance is able to penetrate marginal groups effectively (Gupta & Sharma, 2023). With the full support from Islamic financial institutions, SMC is able to answer the challenges of poverty problems innovatively. The successes of SMC are: (1) the establishment of small firms with high employment, (2) the spread of capital for microentrepreneurs and smallholders, and (3) the development of empowerment programs for the poorest communities. However, all these views indicates that all Islamic banks relate poverty alleviations. in a comparative study, the Islamic banking sector is documented to play a bigger role in poverty reduction as compared to their conventional banking counterparts in Indonesia, Malaysia, Iran, Saudi Arabia, Turkey, and Sudan

Murabaha

Murabaha is one of the most commonly used modes of financing by Islamic banks and financial institutions (Faizin & Djayusman, 2023). Murabaha is a particular kind of sale where the seller expressly mentions the cost he has incurred for the sold commodity, and sells it to another person by adding some profit thereon. Thus, Murabaha is not a loan given on interest; it is a sale of a commodity for cash/deferred price. A Mudarabah agreement creates a partnership business whereby an investing partner (rab al maal) brings capital and a working partner (mudarib) brings time and effort to share in profits according to a percentage agreed upon beforehand. The investor has no direct involvement with the management of the business after the investment is made, though there are restricted Mudarabahs that specify the kind of venture intended, and unrestricted Mudarabahs that leave all discretionary powers in the hands of the worker to invest capital in the most productive manner possible. The investor has the right to oversee business activities and, to the extent agreed upon by the mudarib, work directly with the mudarib. The worker has a fiduciary responsibility to the investor to maximize profits, within the parameters of the Shariah, because the investor is the one owning all the assets and bearing all the losses. There is no salary for the worker in a Mudarabah; he takes only that share of the profits to which he is entitled, while expenses relating to the business come from the business itself.

The Bai' Murabaha involves the bank's purchase of a commodity on behalf of a client and its resale to the latter on a cost-plus-profit basis. Under this arrangement the bank discloses its cost and profit margin to the client. In other words rather than advancing money to a borrower, which is how the system would work in a conventional banking agreement, the bank will buy the goods from a third party and sell those goods to the customer for a pre-agreed price.

Research Objectives

1. To find out the role of Murabaha in poverty reduction.
2. To examine the effect of Mudarabahin poverty reduction.

3. To determine the role of Musharakah in poverty reduction.

Research Questions

1. What is the role of Murabaha in poverty reduction?
2. What is the effect of Mudarabah in poverty reduction?
3. What is the role of Musharakah in poverty reduction?

Research Methodology

Research Design This study is a cross-sectional type of investigation in which the data collected at snapshot of one time because a cross-sectional study is particularly suitable for estimating the prevalence of a behavior in a population. In this research, a survey design contains a quantitative research approach employed using structured questionnaire as the main source of the research instrument.

Data Analysis Plan

This study investigates to test and analyze the influence of Islamic banking on poverty reduction” The study mainly looked at the influence of Islamic Banking on poverty reduction and relationship between Islamic Banking and poverty reduction. The researcher used descriptive research design with quantitative methods with sample size of 45, Premier bank manager 17 and 34 Employees. Simple random sampling used to select the sample, and they included staff, operational, secretaries and departmental officers. Using simple random sampling respondents were chosen from the different departments selected and questionnaires distributed to the selected respondents from the four departments in the bank. Primary data used during collection of data. Data collected by use of questioner method and analyzed in form of tables

Data Analysis

In order to examine whether Islamic banks including (Mubarabaha, Mudalaba, and Musharaka) impact on poverty reduction data it was first tested whether the data showed a normal distribution. Analysis of data in this study was done concurrently with data collection. After data collection the questionnaires of respondents were sorted out accordingly; responses were verified, coded, categorized and entered into the computer using statistical package for Social Sciences (SPSS) version 20.0 software. For easy understanding and following of the results, descriptive data analysis was used and the results were presented using mean and standard deviation.

Descriptive Analysis of the Variables

Statement	Mean	SD
Musharakah takes part improvement of national economy	4.29	.895
Musharakah products are increasing day to day as well as other products	2.91	.596
Musharakah need to improve their marketing strategy effectively by addressing the market ignorance about musharakah products and services	2.13	1.17
Islamic banking institutions all over the world try to benefit from the institutional framework that supports conventional banking	4.13	.548
Musharakah takes part improvement of national economy	3.91	1.04
Total Average Mean	3.47	0.85

Source: Primary Data, 2024

Table 1 Shows that most of the respondents agreed that musharakah has good influence to poverty reduction which was indicated by mean value of (M=3.47) and standard deviation (SD=0.85).

Statement	Mean	SD
Murabaha you acquired from Islamic banks Institutions has improved your business	4.31	.557
Promoting Islamic values and way of life towards staff, clients and offering general public	4.91	.288
Murabaha has no adopted as a mode of interest-free financing as well as a large number of banks	1.27	.447
Many customers think Islamic Banking and Financial Services is Investing in business where there is no Gharar	4.24	.645
Murabaha you acquired from Islamic banks Institutions has improved your business	1.42	.499
Total Average Mean	3.23	0.49

Source: Primary Data, 2024

Table 2 Shows that most of the respondents agreed that Murabaha has good influence to poverty reduction which was indicated by mean value of (M=3.23) and standard deviation (SD=0.49).

Statement	Mean	SD
Because of the religious dimension of Islamic banking and finance, no new product can be adopted until it is cleared by <i>shari 'ah</i> scholars	4.47	.625
Small businesses in Mogadishu endure with High transaction cost when taking Islamic bank loans	4.64	.645
Mudarabah are important factors for the development of Islamic banking.	1.60	.688
Small businesses incur high costs when forming groups to obtain loans	1.44	.546
Because of the religious dimension of Islamic banking and finance, no new product can be adopted until it is cleared by <i>shari 'ah</i> scholars	4.58	.499
Total Average Mean	3.35	0.60

Source: Primary Data, 2024

Table 3 Shows that most of the respondents agreed that Mudarabah has good effect on poverty reduction which was indicated by mean value of (M=3.35) and standard deviation (SD=0.60).

Statement	Mean	SD
Growth of Islamic banks undertaking is more imperative to growth of national economy	4.51	.506
Development of economics is driven by different elements not Islamic banking products	4.13	.625
Islamic banking has affecting to growth of national economy	4.51	.506
In Somalia, Islamic banking industry has emerged as one of the fastest growing industries and has spread to all corners of the country, receiving wide acceptance from Muslims living Somalia	4.44	.503
Total Average Mean	4.40	0.54

Source: Primary Data, 2024

Table 4 Shows that most of the respondents strongly agreed that Islamic banks has good effect on poverty reduction which was indicated by mean value of (M=4.40) and standard deviation (SD=0.54).

Correlation Analysis

Table 5

Islamic Banking and Poverty Reduction

		Islamic Banking	Poverty reduction
Islamic Banking	Pearson Correlation	1	.361*
	Sig. (2-tailed)		.015
	N	45	45
Poverty reduction	Pearson Correlation	.361*	1
	Sig. (2-tailed)	.015	
	N	45	45

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

Source: Primary Data, 2024

Table 5 above shows correlation between Islamic banking and poverty reduction. The result obtained indicated that there is significant moderate relationship between Islamic banking and Poverty reduction. The findings indicate that there is positive relationship Islamic banking and Poverty reduction which was indicated by r-value ($r = .361$) and p-value ($p = 0.015$) as shows in the table.

Findings and Conclusions

The first objectives the was found that that most of the respondents agreed that musharakah has good influence to poverty reduction which was indicated by mean value of ($M=3.47$) and standard deviation ($SD=0.85$).

The second was found that of the respondents agreed that Mudarabah has good effect on poverty reduction which was indicated by mean value of ($M=3.35$) and standard deviation ($SD=0.60$).

The third objectives were found that of the respondents agreed that musharakah has good influence to poverty reduction which was indicated by mean value of ($M=3.47$) and standard deviation ($SD=0.85$).

Recommendation

This study recommended those banks and other Islamic financial institutions which offer Islamic products should offer to community the different ways of Islamic products such as Murabaha to reduce or alleviate poverty and make it easy for the accessibility of Mubaraha. In addition, is needed to determine outcomes of the impact of Islamic banking on poverty reduction which include of outside of Mogadishu and also several studies after this paper will be conducted and also recommends to use a bigger sample size.

Conclusion

This section discovers the research result and findings derived from the distributed questionnaires. The main objective of this study was to examine "To examine the role of Islamic banks in entrepreneurship development". The study had three objectives, the mean value of the first question in relation to the first objective was 3.47 which indicates agree level so this indicates that the answer shows that there is a very good level. The second objective's mean value was 3.23 which indicates agree level so this indicates that the answer shows that there is a very good level. The objective three mean value was 3.35 which means strongly agree level so this indicates that the answer shows that there is a very good level.

Finally, the study indicates the correlation between the two variables which are Islamic banking and poverty reduction is measured using Pearson's correlation method with two tailed and the relationship between the two variables were positive relationship with R-value of 0.361 and this information indicates that there is moderate positive significant relationship between Islamic banking and poverty reduction.

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