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ROLE OF ISLAMIC BANKING PRACTICES ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN SOMALIA

Abdaziz Ahmed Mohamed[1], Dr. Oluoch Oluoch[2]

[1,2] Department of Economics, Accounting and Finance,College of Human Resource & Development (COHRED),

Jomo Kenyatta University of Agriculture and Technology,Nairobi, Kenya

Abstract: **With the slowing economy, the Somali banking industry experienced a drop in performance as of December 2017. During the year 2017, the industry recorded a 9.6% drop in earnings after taxes. The NPLs ratio increased to 12.3 percent in December 2017 from 9.3 percent in December 2016, indicating a decrease in asset quality. The overall goal was to determine how islamic-compliant banking affects the financial performance of selected Somalia commercial banks. Innovation diffusion theory, Modern portfolio theory, and Agency theory led the research. The longitudal research design was used in the study since it helped in the construction of an issue for a more detailed inquiry. There were four commercial banks operating islamic banking in the population. Because the study solely looked at commercial banks operating islamic banking in Somalia, this population was chosen. Because the population is tiny, a census design was used to ensure that all commercial banks who do islamic banking as part of their primary business are included in the study. Data from a secondary panel was used. For the period 2015 to 2020, data on liquidity, asset quality, efficiency, and management quality were gathered from bank supervision reports and chosen bank final audited financial and income statements. The statistical package for social science software was used to do the data analysis (SPSS). The data was seen, analyzed, and documented using SPSS. The descriptive statistical tools aided in the description of the data as well as the amount to which it would be employed. The study's findings revealed that commercial bank asset quality has a beneficial impact on the financial performance of commercial banks in Somalia. The positive association also suggests that asset quality influences financial performance by attracting new clients. Second, the study found that liquidity management had a favorable impact on the financial performance of a few commercial banks. Asset quality ratios demonstrated how the chosen banks fared in terms of placements and advances. The outcomes of the study show a relative stability and growth in liquidity management in the financial performance of the commercial banks studied. Credit risk monitoring and management allow banks to protect their assets and shareholders' interests. The study discovered a weak positive link between the size of a company and its financial performance in Somalia's commercial banks. The selected banks demonstrated an upward trend in company size over a five-year period, leading to the conclusion that firm size had a beneficial impact on the financial performance of Somali banks. The study came to the conclusion that managerial efficiency has a considerable impact on commercial bank financial performance. Over a five-year period, the data demonstrated a continuous increase in management efficiency at the selected commercial banks, as well as a corresponding increase in bank performance. According to the findings, bank management should place a greater emphasis on cost efficiency in order to achieve the ideal expense level in banks. According to the findings, banks should seek liquidity support from the central bank by raising pre-positioned assets that can be used as collateral during a crisis.**

Keywords: **The author gives 4 – 10 keywords which are related to the major part of their research work.**

I. INTRODUCTION

1.1 Background of the Study

With the slowing economy, the Somali banking industry experienced a drop in performance as of December 2017. During the year 2017, the industry recorded a 9.6% drop in earnings after taxes. The Nonperforming loans ratio increased to 12.3 percent in December 2017 from 9.3 percent in December 2016, indicating a decrease in asset quality. The overall goal

was to determine how islamic-compliant banking affects the financial performance of selected Somalia commercial banks. Innovation diffusion theory, Modern portfolio theory, and Agency theory led the research. The descriptive research strategy was used in the study since it helped in the construction of an issue for a more detailed inquiry. There were four commercial banks operating islamic banking in the population. Because the study solely looked at commercial banks operating islamic banking in Somalia, this population was chosen. Because the population is tiny, a census design was used to ensure that all commercial banks who do islamic banking as part of their primary business are included in the study. Data from a secondary panel was used. For the period 2015 to 2020, data on liquidity, asset quality, efficiency, and management quality were gathered from bank supervision reports and chosen bank final audited financial and income statements. The statistical package for social science software was used to do the data analysis (SPSS). The data was seen, analyzed, and documented using SPSS. The descriptive statistical tools aided in the description of the data as well as the amount to which it would be employed. The study's findings revealed that commercial bank asset quality has a beneficial impact on the financial performance of commercial banks in Somalia. The positive association also suggests that asset quality influences financial performance by attracting new clients. Second, the study found that liquidity management had a favorable impact on the financial performance of a few commercial banks. Asset quality ratios demonstrated how the chosen banks fared in terms of placements and advances. The outcomes of the study show a relative stability and growth in liquidity management in the financial performance of the commercial banks studied. Credit risk monitoring and management allow banks to protect their assets and shareholders' interests. The study discovered a weak positive link between the size of a company and its financial performance in Somalia's commercial banks. The selected banks demonstrated an upward trend in company size over a five-year period, leading to the conclusion that firm size had a beneficial impact on the financial performance of Somali banks. The study came to the conclusion that managerial efficiency has a considerable impact on commercial bank financial performance. Over a five-year period, the data demonstrated a continuous increase in management efficiency at the selected commercial banks, as well as a corresponding increase in bank performance. According to the findings, bank management should place a greater emphasis on cost efficiency in order to achieve the ideal expense level in banks. According to the findings, banks should seek liquidity support from the central bank by raising pre-positioned assets that can be used as collateral during a crisis.

1.1.1 Islamic Compliant Banking

In Egypt, Islamic banking was established in 1963, and in 1970, it was introduced to a number of traditional financial systems in Arabic and Asian countries, as well as a number of fully-fledged banks around the world (Usman and Khan, 2012). There are more than 300 Islamic-compliant financial institutions scattered throughout fifty-one nations. During the last decade, the Islamic banking sector has enjoyed extraordinary growth rates of 10% to 15% each year, and this trend is projected to continue (Sole, 2007). As the demand for ethical products and socially responsible services grows, commercial banks are becoming more interested in diversifying their portfolios by investing in Islamic-compliant financial products (Alharbi,2015). Unlike commercial banks, which borrow and lend funds in their operations, Islamic banks partner with their depositors by investing their funds in productive direct investment (Suleiman, 2001). The basis of commercial banking is based on interest, whereas the policy of Islamic banking is based on the prohibition of interest in performing their functions as financial intermediaries. The Islamic PLS principle establishes a partnership and financial trust between the borrower, the lender, and the intermediary (Yudistira, 2003). In comparison to commercial banks, Islamic Compliant banks seek a more equitable allocation of resources. Islamic faith should guide the operations of Islamic-compliant banks, which should function within Islamic Law's limitations.

1.2 Statement of the problem

Commercial banks are vital to a country's economic growth and stability. In their fundamental activity, commercial banks act as intermediaries, receiving deposits from depositors and lending them to borrowers. Commercial banks are vital in wealth generation, job creation, and risk diversification. Banks in Somalia have experienced many challenges. According to the CBK report (2000), the overall number of banks decreased from 67 in 1999 to 60 in 2000. Mergers, bank liquidations, and bank closures reduced this to 43 banks. However, between 2008 and 2014, Islamic funds' assets climbed 13.5 percent annually, surpassing US60 billion, according to a World Bank analysis (2017). In December 2017, the Somali banking industry had a fall in performance due to slow economic growth. In 2017, the industry's earnings after tax fell 9.6%. The Nonperforming loans ratio increased from 9.3 percent in December 2016 to 12.3 percent in December 2017. Central bank of Somali regularly monitors financial institutions that had their asset quality deteriorate during the year (CBS, 201 21).

The 2008-2009 financial crisis and the apparent improved economic performance of IBs during the crisis have raised doubts about the commercial banking system's proper functioning (Hassan & Dridi, 2011). Customers' attention has been drawn to Islamic-compliant banking globally. a Muslim, Ali, Chin-Hong (2015). That's because sharia compliant banks performed better throughout the financial crisis, whereas conventional banks' economic performance declined (Hamid and Masood, 2011). Clients seeking sharia compliant services and goods can find them in the Middle East and Asia (Newell and Osmadi, 2009). These are Istisna, Ijarah, Salam, Murabaha, and Musharakah. The fast expansion of sharia compliant banking as an alternative to the dominant and powerful commercial banking sector has prompted most countries to adopt a dual banking system.

The Islamic banking sector has grown between 10% and 15% each year for the last decade, and this trend is projected to continue. Despite its rapid growth and penetration into the traditional financial system, Islamic finance and banking remain unknown to most practitioners and policymakers. The literature on Islamic banking and finance has considerable gaps. Few scholars have compared islamic compliant and commercial bank performance, specifically profitability and efficiency, using diverse sample selection and research approaches. According to emerging financial trends, Islamic banking will progressively penetrate mainstream systems. Thus, policymakers and practitioners must be aware of new trends, processes, and their consequences for financial supervision. 2007)

1.3. Objectives of the Study

Both the general and specific objectives guided the research study.

1.3.1 General objectives

The general aim was to establish the influence of islamic banking on financial performance of selected commercial banks in Somalia

1.3.2 Specific Objectives

i. To determine the influence of asset quality on financial performance of selected commercial banks in Somalia.

ii. To examine the influence of liquidity management on financial performance of selected commercial banks in Somalia.

iii. To explore the effect of firm size on financial performance of selected commercial banks in Somalia.

iv. To establish the influence of management efficiency on financial performance of selected commercial banks in Somalia.

1.4. Research Questions

- What is the influence of asset quality on financial performance of selected commercial banks in Somalia? What is the influence of liquidity management on financial performance of selected commercial banks in Somalia?
- What is the effect of firm size on financial performance of selected commercial banks in Somalia?
- What is the influence of management efficiency on financial performance of selected commercial banks in Somalia?

1.5 Significance of the Study

This research will be beneficial to Commercial Banks and financial institutions to better strategize on the future opportunities that *islamic* banking provides through diversification. Commercial banks looking to diversify into *islamic* banking could rely on this research to further understand the feasibility of future investments in *islamic* banking. It will also assist in Policy formulation regarding introducing *Riba* Accounts and implement policies that support a conducive environment for Islamic banking growth in the country.

The government will benefit from the study, being a custodian of public interest; they will use the study information on regulations besides government relies on commercial banks in the form of taxes and revenues. The government will also be tasked with policy formulation and institutional infrastructure that would ensure they create a conducive environment for islamic banking to take root in Somalia.

The research will be a resourceful piece of literature. Researchers in the field of finance and banking will find this study as a valuable guide for carrying out further research in the area. This study will impact the public in decision making

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especially on deciding which banking system is more convenient and appealing to them. Bank employees will use the survey to understand their knowledge in *Islamic* banking better. They will be able to provide information to clients regarding the banking system and services they are offering.

1.6 Scope of the Study

The scope of this research was on the effect of *islamic* -compliant banking on the financial performance of selected commercial banks in Somalia. These selected banks were Dahabshiil Bank International Bank, Salaam Somali Bank, Premier Bank and Amal Bank (Sahil). The population of focus was all the commercial banks operating islamic banking in Somalia. Data was obtained from the CBS Bank supervision annual report financial statements and comprehensive income reports of the selected commercial banks. The time frame for the study was between the year 2015 and 2020.

II. LITERATURE REVIEW

2.1 Theoretical Literature

There are several hypotheses that explain why commercial banks diversify in order to increase their profitability. The theories of innovation diffusion, modern portfolio, and agency theory served as guides for the investigation. The three ideas are addressed in detail in order to explain how the introduction of Islamic banking has an impact on the profitability of commercial banks that operate Islamic windows.

2.2 Conceptual Framework

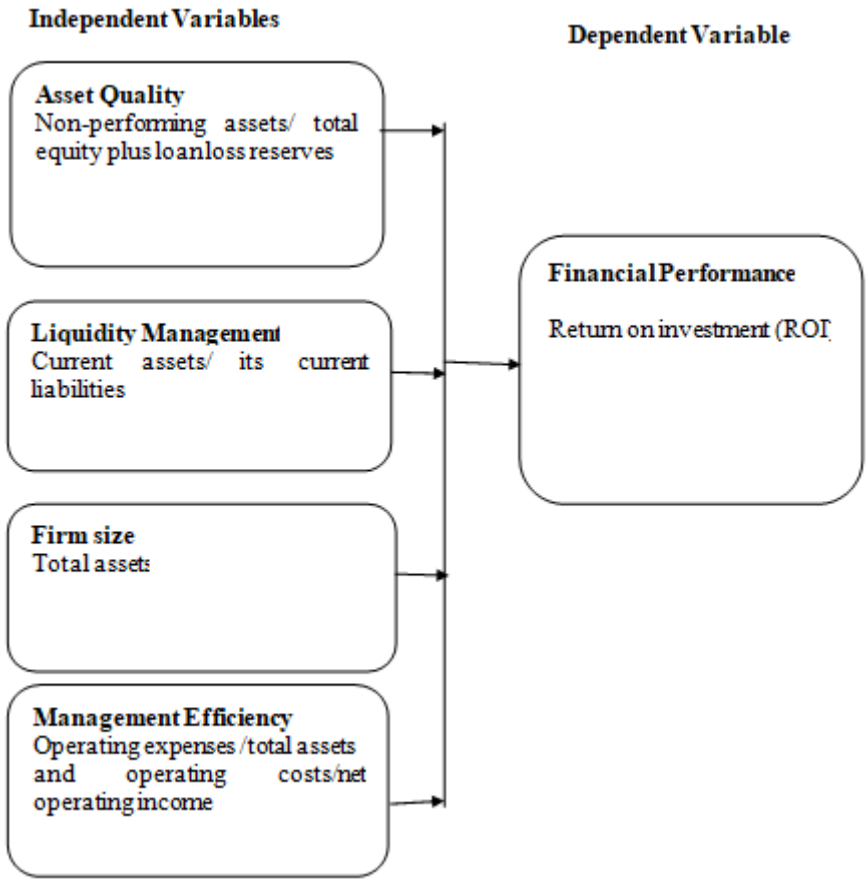

Figure 1

Asset quality measures the financial institutions ability to manage it assets and how well it can predict the credit risk associated with its assets. On the other hand, financial performance measures how well financial institutions can utilize its assets from its core business to generate revenue. Sowerbutts and Zimmerman (2016) illustrated theoretically how management choices on loan portfolio concentration were a critical contributing and determining factor to the financial performance of financial institutions. They attributed robust financial performance of financial institutions to quality

management. Quality management was assessed in term of control of banks policies, performance and senior staff knowledge and skills.

On the other hand, Sheikhdon, (2016), noted that weak liquidity management in financial institutions negatively affects earnings and capital. Bank failure and insolvency is the extreme consequence of poor liquidity management as distressed banks can only access funds at exorbitant interest rates in the market. Eventually this scenario leads to a decline in the earning of the institution. Banks capital may be put at stake when additional borrowing is acquired to meet the depositors demand. On firm size, Compared to small firms, large firms have ability to efficiently manage their working capital components .Economies of scale is enjoyed by large firms as they are able to boost firm's financial performance and mitigate their costs. This postulates that strong positive relation is expected between profitability and the size of the firm (Aguenaou, Lahrec, and Bounakaya, 2017). Lähtinen and Toppinen (2008), in their report, found out that the management efficiency, explains better statistically on the short term financial performance, while value added creation has a long term positive effect on the turnover growth and financial performance of the firms. Management efficiency is a prerequisite for any business survival and the recent economic recession of 2008-2009 is one of the examples that confirm its validity (Lähtinen and Toppinen, 2008).

III. RESEARCH METHODOLOGY

Research Design

The longitudinal research design was employed in the research this is since it aided in constructing a problem for a more precise investigation. A longitudinal study is a type of correlational research study that involves looking at variables over an extended period of time. longitudinal Research design suggests (Mugenda, & Mugenda, 2011) linkages that exist between variables through observation of existing phenomena and researching through available data in order to identify plausible relationships (Kothari, 2004).

Target Population

The target population was 4 commercial banks operating islamic Banking, (Appendix 1). The justification for this population was because the study only considered commercial banks operating islamic banking in Somalia. The unit of analysis was 4 commercial banks operating islamic banking in Somalia.

Sampling Technique and Sample Size

The sampling design describes the sampling unit, sampling frame, sampling procedures and the sample size for the study. The sampling frame describes the list of all population units from which the sample is selected (Cooper & Schindler, 2006). Since the population was fairly small, a census design was employed to ensure that all commercial banks operating islamic banking in conjunction with its core business are participants to the study (Mugenda, & Mugenda, 2011). The unit of analysis is commercial banks operating islamic banking in Somalia.

Data Collection Procedure

Secondary data was acquired from banks financial reports and websites of the licensed commercial banks operating islamic banking in Somalia. Data was obtained from the end year annual financial statements for Somalia commercial banks operating islamic banking between 2015 and 2020.

Statements of annual financial position and comprehensive income statements of the selected commercial banks were used to construct variables of interest. The time frame of the study ensured that multiple financial cycles are fully represented, with the data providing definite bank observations. Data on Liquidity, asset quality, efficiency, firm size and management efficiency was all obtained from financial reports.

Data Presentation and Data analysis

Analysis involved examination of collected data then creating deductions and inferences from the data (Kombo & Tromp, 2006). The quantitative Data was organized by use of descriptive statistics which included percentages, frequencies, standard deviations and mean (Cooper, & Schindler, 2006). The analysis involved the use of descriptive, regressive and correlation techniques. The data analysis was executed using the Statistical Package for the Social Science software, (SPSS). SPSS was used to observe, analyze and document the data. The descriptive statistical tools assisted in describing the data and the extent to be used.

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IV. STUDY RESULTS, INTERPRETATION AND DISCUSSION

4.1 Introduction

This chapter discusses the presentation and interpretation of the study findings. The chapter comprises of; descriptive statistics, correlation analysis, regression model summary, analysis of variance and multiple regression analysis

Table 4.1: Descriptive Statistics: Islamic Banking and Financial Performance

	Asset Quality	Liquidity Management	Firm size	Management Efficiency	Financial performance
Mean	0.06	67.85	5.22	49.68	2.56
Median	0.012	67.7	5.4	54.9	2.73
Highest(2013)	1.232	2.97	0.32	0.67	4.98
Lowest(2017)	0.248	2.68	0.25	0.54	2.01
Std. Dev	0.299	0.18	0.724	1.035	0.71

Study Variables *Source: Researcher (2019)*

The findings on Table 4.1 indicates that the mean for asset quality liquidity management, firm size, management efficiency and financial performance was lowest in 2019 as indicated by 0.248,2.68, 0.25,0.54 and 2.01 respectively while in 2015 high levels were recorded as indicated by 1.232, 2.97,0.32, 0.67, 4.98. This implies that the general financial performance of banks decreased gradually for the five years. The findings are in line with CBK, report (2018) that lending was also affected by the adverse operating environment, with gross lending decreasing by 5 percent to Ksh.2.16 trillion in 2019 from Ksh.2.29 trillion in 2018. Credit risk was enhanced in 2019 as economic activity slowed down during the protracted election period (CBK, 2018). The slowdown in economic activity affected debt servicing across the sectors

as well as overall asset quality in the banking sector. The findings concur with CBK report, (2018) that Lending was also affected by the adverse operating environment, with gross lending decreasing by 5 percent to Ksh.2.16 trillion in 2019 from Ksh.2.29 trillion in 2018.

4.1.1 Financial Performance

Return on investment ratios indicates banks efficiency in generating revenues from assets before contractual obligations are honored. Higher return on investment signifies better financial performance. Table 4.2 analyzes the higher return on investment of the selected banks from year 2015-2016

Table 4.2: Return on Investment (ROI)

Variable	Year	N	Mean	StDev	Min	Max	Qi	Q3	CoVar
ROI	2015	4	0.012	0.021	- 0.059	0.07	0.009	0.039	0.0844
ROI	2016	4	0.018	0.012	- 0.031	0.05	0.015	0.031	0.79
ROI	2017	4	0.021	0.019	-0.029	0.088	0.08	0.036	0.7
ROI	2018	4	0.037	0.018	- 0.098	0.059	0.009	0.037	1.601
ROI	2019	4	0.042	0.048	-0.174	0.06	0.014	0.05	3.742

Source: Adopted from the CBS (CBS 2018)

Table 4.2 outlines the performance of ROI from year 2015-2016. ROI posted the highest mean of 0.042 in 2019 and lowest mean of 0.012 in 2015. These findings show the steady rise in the 4 commercial banks performance over the period. This reveals that islamic banking significantly contributed to productivity of commercial banks. ROI indicates the performance of banks and how efficiently bank assets are being utilized. The study findings reveal enhanced bank performance in return on investment over the period of the review that reflects general financial performance improvement by the banks. The ROI value mean showed an improvement of 0.042 in the year 2019 from a mean of 0.012 in the year 2015. This shows a steady increase in financial performance over the five years by the selected commercial banks. Hence introduction of islamic banking by the commercial banks enhances bank financial performance. The findings are in concurrence with Haque and Sharma, (2017) research conclusions, who indicates that profitability is high

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in islamic compliant banks than their commercial counterparts who predominantly enjoy similar balance sheet structure. They argue that insolvency risk and lower cost to income ratio in islamic banks is low as well have lower non-performing loan ratios; further they have a higher ROI and are better capitalized due to being conservative in nature when it comes to provisions for non-performing loans.

Return on investment indicates how effectively the banks utilize their assets to generate revenue before payments of contractual obligations are honored. The higher the ratio of ROI, the better the banks performance, as it is able to generate more earnings from its assets. Return on investments (ROI) for banks depends on the banks policy decisions and uncontrolled factors relating to government regulations and economy. Majority of the regulators agree that the superior measure of bank efficiency is ROI. The findings are in line with Salim and Mohamed, (2016) that banks financial performance guides outcome analysis of policies, performance, efficiency and effectiveness of the firm in economic terms. This reflects in the bank's profit earning, return on investment and return on investment.

4.1.2 Asset Quality

Asset quality ratios demonstrate banks' ability in managing outstanding loans. Table provides the result of how the asset quality ranked performed in relation to financial performance of the selected banks

Table 4.3: Asset Quality

Variable	Year	N	Mean	StDev	Min	Max	Qi	Q3	CoVar
AQ	2015	4	0.112	0.04	-0.197	0.5	0.068	0.264	0.06
AQ	2016	4	0.117	0.11	-0.187	0.453	0.104	0.303	0.012
AQ	2017	4	0.156	0.192	-0.372	0.412	0.055	0.298	1.232
AQ	2018	4	0.166	0.196	-0.421	0.487	0.049	0.264	1.248
AQ	2019	4	0.160	0.22	0.423	1.154	0.11	0.349	0.299

Source: Adopted from the CBS (CBS 2021)

LDR (Total loans over total deposits) ratio calculates the percentage of the total bank loans financed by bank deposits; higher LDR ratio indicates banks effectiveness and bank superiority management in sourcing for more deposits from dependent and financially strong investors and clients. The research findings reveal that the lowest value of asset quality was in the year 2015 with a mean of 0.112 and the year 2018 posted the highest asset quality ratio of 0.166. The standard Deviation values indicate variability, with the lowest deviation of 0.04 in year 2013 and the highest value of 0.22 in the year 2019. This reveals a slight increase over a period of five years in the asset quality ratios of the selected commercial banks. Thus, the financial performance of the selected banks was positively impacted by the asset quality ratios. The findings are in line with Pinto, et al, (2017), financial performance evaluation is a subjective measure to assess firm's usage of assets from its core business operations and generation of revenues

4.1.3 Management Efficiency

Efficiency ratio enables banks to evaluate financial performance as it measures the banks capacity to convert assets into revenues. Table 4.4 shows the value of efficiency ratios in relation to return on investment of the selected banks.

Table 4.4: Management Efficiency

Year	**Return on investment (%)**	**Efficiencies**
2015	2.89	0.67
2016	2.45	0.68
2017	3.32	0.68
2018	3.97	0.69
2019	4.65	0.69
Totals	3.456	0.682

Source: Researcher (2021)

From the data, the average Return on investment was usually on the rise for the five- year period to 2015 accompanied by a similar rise in efficiency. As can be noted, there is a general increment for ROI from 2.89% in 2013 to 4.65% in 2019. From the findings, it can generally be deduced that return on investment for the banks rose concurrently with a rising

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efficiency over the 5-year period. Bank efficiency ratio enables business analysts to evaluate the performance of commercial banks over time. Efficiency ratios provide banks with an easy way to measure its ability to convert investments into revenues. Table 4.1 illustrates efficiency ratio drift of the selected commercial banks from 2015 to 2019. The banks posted a minimum efficiency ratio of 0.54 in the year 2019 and highest efficiency ratio of 0.67 in the year 2019. The findings concur with Majakusi, (2016), efficiency measurement determines how banks provide an optimal combination of financial services with a set of inputs. On the one hand, one is asking oneself bank capability to efficiently and technically produce, financial services for economic agents. On the other hand, banks as financial companies look for profitability.

4.1.4 Liquidity Management

Liquidity is essential for banking as the core business in based on lending and borrowing. Determining the financial institutions capacity in clearing all debts using the available assets is liquidity's fundamental purpose. Table 4.5 provides how Liquidity ratio of the selected banks performed against the other factors in relation to the influence on banks financial performance from year 2015-2019.

Table 4.5: Liquidity Management

Variable	Year	N	Mean	StDev	Min	Max	Qi	Q3	CoVar
Liq	2015	4	0.671	0.753	1.263	5.802	1.377	1.739	0.429
Liq	2016	4	0.725	0.140	0.251	0.831	0.015	0.031	0.209
Liq	2017	4	0.709	0.262	0.279	2.058	0.08	0.036	0.369
Liq	2018	4	0.703	0.159	0.155	0.883	0.009	0.037	0.226
Liq	2019	4	0.849	0.143	0.080	0.880	0.014	0.05	0.197

Source: Adopted from the CBS (CBS 2021)

The study exposed in Table 4.5 that the commercial banks reviewed had lowest liquidity ratio mean of 0.671 in the year 2015 and highest mean of 0.849 in the year 2020. This illustrates a liquidity ratio increment in year 2018 to 2020 of the selected commercial banks. The findings concur with Talam (2014), found that Somalian commercial banks' financial performance was impacted positively by liquidity ratio. Liquidity ratio points out the financial soundness and strength or weakness of a financial institution and its capability in clearing outstanding obligations and is of utmost importance to potential bank investors, borrowers, shareholders and business analysts. The possibility for a bank to experience financial turmoil is higher when the liquidity ratio is lower.

The statistics show stable liquidity for banks except in 2015 when the liquidity increased significantly, a year before general elections. In 2015, banks invested heavily in marketable securities and treasury bills. From 2016, the banks have been increasing their liquid assets relative to other assets. The increase in liquidity ratios of the selected banks can be mainly attributed to a higher growth in total liquid asset compared to the growth in total short-term liabilities. Consequently, Banks liquidity ratio had a significant impacted the Somalian commercial bank's financial performance. The findings in tandem with past research studies conducted by Sheikhdon (2016), who concluded that islamic banks are more profitable and effective in cost than their counter parts as they don't suffer from surplus liquidity. **Firm size**

Keeping all other factors constant, firm size determines the level of risks it is exposed to. Table 4.6 provides for the firm size of the selected banks against the other factors in relation to the influence on banks financial performance from year 2015-2019.

Table 4.6: Firm size

Variable	**Year**	**N**	**Mean**	**StDev**	**Min**	**Max**	**Qi**	**Q3**	**CoVar**
Size	2015	4	9.214	1.275	6.263	11.802	8.377	10.739	0.138
Size	2016	4	9.331	1.223	6.251	11.831	8.015	10.031	0.139
Size	2017	4	9.391	1.314	6.279	12.058	8.08	10.036	0.140
Size	2018	4	9.470	1.373	6.155	12.883	8.009	10.037	0.145
Size	2019	4	9.880	1.310	7.080	12.880	8.014	11.05	0.133

Source: Adopted from the CBS(CBS 2021)

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In this study the firm size was based on the total assets. There is steady growth in bank size from 2013 to 2017. At the same the large standard deviation of firm size , which is greater than one in all the years, confirm the existence of medium sized and large banks in the population. Table 4.6 indicates that the 9.214 mean was the lowest firm size value in 2013 and a maximum score 9.880 of firm size was posted in the year 2017. Therefore, bank size has a positive affect the financial performance of the selected commercial banks in Somalia. This result concurs with Talam (2014) who posits that the relationship between financial performance of Somalian commercial Banks and bank size was positive. Larger banks are able to generate significant revenues due to their ability to diversify their portfolio taking advantage of the economies of scale. In Somalia firm size is measured in terms of assets owned by banks as high asset ownership enables banks to offer financial services at relatively low costs. Larger banks generally translate to high profitability, greater efficiency, and diversification ventures as evidences by Amal BanK.

Bank trade-off between risk and return is presented by size, but systemic size is an unmitigated risk that reduces return on investment (ROI) without a corresponding reduction in risk. Furthermore, large banks are generally subjected to greater market discipline due to their funding requirements. The fear is that large banks are prone to failure. The problem is that when large banks fail, they can trigger national bankruptcy as happened in Iceland in 2008, and not surprisingly (Demirgiiq-Kunt, and Huizinga, 2012) in US, from July 2010 a law was enacted that prohibits mergers within banks that result in a banks holding total liabilities exceeding 10% of the gross consolidated liabilities of all financial institutions. This law further prevents the emergence of an oversized bank that is prone to failure. The findings are in line with Whittington (2012) who noted that larger firms may have overly bureaucratic management structures, thereby inhibiting swift and efficient decision-making process. It is also possible that with the additional management layers needed to organize an increasingly large and diverse workforce, management may be affected by the agency problems.

Table 4.7: Financial Performance for the Banks Offering Islamic Banking

ROI	2015	2016	2017	2018	2019
Amal Bank	0.0498	0.052	0.0591	0.06442	0.06442
Dahabshiil Bank International	0.0368	0.048	0.0501	0.05461	0.05461
Salaam Somali Bank	0.0503	0.059	0.0572	0.06235	0.06235
Premier Bank	0.0307	0.027	0.0307	0.03346	0.03346

Source: Adopted from the CBS (CBS 2021)

Table 4.7 shows the four Somalia commercial banks' financial performance in islamic compliant banking. The results show that, amal performance from the year 2015 has been on a steady increase till 2020 depicted a sharp increase in performance from 4.98% in 2013 to 6.44% in 2020. This could be as a result of the diversification in offering islamic compliant bank in attracting Muslim clients and investors from the Middle East states. The trend is quite the same with the financial performance of commercial banks tabled. According to the statistics obtained from these banks, it was realized that since the bank introduced Islamic banking, the rate of the improvement in financial performance has been higher compared to the earlier years. This impressive improvement in performance could be attributed by the increase in the intake of islamic compliant products like Murabaha, Ijara and Mudaraba which have become more popular among the customers. Generally, all the banks under the study recorded improvement in financial performance with the introduction of islamic compliant banking. The findings are in line with Usman and Khan (2012), that Commercial banking principle is based on interest while *islamic* banking the policy is based on the prohibition of interest in performing their operations as financial intermediaries.

The principal rationale of the percentage improvement is that Islamic banks predominantly gain from a market shortage of innovate products that meet clients varied needs. These research findings concur with Josephat (2012) findings who was investigating how Somalian commercial banks' financial output is affected by SCB products offering. Josephat conclusions was that to offer products that are new and innovative such as *Murabaha and Ijara* had a positive effect on Somalian Commercial banks' financial performance.

Inferential statistics

Having carried out the descriptive statistics, this research employed inferential statistics so as to draw conclusions and recommendations. Multi-regression analysis was performed to identify the nature of the dependent and independent variables' relationship.

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Correlation Analysis

The Pearson product moment correlation coefficient was used to test the direction and magnitude of the relationship between the dependent and independent variables at 95% confidence level and the results are as presented in the Table below.

Table 4.8: Correlations Analysis

		Financial performance (Y)	Asset Quality	Liquidity Management	Firm size	Management Efficiency
FinancialPerformance (Y)	Pearson Correlation	1				
	Sig. (2-tailed)					
Asset Quality	Pearson Correlation	.358*	1			
	Sig. (2-tailed)	.006				
Liquidity Management	Pearson Correlation	.419*	.251	1		
	Sig. (2-tailed)	.001	.060			
Firm size	Pearson Correlation	.325*	-.014	.279	1	
	Sig. (2-tailed)	.004	.916	.036		
Management Efficiency	Pearson Correlation	.456*	.014	.178	1	.325
	Sig. (2-tailed)	.002	.815	.022		.002

** Correlation is Significant at 0.05 level (2tailed). Source; Research findings, 2021*

On the correlation of the study variables, the study found a strong positive correlation coefficient between asset quality and financial performance of commercial Banks in Somalia, as shown by correlation factor of 0.358. This strong relationship was found to be statistically significant as the significant value was 0.006 which is less than 0.05, These findings upholds the findings by Omoudo (2013), who found that firm size is positively correlated with banks financial performance

The study also found a positive correlation between liquidity management and financial performance of commercial Banks in Somalia as shown by correlation coefficient of 0.419, the significant value was 0.001 which is less than 0.05, the study found a positive correlation between bank size and financial performance of commercial Banks in Somalia as shown by correlation coefficient of 0.325 The significant value was 0.004 which is less than 0.05; these findings are in line with the study findings by Olokoyo (2011), who found a positive relationship between liquidity ratio and financial performance. The study also found a positive correlation between management efficiency and financial performance of commercial Banks in Somalia as shown by correlation coefficient of 0.456, the significant value was 0.002 which is less than 0.05. The findings are in line with Barus, Muturi, Kibati, and Koima, (2017), who found that management efficiency has strong significant influence on the financial performance of savings and credit societies in Somalia.

4.1.5 Regression Model Summary

The regression model was summarized in table 4.9

Table 4.9: Regression Model summary

Model	R	R Square	Adjusted R Square	Std Error of the estimate
1	.8001[2]	.6401	.346	0.0122

Source: Researcher (2019)

Dependent variable: Bank Financial performance. Predictors (constant): asset quality, liquidity management, firm size and management efficiency

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The regression model results are indicated in table 4.9 presents the fitness of model utilized in explaining the study variables. Asset quality, liquidity management, Firm size and management efficiency were found to be satisfactory variables in explaining profitability of the selected commercial banks in Somalia. This is supported by the R square (coefficient of determination) of 64.01%. Coefficient of determination interprets the dependent variable variance that can be explained by independent variable changes. This implies that asset quality, liquidity management, firm size and management efficiency explains the 64.01% variations in the dependent variables which is profitability of the selected commercial banks. Other dynamics not conducted in the study account for the 35.99% discrepancy in the reliant variable. The study findings imply that the regression model used in linking the relationship of the variables was indeed satisfactory. The findings are in line with Hamid and Masood, (2011) who indicated no notable difference in respect to profitability and liquidity between *islamic* compliant banks and commercial banks.

Analysis of Variance

ANOVA measures the statistical difference in more than two independent Variables and involves computations providing information on the inconsistence degree within a regression model.

Table 4.10: ANOVA Table

Model	Sum of Squares	Df	Mean Square	F	Sig
Regression	1.216	4	0.304	2.73	0.003[a]
Residual	5.46	15	0.364	2.63	
Total	6.676	19			

Source: Researcher (2021)

Significance testing using the p-value (probability value) in statistics stipulates the degree of relationship of the independent variable on the dependent variable. The model will be significant in explaining the degree of relationship when the significance value is less than the critical value (P-value) which is statistically set at

0.05. The F value yields a statistic for testing the hypothesis that all $\beta \neq 0$ against the null hypothesis that $\beta = 0$. Further, the study results implied that the independent variables were efficient in predicting financial performance of the selected commercial banks. This prediction was further supported by an F statistic of 2.73 and the reported p value (0.003) which was below 0.005 significance level (conventional probability). Thus, the study results reveal that the model was analytically significant in forecasting how asset quality, liquidity management, firm size and management efficiency influence selected Somalian commercial banks financial performance. The findings concur with Haque and Sharma (2011), banks financial performance guides outcome analysis of policies, performance, efficiency and effectiveness of the firm in economic terms. This reflects in the bank's profit earning, return on investment and return on investment.

4.1.6 Multiple Regression Analysis

Table 4.11 presents a multiple regression coefficient for all the variables used in the study.

Table 4.11: Multiple Regression Coefficient

Model	Un standardized Coefficients		Standardized coefficients	T	Sig
Variable	**B**	**Std Error**	**Beta**	**B**	
Constant	3.701	0.837		3.41	0.000
Asset quality	0.442	0.782	0.114	1.47	0.0128
Liquidity management	0.618	0.384	0.218	1.84	0.0006
Firm size	0.643	0.670	0.148	5.56	0.0024
Management efficiency	0.734	0.894	0.180	7.84	0.0120

Source: Researcher (2021)

From the regression equation, the coefficients can be substituted as follows;

$$\mathbf{Y= 3.701+0.442AQ_{it}+0.618LM_{it}+0.643FS_{it}+ 0.734ME_{it}+ \varepsilon.}$$

From the regression model obtained above, a unit change in asset quality while holding the other factors constant would increase the financial performance of commercial Banks in Somalia by a factor of 0.442, the findings concur with

Bhattarai (2017) that that profitability of Nepalese commercial is influenced by quality of assets and other covariates like: bank size, cost per loan assets and gross domestic product growth rate. A unit increase in liquidity management while holding the other factors constant would increase the financial performance of selected commercial Banks in Somalia by a factor of 0.618. The findings concur with Majakusi, (2016), who found that performance and liquidity management are positively correlated. This relationship is also statistically significant.

A unit change in firm size while holding the other factors constant would increase the financial performance of commercial Banks in Somalia by a factor of 0.643. The findings are Whittington (2012) that larger firms may have overly bureaucratic management structures, thereby inhibiting swift and efficient decision-making process. Finally, a unit change in management efficiency while holding the other factor constant would increase the financial performance of commercial Banks in Somalia by a factor of 0.734. The findings concur with Iqbal, (2012) who found out average liquidity ratio is positively related to with financial performance of in financial institutions The analysis was undertaken at 5% significance level. The criteria for comparing whether the predictor variables were significant in the model was through comparing the obtained probability value and $\alpha = 0.05$. If the probability value was less than α, then the predictor variable was significant otherwise it wasn't. All the predictor variables were significant in the model as their probability values were less than $\alpha = 0.05$

V. SUMMARY, CONCLUSION AND RECOMMENDATION OF THE STUDY

Summary of Findings

The general objective of the study was to determine the effect of *islamic* -compliant banking on the financial performance of selected commercial banks in Somalia. The findings of the study were therefore based on research objectives and research questions. On the correlation of the study variables, the study found a positive correlation coefficient between asset quality and financial performance of commercial Banks in Somalia, as shown by correlation factor of 0.358. This strong relationship was found to be statistically significant as the significant value was 0.006 which is less than 0.05. This implies that asset quality influence positively financial performance of the islamic banks in Somalia On the liquidity management, the study also found a positive correlation between liquidity management and financial performance of commercial Banks in Somalia as shown by correlation coefficient of 0.419, the significant value was 0.001 which is less than 0.05, the study found a positive correlation between liquidity management and financial performance. This implies that liquidity management influence positively financial performance of the islamic banks in Somalia. On the management efficiency, the study also found a positive correlation between management efficiency and financial performance of commercial Banks in Somalia as shown by correlation coefficient of 0.456, the significant value was 0.002 which is less than 0.05, the study found a positive correlation between management efficiency and financial performance. This implies that management efficiency influence positively financial performance of the islamic banks in Somalia

On firm size, the study also found a positive correlation between firm size and financial performance of commercial Banks in Somalia as shown by correlation coefficient of 0.325, the significant value was 0.004 which is less than 0.05, the study found a positive correlation between firm size and financial performance. This implies that firm size influence positively financial performance of the islamic banks in Somalia

Conclusions of the Study

In determining the impact of asset quality on the financial performance of the selected Somalia commercial banks. The finding of the study indicated that asset quality of commercial banks had a positively influence on the financial performance of the commercial banks in Somalia. The positive relationship further indicates that asset quality to financial performance through attracting potential clients. Thus, the financial health and stability of the commercial banks has been enhanced through the introduction islamic compliant banking in conjunction with their core business. Islamic compliant banking intermediation is purely asset based allowing the element of risk sharing. Secondly, the study concluded that liquidity management had positively influenced selected commercial banks financial performance. The study findings indicate a relative stability growth in liquidity management in financial performance of the selected commercial banks. Credit risk monitoring and management enables banks to safeguard its assets and secure the interests of shareholders. Islamic compliant banking allows commercial banks with features closely related to the real economy thus reducing their

contribution to bubbles and excesses. The PLS mechanisms allow Islamic compliant banks to maintain their net worth and avoid the deterioration of their balance sheets under difficult economic situations

Thirdly, the study identified a weak positive correlation between firm size and financial performance of the selected commercial banks in Somalia. Over a span of five years, the selected banks showed an increasing trend in firm size leading to the conclusion that firm size positively affects the financial performance of the banks in Somalia.

The study finally concluded that management efficiency has a significant effect on financial performance of commercial banks. The findings revealed a steady increase of management efficiency of the selected commercial banks over a span of 5 years and a proportional increment in banks performance under the same duration. Banks should consider diversifying the portfolios in islamic banking to benefit from economies of scale. A high level of financial performance is enjoyed by large banks due to economies of scale, diversification and banks dominant reputation.

The study concluded that implementing Islamic banking enhances financial soundness and stability of commercial banks in Somalia. Banks should regularly monitor liquidity ratios to ensure informed and sound decisions that drive growth are profitability are made on a timely basis. The findings further concluded that there is a significant and a progressive relationship between commercial banks' financial performance which concurrently offered islamic banking.

Recommendations

This research recommends that bank management should place more emphasis on cost efficiency in ensuring attainment of optimal expense level in banks. In strategizing towards cost efficiency banks should strategize their efforts in monitoring and controlling costs.

The research recommends that for banks to continue achieving sound liquidity position they should obtain liquidity protection from central bank by increasing pre- positioned assets that can be used as collateral in crisis period. Banks in Somalia should cooperate to establish a robust Islamic financial market in order to control liquidity risk and improve liquidity management of their respective banks.

Based on the research findings, the study recommends that more emphasis should be placed on improving operational efficiency thereby improving banks fiscal performance. For banks to be efficient then it is essential to maintain the efficiency management as low as possible by generating higher revenues with low expenses.

Policy Implications

Implementation of dual banking in Somalia would require reframing of banking laws, restructuring of the economic system and reshaping the society according to dictates that support commercial banks operating islamic compliant banking. Islamic banks mobilize private savings for public sector projects related to infrastructure. The first way is based on profit sharing and can be applied to projects capable of yielding measurable monetary returns such as toll taxed highway projects. Funds mobilized in this framework can be rewarded by a percentage share of the actual returns. Secondly, funds can be mobilized by selling at a higher than cost price services /benefits of certain infrastructures which are 'purchased' on deferred payment from the private sector which builds them for the government in expectation of good returns on their investments. Financing under profit and loss sharing agreement requires a conducive environment that promotes ethics, integrity and values of the society it seeks to serve. The banking system generally should develop a risk bearing instruments that provides investors and shareholders a sufficient degree of profitability, security and liquidity.

Majority of the countries presently operate islamic banking with fixed exchange rates that are subject to liquidity shocks. When Commercial banks lack appropriate processes, capacities and tools to offset the liquidity shocks, they can be transmitted to the financial system and therefore greatly impact financial and economic cycles. The conduct of monetary policy can be interfered with by the government cash management whenever public treasuries

Recommendations for further studies.

This study was conducted on the commercial banks operating Islamic banking in Somalia in conjunction with their core operations. Research studies can be extended to specific areas such as the islamic banking and income diversification to understand the impact of Islamic finance to the financial system in Somalia. The research further suggests that future studies could involve analyzing the motives behind implementing islamic banking by the Somalian banking industry.

Is it for increasing market share or for other reasons like improving liquidity standards, relative advantage or profitability dominance? Therefore, future studies should focus on the relationship between financial innovations offering and liquidity of banks offering islamic compliant products and services. The role of Islamic banking on economic development should be researched further. Adoption of islamic banking should be implemented globally as there is clear evidence of the strength ofislamic baking during the global financial crises. It would be important to also know if the presence of banking that is consistent with faith has encouraged those that had shunned away from the commercial banking system to join the Islamic based banking system and therefore have access to all the financial services that joining a bank affords.

The study's scope was limited to evaluating commercial banks operating islamic banking within Somalia boundaries. However, this many differ in case of other financial institutions like insurance companies and microfinance institutions offering islamic compliant services were included to increase the study population. The study can be extended to insurance and micro finance institutions offering islamic compliant products and services.

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