A REPORT ON THE

EVALUATION OF IMPLEMENTATION OF

THE STRATEGY FOR EXPANSION & DEVELOPMENT OF THE MICRO FINANCE SECTOR IN SUDAN

Prepared by

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November 2008

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TABLE OF CONTENTS

LIST OF TABLES

List of Abbreviations

ABS	Agricultural Bank of Sudan
BDS	Business Development Services
BDAS	Business Development & Advisory Services
CBO	Community Based Organization
CBS	Central Bank of Sudan
CGAP	Consultative Group for the Assistance of the Poor
CPA	Comprehensive Peace Agreement
FHHs	Female Heads of Household
FSS	Financial Self-Sufficiency
ICB	Information Credit Bureau
IDP	Internally Displaced People
IFAD	International Fund for Agriculture Development
IT	Information Technology
MDTF	Multi-Donor Trust Fund
MF	Microfinance
MFIs	Microfinance Institutions
MFU-CBS	Microfinance Unit of the Central Bank of Sudan
MIS	Management Information Systems
MOFNE	Ministry of Finance and National Economy
MON	Microfinance Organizations Network
MSEs	Micro and Small Enterprises
MSWWCA	Ministry of Social Welfare, Women and Child Affairs
NGO	Non-Governmental Organization
OSS	Operational Self-Sufficiency
PAR	Portfolio at Risk
PRSP	Poverty Reduction Strategy
SDG	Sudanese Pounds (One US$ = SDG 2.1)
SDF	Social Development Foundation
SHG	Self Help Groups
SMDF	Sudan Microfinance Development Facility
SRO	Self Regulatory Organizations
SSDB	Savings and Social Development Bank
TOT	Training of Trainers
WB	World Bank

Executive Summary

In recognition of the important role that microfinance can play in reducing poverty and realizing a sustainable peace in the Sudan, the Central Bank of Sudan developed a national vision for developing and expanding the microfinance sector in Sudan with the aim of creating an enabling environment for the industry's sustained economic and social growth. Through a widespread consultative process that engaged various stakeholders, the vision was captured in a document that defines the framework for the identified MF Strategy. The vision was developed within a framework that focuses on three cross-cutting areas of intervention, considered as crucial in expanding the role of the sector in Sudan. These areas are the policy environment, the institutional and regulatory framework, and the supporting infrastructure. Recommendations were presented in a comprehensive action plan that set out specific actions to be undertaken in accordance with priority levels and time frames for implementation.

Following endorsement of the vision by the Government of the Sudan in late 2006, the Central Bank of Sudan established the Microfinance Unit to serve as its specialized department endowed with the task of realizing the vision and implementation of its strategy. Since its establishment the MFU has been actively pursuing the achievement of the different activities and has played the lead role in driving progress forward.

Part I of the report (Part I-chapters 1 & 2) covers the findings of the evaluation team with regard to implementation of activities as well as presenting an analysis of some of the most prominent issues that have been identified. The report finally draws its conclusions and makes specific recommendations for improvement and realization of the vision for expanding and developing the micro-finance sector in Sudan. In reviewing the strategy implementation and making recommendations for progress towards achieving its goals, the various components of the strategy itself came under scrutiny to identify possible improvements/adjustments therein.

Part II of the report focuses on the intensive exercise undertaken with the MFU to formulate a detailed Monitoring and Evaluation Plan for the MF Strategy. The Plan is set to assist the stakeholders in the MF Strategy to determine the related benchmarks for future measuring of progress in its implementation.

The review process covered the three strategic components of the strategy, namely 'Creating a conducive legal and policy framework', 'Enhancing the role and supporting the growth of MFIs' and lastly, 'Establishing a supportive infrastructure'. Through a review of secondary data in combination with semi-structured interviews with stakeholders, the implementation status with regard to the outcomes and outputs under each component was thoroughly captured.

Within the first of these components, one of the most prominent areas requiring attention is the CBS credit policies of setting 10% as an indicator of the profit margin on Murabaha transactions of Microfinance Institutions (MFIs). In compliance, MFIs charge a rate in the range of 10-12% as a flat rate even though, in the majority of cases, such a rate does not cover the cost of providing the service. This has served to accentuate the perception that MF is an unprofitable activity and therefore less lucrative.

Analysis of the information generated through the review process reveals that the Microfinance Unit (MFU) is playing a pivotal role in driving the vision forward and its activities are therefore, nation-wide, advocating for sector requirements among various stakeholders, providing and facilitating financial services and, in some cases, facilitating non-financial services and finally targeting multiple-sectors of economically active micro-entrepreneurs in Sudan. Moreover the dual nature of its role as both regulator of the Micro-financial sector and promoter of micro-finance necessitates a careful consideration of its relationship vis-à-vis different stakeholders.

The relationship between the MFU and the Sudan Microfinance Development Facility (SMDF) established in early 2008, has the potential to assist or, on the contrary, hinder the development of the sector. At present the role of the MFU vis-a-vis the emergence of the SMDF and structured mechanisms for coordination remains blurred although there seems to be a delineation of roles with the MFU handling formal MFIs.

The current engagement with the Humanitarian Aid Commission intended to facilitate the provision of micro-finance services by non-governmental organizations is feared to have an adverse effect if it is perceived as an additional regulatory body. In this regard, the non-inclusion of representatives from the NGO sector in the joint committee formed between the MFU and HAC sends the wrong signal.

In striving to build a supportive infrastructure for the micro-finance sector in Sudan the absence of performance benchmarks and adherence to best practices amongst the bank institutions has not been tackled. In the rush to provide services and the incentive generated through the Central Banks strategy of co-financing MF operations, initial analysis reveals that effectiveness and efficiency of Banks partnering with the MFU is a serious concern.

Overall, the report recognizes the tremendous effort that has been exerted by the MFU since its establishment in early 2007. It also recognizes the considerable progress that has been achieved in moving forward towards an expanded MF sector. Having said that, it is recognized that the Strategy implementation is still in its early stages and much work remains to be done towards achieving the primary goal of the MF Strategy - the establishment of a self-sustaining MF sector with expanded outreach to the majority of the economically active poor in Sudan.

The challenges ahead can be summarized as follows: **Firstly**, changing the perception among both banks and policy makers so as to recognize the viability of microfinance, not only as a social undertaking, but also as a sustainable financial tool that can also be a profitable activity. In this respect, unification of the messages that address the target client and promote a real understanding of the role of microfinance, should be undertaken as a collective effort by both government and non-government stakeholders. The MFU/CBS cannot do it on its own but must sensitize and work closely with its partners (government institutions and MFIs) to complement, support and strengthen its efforts in laying the foundation for a sustainable MF industry in Sudan;

Secondly, motivating banks to more effectively engage in microfinance and so change their traditional approach to such services. In this respect, incentives should be linked with performance, achievement of targets and plans. Such performance will necessarily include Reduction in operation costs to be more in line with the 10% profit margin (charged on Murabaha transactions); Diversification of MF products based on the needs of clients, identified through MF demand market studies; Expansion of outreach by the adoption of well known best practice in the delivery of micro-financial services; Adoption of microfinance technical packages, including Management Information Systems, Computerized loan tracking systems etc., required for efficient and effective MF operations. But prior to that, there is a need for a unification of the definition of the targeted client, among MFIs as well as policy makers, to effectively increase their access to microfinance services. **Thirdly**, the challenge remains of increasing the number of Sudanese who are technically and practically skilled and enabled to efficiently and effectively manage microfinance operations and disseminate information on best practice. Capacity building efforts being undertaken will need to be intensified with a focus on training of trainers as well as strengthening local MF specialized organizations. The role of the MFU and SMDF in this respect is critical. Complimentary capacity building efforts aimed at the micro-entrepreneur in the form of business development services will also need to be developed and expanded.

Fourthly, the Field Survey as well as the M&E planning exercise, both undertaken as part of the current evaluation, brought to the forefront the need for a careful review of the structure and capabilities of the MFU as the driving force for progress in developing the sector. The MFU should capitalize on the presence of the advisory capacity within the SMDF project in order to arrive at the roles and complementarities between the Unit and the SMDF in its perceived form as the potential apex institution for MF in Sudan. By the same token, the SMDF project should, jointly with project stakeholders (non-bank MFIs- NGOs), revisit the SMDF performance through a mid-term evaluation with a focused purpose of evaluating the value added by the project as well as validating the suitability of its current legal structure.

Finally and most importantly, it cannot be overstressed that microfinance is an effective poverty alleviation tool but it is effective when undertaken within an overall package of poverty reduction policies. Tremendous public mobilization has been effected by the adoption of the MF Strategy, however, the concern remains that such efforts will be undermined by the need for complimentary efforts in reducing the burden on micro-entrepreneurs from a multiplicity of other factors. Among the most important of these factors are those arising from excessive taxes and governmental harassment as well as lack of human resource development services (basic services of education, health and water).

The evaluation process and recommendations emanating from it are meant to assist in making future activities, undertaken as part of the strategy implementation for development of the MF sector, more effective in achieving the desired goals. In no way do they undermine the great efforts undertaken so far. They are an effort at enhancing the impact of these efforts.

Prologue

In recognition of the important role that microfinance can play in reducing poverty and realizing a sustainable peace in the Sudan, the Central Bank of Sudan developed a national vision for developing and expanding the microfinance sector in Sudan with the aim of creating an enabling environment for the industry's sustained economic and social growth. Through a widespread consultative process that engaged various stakeholders, the vision was captured in a document that defines the framework for the identified MF Strategy.[1]The vision was developed within a framework that focuses on three cross-cutting areas of intervention, considered as crucial in expanding the role of the sector in Sudan. These areas are the policy environment, the institutional and regulatory framework, and the supporting infrastructure. Recommendations were presented in a comprehensive action plan that set out specific actions to be undertaken in accordance with priority levels and time frames for implementation.

Following endorsement of the vision by the Government of the Sudan in late 2006, the Central Bank of Sudan established the Microfinance Unit to serve as its specialized department endowed with the task of realizing the vision and implementation of its strategy. Since its establishment the MFU has been actively pursuing the achievement of the different activities and has played the lead role in driving progress forward.

Given the importance it attaches to the success of the strategy, and recognizing the importance of undertaking periodic reviews and evaluations of the progress made on the plan, the CBS, represented by the MFU, commissioned UNICONS Consultancy Firm to undertake a review and implementation evaluation of the Strategy. The review which is the first such undertaking since establishment of the MFU in February 2007,,is documented in the report herein as follows: The first chapter reviews the activities undertaken by the MF Unit, since its inception, with the aim of assessing the degree to which the strategy is being implemented as envisioned and planned- ***Implementation Evaluation***. The information gathered and analysis made in this stage of the evaluation will also provide the basis for assessing progress in meeting the strategy's goals - ***Progress Evaluation***. It is important to note, at this juncture, that evaluation of progress is limited given the short-space of time (just over a year) since the inception of the MF Unit and the absence of initial benchmarks against which progress can be measured. As such, the purpose of the Progress Evaluation is **firstly**, to review the activities of the MFU and provide recommendations on the way forward. The recommendations are based on internationally known best practice but taking into consideration the special characteristics of Sudan; Specific recommendations are made following the implementation evaluation and in accordance with the sequence adopted in the Action Plan of the MF Strategy (chapter 1-PartI of the report). A more general discussion of important issues arising from the Implementation Evaluation will be taken up in chapter 2 of Part I of the report. **Secondly,** the purpose of the Progress Evaluation is set to determine the related benchmarks for future measuring of progress; i.e. formulating a detailed Monitoring and Evaluation Plan (M&E Plan). The comprehensive M&E Plan is presented in Part II of this report. In reviewing the strategy implementation and making recommendations for progress towards achieving its goals, the various components of the strategy itself came under scrutiny to identify possible improvements/adjustments therein.

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[1] Refer to document titled 'A Vision for the Development & Expansion of the Microfinance Sector in Sudan'.

Chapter One - Review of Implementation of Strategy

1. INTRODUCTION & METHODOLOGY

This chapter will analyze and make recommendations based on the "Implementation Evaluation", as stated in the Prologue. The "Implementation Evaluation" consisted of two main phases- Desk phase and a Field phase. The purpose of the Desk Phase Report is two-fold. Firstly, to allow the evaluation team to formulate an initial impression on implementation with regard to each component of the strategy and reflect this to the MFU for feedback. This impression was formed in light of the preliminary interactions with the MFU as well as the review of secondary sources received from the MFU. Secondly, to build on the findings and analysis of this initial review of the strategy so as to identify areas that need further investigation and directives for the field phase of the evaluation process. These are then translated into the more detailed evaluation plan which will guide the fieldwork. As such, initial findings from the review of secondary data captured in the desk phase report were further investigated during the fieldwork phase.

The Field phase took the form of semi-structured interviews guided by carefully designed questionnaires which were distributed to some selected MFIs prior to field visits [see Annex Table A1 for listing of institutions targeted in the semi-structured interviews]. Semi-structured interviews were also conducted with the CBS Microfinance Unit (MFU-CBS) – the body entrusted with implementing the five-year microfinance strategy – and the selected institutions, participating in the implementation of the experimental microfinance project. Six out of nine MFIs were selected as a sample for this study. The selection observed the following criteria: Number of microfinance clients, representation of banks and non-banks, geographical spread, history in extending micro-loans and representation of old and new institutions. In addition to the newly established Family Bank, the six institutions interviewed were the Agricultural Bank, the Savings and Social Development Bank, Farmers Commercial Bank, Industrial Development Bank, Real Estate Commercial Bank and the Social Development Foundation.

Semi-structured interviews were also conducted with the main partners in execution of the MF strategy. These being the local partners, namely the Ministry of Finance and National Economy and the Federal Ministry of Social Welfare; the main donors, namely the World Bank (WB), United Nations Development Program in Sudan (UNDP) and the International Fund for Agriculture Development (IFAD).

In reviewing the implementation of the microfinance strategy, the sequence of the strategic objectives stated in the Strategic Plan document were followed. While focus is on the status of implementation of the short term activities, medium to long term activities are reviewed for any possible amendments in view of changes in the current status of the microfinance sector.

I. CREATING A CONDUCIVE LEGAL AND POLICY FRAMEWORK

The Strategic Plan for development of the microfinance sector in Sudan recognizes the importance of devising a policy framework that is conducive to a competitive macroeconomic environment that serves to spur equitable economic growth, employment and social policies that address poverty and human development issues. It cannot be overstressed that Microfinance is but one of the tools for poverty reduction. It must be developed within the wider context of a comprehensive strategy for poverty reduction in which the basic needs of the poor are addressed. Accordingly, the implementation of the MF Strategy must align policies that have a pro-market orientation with an unwavering commitment on the part of the state, civil society and the private sector to poverty reduction.

To this end there has been significant progress in the implementation of different activities that build up the desired regulatory and policy framework and which stimulates the development of the sector and provides adequate financial services while protecting people's savings. The review will follow the sequence of activities planned in the strategy to achieve this first strategic objective.

I.A. REVIEW OF BANKING LAWS AND CBS POLICIES

Official Endorsement of the MF Strategy: Although no formal single document representing an official endorsement of the MF vision has been issued by the Government of Sudan, nonetheless embracement of the strategy by the GoS is evident in the various formal statements of ministers as well as the inclusion of the MFU in a number of national/ministerial committees most notably the Poverty Eradication Unit of MoFNE and that of Ministry of Social Welfare as well as in the Agricultural Revival "Al-Nahda" Program.

Funding provided to banks engaged in microfinance: Soon after establishment of the Microfinance Unit (MFU) in March 2007, the Unit launched a microfinance experimental project in July of the same year. The Sudan pilot microfinance Project, an activity not stated in the MF Strategy, consisted of a kick-off fund amounting to SDG 120 million and provided as Musharaka financing to 9 financial institutions. The purpose was the perceived need for encouraging financial institutions to actively engage in microfinance operations. The financial support provided was in the form of partnership (Musharaka), whereby each participating institution matches the fund raised by the MFU by an equal amount, i.e. a 50% contribution to the fund. The selection of the institutions to benefit from this financial support was based on certain criteria developed by the MFU and disseminated to interested banks. Among the conditions for benefitting from the financial support was the need for banks to establish separate microfinance units/branches and to develop a strategy for their microfinance operations. Table 7: Deatils of the MFU-CBS wholesale finance to MFIs shows the institutions selected for the pilot experiment and their performance as of September, 2008.

The following important issues have emanated from the desk and field review:

1. Although the MFU adopted criteria for the selection of MFIs to benefit from the CBS funds, yet the list of assisted banks included some of limited capacities and experience vis-à-vis dealing with the Project's target group (the economically active poor), e.g. the Real Estate Commercial Bank which, in accordance with its mandate, is specialized in financing construction and maintenance.

2. The accumulated volume of microcredit provided, up to September 2008, amounted to SDG million 51.7, extended to 21,303 clients, an average of SDG 2,429 per client. The number of banks' microfinance borrowers has increased, compared to 2006 estimates of about 13,000 clients[2]. However, in comparison to other countries in similar development circumstances, these numbers are still very small (in Bangladesh the MF institutions reach about 8 million clients and in Egypt they reach more than one million clients).

[2] A Situational Analysis of the Microfinance Sector in Sudan. 2006, Unicons Consultancy on commission from the Central Bank of Sudan

3. Out of an outstanding loan portfolio of SDG million 58.5, the repayment (up to 31/8/2008) amounted to SDG 5.4 million, i.e. 9.2%. It is striking that the repayments collected up to now mostly consist of clients' down payments. The repayment rates are very low, e.g. the repayment rate of the Agricultural Bank of Sudan, which joined the MF project in January 2008, is zero % (due to the nature of the horticultural activities financed, the first payment is expected after 3 years! The repayment rate of the Industrial Development Bank (joined in November 2007) is 7% and the SSDB (December 2007) is 9%. All these rates are very low, given the short-term lending nature of microfinance.

The MFU intends to conduct its evaluation of the project of extending wholesale financing to MFIs at the end of a year since its implementation. It is hoped that in doing so, it will take into consideration the recommendations of this report.

Recommendation: Given the importance of this initiative, it will be discussed in the next chapter.

Review of Credit Policies: By-laws for registering new MFIs were issued by CBS in 2006 and amended in 2007. This resulted in a number of institutions obtaining provisional licenses to start microfinance operations. These being four State MFIs (North Kordofan, South Kordofan, Northern State and Kassala) in addition to one private bank (Aljawda Bank). The Family Bank, which was also under provisional licensing, recently obtained its operational license and started serving the poor in August 2008. The transition from provisional to operational is contingent on satisfying the capital requirement as well as submission of a well designed business plan. Licensing of non-deposit taking MFIs is more flexible requiring registration rather than capital requirement.

The Central Bank's annual credit policy now includes a section on microfinance policy. Moreover, CBS circulars encouraging banks/MFIs to follow microfinance best practice have been dispatched to banks wishing to engage in MF. However, in reviewing the CBS's framework for regulating MFIs, it appears that the same monitoring prudential ratios and other formulae developed for commercial banks (capital adequacy ratio, limits on unsecured lending, etc) were applied to banks engaged in Microfinance.

Recommendation: Further reviews of CBS policies should take into consideration the fact that MFIs require different treatment than those applied to normal commercial banks. This is needed to take into account MFI's different risk profiles, volatility, and lending technology involved in their portfolios that may deteriorate rapidly as they are usually unsecured, or secured by assets that are insufficient to cover the loan, once collection costs are included.

The credit policies of CBS allow MFIs to charge a profit margin on Murabaha transactions in the close vicinity of 10%. According to the MFU, acceptable margins fall in the range of 8-14%. In compliance, most MFIs charge 10% as a flat rate that is reportedly based on the prevailing inflation rate. However, the majority of interviewed MFIs stated that the 10% profit margin charged on Murabaha does not cover their cost which was estimated to be in the range of 21-56%. It is to be noted that Murabaha transactions constitute 97% of the total number of micro-loans provided during 2008 (see Table 5: Analysis of MF operations). Only two MFIs stated that the 10% actually covered their running cost and one of these MFIs stated that such cost coverage would only be achieved if the default rate did not exceed 5% (previous studies showed that most MFIs in Sudan reported default rates exceeding 20%. However, in all these cases, it remains to be determined whether the costing is based on acknowledged costing methods, as most MFIs admitted that they still have no separate costing systems for MF. In any event, it is clear that in the majority of cases, the 10% profit margin is far below that needed for cost recovery. This may adversely affect the MFIs' ability for effective market penetration and would directly affect their performance and thereby discourage banks from expanding their microfinance portfolio.

The profit margin ceiling imposed on banks in their Murabaha transactions has now been extended to the SDF which is under the stewardship of the Khartoum Ministry of Social and Cultural Affairs. Although the SDF, being a non-bank (not deposit-taking), does not fall under the jurisdiction of the CBS, it was still obliged to comply with the directive issued by the MFU to reduce its profit margin from 24% per annum to 12%. This is expected to have consequences on the sustainability of the SDF and its ability to expand its outreach. It will also be an issue of concern for other non-bank MFIs if CBS wholesale financing to them, either directly or through the SMDF, is conditioned on complying with CBS-MFU directives.

A number of studies and consultations with government institutions have been undertaken by the MFU to identify unnecessary taxes and fees levied on microfinance projects/clients. In an attempt by the Central Bank to reduce the cost of financial services to micro-entrepreneurs, the CBS issued a circular directing banks not to charge fees and government stamp duties to microfinance clients.[3] While this might in effect reduce the burden on the client, it might act as a disincentive for banks to provide microfinance given that they are not allowed to pass on this cost to the client. A more direct benefit to the micro-entrepreneur would be for the government to reduce or cancel the myriad of fees and taxes levied on the productive activities undertaken by the under privileged and poor communities.

Recommendation: The issue of ceiling imposed on the cost of micro-finance will be discussed in greater detail in the next chapter.

Assessment of the policy of directed micro-credit as Percentage of Bank Portfolio:

Banks were directed by the CBS to allocate 10% of their portfolio to microcredit. In October of 2007 the CBS increased this percentage to 12%.[4] However, evidence shows that banks are still far from spending even the previously stated 10% let alone the newly stipulated 12% of their portfolio which should be directed to microfinance. Although the actual amounts allocated to microfinance have significantly increased (partly due to the injection of funds by the CBS), as a percentage of total lending portfolio, it is still in the low range of 3% (see Table 6: Status of implementation of the 12% portfolio allocated to MF). This low percentage, as an average for all banks, is somewhat misleading as it includes the MF specialized banks' portfolios which are the SSDB (50% allocated to MF), the ABS (58% allocated to MF) and the newly established Family bank (100% allocated to MF). The implementation of other banks is far below expectations, as reflected in Table 6: Status of implementation of the 12% portfolio allocated to MF.

Recommendation: The poor implementation of the Central Bank's directive for the allocation of 12% (previously 10%) of total loan portfolio to MF suggests a continued need for re-assessing this policy in a structured manner to learn why this policy remains far from reach, to assess its effectiveness and identify possible more effective measures for encouraging banks to allocate more resources to microfinance.

Restructuring of Banks: Although "restructuring of banks for a more effective MF delivery" was planned for the medium term, the CBS/MFU urged banks to establish separate branches/units for MF delivery. This has resulted in 8 banks (see Annex for listing) - all state-

[3] CBS circular, date 25/6/2008
[4] CBS circular No 18/2007

owned - having developed internal units for provision of microfinance services. The units are mostly attached to investment departments within the banks but in some cases, specific branches of the banks have been entrusted with handling solely MF transactions (e.g. SSDB which directed 15 branches, out of a total of 30, to solely work in microfinance). However, the implementation still seems to be poor as most of these institutions are still handling microfinance operations in the same traditional manner they were adopting in the past. Banks continue to use traditional lending methods (desk work) with microfinance staff in the specialized units still being very small, sometimes part of an already understaffed investment department, with 1-2 officers at best in each unit. This is not in line with sound microfinance practice in which microfinance institutions rely on labor-intensive mechanisms, and intensive field work, to expand outreach and keep a close link to clients. An example of good performance in the delivery of micro-credit is the SDF which is currently operating in the field with 25 loan officers, covering a total of 7,000 clients, i.e. a productivity of 280 clients per officer.

A major requirement of the MF Strategy, in the short term, was for an evaluation of the effectiveness of the specialized MF banks, namely, the Savings and Social Development Bank (SSDB) and the Agricultural Bank of Sudan (ABS). The aim of such an evaluation was to identify and implement the reforms/restructuring needed for more efficient delivery of microfinance services by the two leading banks in this sector. Although this was not specifically achieved, there was an intention to carry out an evaluation and restructuring of the branches of the two banks in Northern Kordofan State. This was to be funded by IFAD which has a large rural development project in that part of the country.

In accordance with the MF Strategy, the need for establishment of a new bank for the poor was to be considered in the medium term, following the evaluation of the existing leading MF banks. However, the CBS in conjunction with other government bodies decided to support an initiative by the Businesswomen's Association for the establishment of a new bank specialized in the delivery of MF services – hence the birth of the Family Bank. The Family Bank, the first fully MF specialized bank in Sudan started microfinance operations on the first of July 2008. The Bank which is registered as a public company, has as its shareholders: Central Bank of Sudan (the largest shareholder), Khartoum State, the National Social Insurance Fund and the Zakat Chambre. Other shareholders are the Sudanese Business Federation, Sudanese Businesswomen, Local NGOs and 15 individuals.

Recommendation: As the first fully specialized MF bank, it will be important for it to set an example in successfully offering cost effective and efficient services with maximum outreach. It will, therefore, be pertinent for its progress to be monitored by the MFU to ensure the application of best practice in MF.

Revision of the current lending procedures for banks engaged in MF provision. In stating this activity, the Strategy envisaged a profound change in the existing non-conducive lending procedures of MFIs, particularly banks providing micro-credit. These procedures are still much in evidence: as observed in the application of prolonged procedures in extending microfinance; clients being required to open a bank account in order to be eligible for financing; clients being requested to write post-dated cheques for repayment; focus on desk work rather than extensive field work to know the client well, ..etc. The strategy envisaged the MFU role as one of reviewing these procedures with banks to ensure that there is change towards microfinance best practices. However, what has been accomplished is an agreement with banks to facilitate microfinance operations rather than a reform of current practices in line with known microfinance best practices in this field.

Recommendation: The original activity stated within the MF Strategy of reviewing lending procedures of banks still holds. While training in best practice lending procedures for MFI staff is still warranted, it will be up to the MFU to establish its own expertise so as to be able to advice as well as critically and frequently review these procedures with banks. However, vitalizing and expanding banks' portfolio in MF will require a lot more than an agreement to facilitate microfinance operations and even capacity building of staff. It will require motivating these banks to actively engage through a variety of ways, examples of which are discussed in the next chapter.

Facilitating Wholesale financing to NGOs, CBOs & SHGs: Wholesale financing has been provided by the CBS to the Social Development Foundation and the Sudan Rural Development Company (through the Industrial Development Bank) but NGOs or CBOs continue to have limited access to such financing from banks. In promoting wholesale financing, the MF Strategy had envisioned the formulation of clear guidelines or written plans for identifying organizations with good access to the targeted client, however, this has not been accomplished. The limited progress in this area has been explained by a lack of registered and competent NGOs/CBOs working in micro-finance provision. Specifically, such organizations were seen to lack adequate credit management skills for on-lending to members.

Another reason hindering wholesale financing to NGOs/CBOs is the constraints imposed by CBS Act (Article 51) and the Humanitarian Aid Act, both of which, limit deposit taking and profit-oriented financial transactions by NGOs/CBOs and non-bank institutions. It is worth noting in this respect that MFIs in different parts of the world deal with primary, unregistered groups to expand outreach. However, most microfinance providers in Sudan have NOT been actively engaged in the formation of such informal groups or engaged in the extensive field work needed to reach a larger number of clients, particularly in the rural areas. Manuals to help staff do this have been prepared for the newly established Family Bank and it is hoped that it will apply these manuals within and so lead the way for other MFIs to follow.

Recommendation: The mandate of the newly established Sudan Microfinance Development Facility (SMDF) calls for it to strengthen non-bank MF providers. Such capacity building should be given high priority by the SMDF as it is expected to enable these organizations to subsequently access banks' wholesale financing in a big way. The MFU should, therefore, coordinate closely with the SMDF so as to encourage banks to link up with those enabled organizations to achieve the desired expansion in outreach which is the ultimate aim of wholesale financing.

N.B. A brief on the SMDF is given in Box 1 below but a more specific discussion of the SMDF as it relates to development of the sector and its relation to the MFU will be taken up in the next chapter.

BOX 1: The Sudan Microfinance Development Facility

The Sudan Microfinance Development Facility (SMDF) has been initiated as project jointly and equally funded by the Government of Sudan (the Central Bank) and the Multi-donor Trust Fund (MDTF) being administered by the World Bank (each US$ 10 Million). The aim of the project is to champion the emergence of a strong and sustainable microfinance sector in the country. To achieve this objective, the SMDF is to provide (a) technical assistance for development of institutional capacity of non-bank microfinance service providers and (b) financial support for the efforts of these MFIs to assist the poor and low income households with access to financial services and in particular access to credit. The SMDF will also provide on-the-job training for local staff so as to facilitate a gradual transfer of responsibility to them by by the end of the two year period of the project. The management and operation of the SMDF, including the establishment and operation of accounting and management information systems, has been awarded to the Frankfurt School of Finance and Management.

The SMDF has now been registered as a 'for-profit' company under the 1925 Sudanese Companies Act, with its two shareholders being the Central Bank of Sudan (99%) and the MoFNE (1%). The company is governed by a 7 member Board of Directors represented as follows: 2 seats for representative of the donor community; 3 seats for representatives of the industry/civil society; 1 seat for the MOFNE and 1 seat for the CBS. The facility is currently housed in the buildings of the CBS which also house the MFU. The team currently running the SMDF consists of three international staff (a Team Leader, a MF specialist and a Financial manager) and one National (Training Coordinator). Although it was officially established in early 2008, it has only established itself on the ground in July, 2008 and has shortly thereafter submitted its plan of action to its Board of Directors.

I.B. Diversification in the Range of Microfinance Services

The strategy for the development of the microfinance sector planed two activities in order to diversify the range of microfinance services on offer in the short to medium term. These were as follows: (a) examining the addition of new microfinance services in compliance with Islamic Sharia Law, and b) examining "Savings and Investment" schemes for micro savers.

Diversification of the range of MF Services/products; The range of microfinance products on offer is still very limited being focused on micro loans for productive purposes only. The SDF is ahead of banks in this respect as it had introduced consumption/emergency loans (e.g. to pay school fees), home maintenance loans etc. Generally speaking, loans are needed by MF clients in many and diversified situations. One of the commonly needed loan types is *"emergency loans"* which results from an unanticipated need (family emergency) or to grab an unplanned opportunity (reasonably guaranteed business deal with high revenue/profit potential). In these cases, clients would attempt to borrow funds from another creditor to satisfy their needs, resulting in having simultaneous debts to settle and potentially defaulting on one of them. That is why in some cases, MFIs may opt to provide its credit worthy clients with an additional loan to maintain client loyalty and ensure client debt-service capacity.

Another important service required of MFIs and stated in the MF Strategy is the mobilization of savings. As would be expected given the early age of the MF Strategy, savings mobilization is still limited to the SSDB and the ABS. The latter benefited from its long experience as a financing intermediary for international donors co-financing local development projects with the Sudan Government. Such development projects, e.g. those implemented with IFAD in rural areas, stipulate savings as a pre-requisite for benefiting from their credit program.

The circular issued by the MFU in relation to diversification of products provided general guidance on the importance of awareness raising, follow-up etc.;[5] The MFU has also communicated to the banks specific features and practical requirements to engage in MF lending and other services. While these types of correspondences are greatly needed and represent the first logical step, it is well known that convincing banks to take the extra step to engage in a wider range of MF services require greater awareness of the value and financial benefits associated with such MF operations.

Recommendation: The MFU/SMDF should ensure that the SDF experience is closely studied in order to derive lessons to be disseminated to other banks and MFIs; a workshop

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[5] dated 17/7/2008

specifically targeting “Product Diversification” could be thought of where various players who have MF product initiatives could present their experience for a wider sector benefit.

MFIs should specifically be encouraged to design appropriate savings products that are both attractive to MFIs and clients. Greater linkages between savings and credit could be fostered. One example is to establish micro-saving services in which MF clients who have active savings are provided with more relaxed terms in their credit. This would benefit both client and MFI since the client’s savings can be construed as collateral against which the risk-exposure of the bank could be revised and translated into a reduced premium on the credit transaction. Other incentives that could be considered for mobilization of micro-savings are: safety, a mark-up or profit on the amount invested, geographical proximity to the targeted areas and ease of depositing and withdrawal. In this regard, banks/ branches specializing on the delivery of MF services should be encouraged to adopt more flexible working hours and be closer to the clients to facilitate deposit and withdrawal of savings.

I.C. ALTERNATIVE COLLATERAL MECHANISMS

The following activities were stated in the strategy for dealing with the constraint of collaterals in the provision of microfinance services: a) introducing non-conventional collateral mechanisms; (b) unregistered land (scheduled for the medium to long term); (c) studying the different credit guarantee schemes and applying the most appropriate one to the financial system in Sudan (conventional and Islamic); d) studying the possibility of using Zakat Funds in partnership with MFIs and SHGs as an additional leverage for loan capital (i.e. credit guarantee) and, e) promoting micro-insurance as a hedging mechanism for micro financing.

The introduction of non-conventional collateral mechanisms, envisaged for implementation in the short to medium term, was among the first activities tackled by the newly established MFU. The Unit commissioned a study on the subject and based on its findings, the CBS issued its circular[6] encouraging micro-finance service providers to adopt non-conventional collaterals. However, there is still some confusion as to the applicability and meaning of non-conventional collaterals and the need for banks to be innovative in adapting the technique to the surroundings in which they work. Nevertheless, there are some positive signs of movement towards acceptance of non-conventional collaterals albeit limited and in most cases still requiring local CBO issuance of post-dated cheque as collateral for its groups members. Examples are: the SSDB (acceptance of a legal undertaking as collateral for loans less than SDG 2000, accepting salaries and pension, accepting the guarantee of tribal leaders), by the SDF (salary and group collateral within CBOs' guarantee), the ABS (dealing with informal groups and accepting group collateral), the Framer's Bank (salary and pension and group collateral supported by a post-dated cheque from their CBO) and the Industrial development Bank when extending credit to groups.

It is still too early to expect change in the well entrenched culture of commercial banks of focus on traditional collateral (third-party guarantee and the issuing of post-dated cheques). The transition will take more effort than disseminating information and can only take place gradually as the perceptions of bankers evolve and as they gain more experience.

Recommendation: As a starting point, banks will continue to have collaterals such as post-dated checks and third party guarantor. In such a situation, the challenge becomes one of easing down the collateral requirements with borrowers who prove credit-worthiness. This

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[6] CBS circular No 5/2008, dated 10/3/2008

can be done by gradually introducing other forms of financing which entails partial risk sharing by the bank “Mudaraba and potentially Musharaka”. There is also a clear need for practical capacity development and information exchange regarding the following aspects of MF operations:

- Delinquency management (paperwork and field operations)
- Peer pressure and community pressure techniques to emphasize repayments
- Internal Control Policies and Procedures in MF best practices
- Exchange fora with prior successful experiences in similar communities and countries

A solidarity fund "Sandug Altakaful" was proposed by the MFU to protect microfinance clients. The proposed shareholders are the CBS, Ministry of Finance, Ministry of Social Welfare, Zakat Chambre and donors. The idea was approved by the "Sharia Supervisory Board (SSB)" (the Board that ensures compliance with Islamic principles)[7]. However, it was later rejected by the Insurance Supervisory Board[8] and the issue is still pending.

Recommendation: It would be recommended that the MFU review its proposal for a solidarity fund so as to better define and take into consideration the aspects that are of concern to the Insurance Supervisory Board and possibly other stakeholders.

An insurance scheme for MF clients has been proposed by the government-owned Shaikan Insurance Co. providing insurance and reinsurance services based on Islamic principles. These services are to be provided through a "microfinance insurance fund" with contributions from institutions (banks or non-banks) engaging in the provision of microfinance services. The company has started implementing the scheme and three banks have signed agreements to contribute to the fund (Family Bank, ABS and the Animal Resources Development Bank). The fund is to provide insurance for loans extended by contributing MFIs so that in the case of delinquency, and after the financing institution has exhausted all means of effecting repayment, cases would be submitted to Shaikan Insurance company for compensation. While this is a desired step in the direction of expanding microfinance services, its caveats need to be carefully considered.

Recommendation: Agreements being drawn between MFIs joining the insurance scheme and the insurance company should be made crystal clear in terms of the conditions precedent to compensation. This would include the maximum time allowable between the MFI re-imbursement request liquidation by the insurance company; the role of the insurance company in assessing the MFI’s performance, i.e. in the due diligence process and linkages to the contributions/compensations of MFIs. Another important issue to be considered is the cost of these insurance services and the extent to which the cost is “passed-on” to the client or alternatively absorbed by the MFI; or a combination of both. To that end it should be noted that the MFIs financial performance will not be able to absorb additional costs since its revenue stream is majorly set at a 10% ceiling.

The MFU in cooperation with the SMDF should closely observe this experience in order to effectively document it with the intention of assisting other MFIs (besides those that have already joined the scheme) to benefit from the insurance scheme.

The issue of utilization of the Zakat Funds for promoting the MF sector, has been discussed on several occasions with the Zakat Chamber. Although no specific agreement has been

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[7] Monthly Report of June, 2008
[8] Monthly Report, August 2008

reached, the Zakat Chamber has demonstrated its interest in the sector in several aspects. The Chamber contributed to the capital of the Family Bank and has expressed its willingness to avail additional funds to the bank in the form of deposit. The Chamber has also initiated a community mobilization effort aimed at enhancing productive capacities in the rural areas. This could be regarded as complementary to the MF strategy as the community-based organizations (CBOs) could then benefit from microfinance services. An example would be the organizing of people in Sinnar state into agricultural cooperative societies, each of which received a tractor donated by the Chamber.

I.D. Establishing a Specialized MF Department at the Central Bank of Sudan

The first activity that the Central Bank undertook, once the MF strategy was endorsed, was to establish a specialized microfinance MF unit (see Annex 2 for details on structure of MFU). Since its establishment early in 2007, the MFU has actively and successfully campaigned to create greater public awareness of the benefits and requirements of the microfinance industry. The Unit has also provided substantial financial support and capacity building to MFIs. It has also worked towards the creation of a conducive legal and policy framework through the issuance of guidelines and regulatory and supportive policy circulars. As a result of these efforts, a number of financing institutions started engagement in microfinance operations or expressed their interest and readiness to provide financial support to the institutions already engaged in the provision of MF services (e.g. Khartoum Bank and the Egyptian Sudanese Bank have expressed interest in contributing to the capital of the new MF specialized Aljawda Bank). This positive environment has also encouraged a number of states (North Kordofan, South Kordofan, Kassala and North State) and the Social Development Foundation as well as some private sector institutions to submit applications for licensing as fully specialized MFIs. This is in addition to the Family Bank (mostly government owned), which has already started operations and Aljawda Bank (privately owned) which still has a provisional license.

However, many banks still remain skeptical of the whole issue of expanding their MF services and are playing a ‘wait’ and ‘see’ game to see how these newly specialized banks fare in what they still consider is a social service rather than a financial undertaking. This is reinforced by the vocal resistance by the Federal Ministry of Social Welfare, Women and Child Affairs to the acceptance of market-based lending to its constituencies (the poor).

The MFU has been represented in many national committees handling issues related to poverty reduction or employment opportunity creation. This has put much pressure on the already overloaded staff.

The MFU staff participated in several microfinance events and attended several training programs abroad. However, the training has not been tailored specifically to the needs of the unit. The technical capacity of the unit is seen to be lacking in many respects by the partner MFIs. Areas to be considered for targeting in further capacity building of the MFU are: control, supervision, agricultural finance and MF delivery mechanisms and techniques. The Unit proposes to address this shortcoming by recruiting an advisor with strong regional expertise in the provision of MF services. However, it remains that the Unit needs to build in-house expertise targeting the specific areas identified as lacking in the support it gives to its partner MFIs.

The semi-autonomous nature of the MFU has its benefits in that it reduces the bureaucracy associated with the Central Bank’s operations. Nevertheless, the Unit depends on other departments of the Central Bank to conduct various activities connected to its work, such as financial oversight, supervision of MFIs and legal matters. So although the Unit has an almost free hand in implementing the strategy, such autonomy must be accompanied by a highly qualified MF team working in close coordination with other departments in the Central Bank who also need to have the appropriate skills in relation to microfinance.

There seems to be a lack of information on the part of the other stakeholders, namely, MOFNE and the Federal Ministry of Social Welfare (see Annex 3 on Interview with relevant ministries). Also the relation with the banks engaged in the MF pilot project, seems to be one in which the MFU is regarded as the ‘boss’ rather than one of partnership. The Unit needs to foster a relationship of partnership with its local stakeholders so that efforts for developing the sector are pooled and are complementary to each other.

The MFU has developed extremely good relations with the main donors contributing to the development of the MF sector. The Multi-donor Trust Fund which is being administered by the World Bank has contributed $10 million dollars to the creation of the Sudan MF Development Facility (see Box 1 above). The World Bank focal point for this project has confirmed the good working relationship it has with the Unit. Likewise, the UNDP in Sudan focal point, which has contributed to the development of the sector through the International MF Forum organized in November, 2007, has confirmed its close coordination with the MFU. Another contributor, the IFAD, is supporting the MF sector through the restructuring of the branches of ABS and SSDB in Northern Kordofan although that has yet to materialize.

Recommendation: The MFU current set-up in terms of organizational structure, capacity building needs of its staff as well as those of related departments within the CBS should be reviewed to strengthen the Unit’s ability to monitor and evaluate and further improve its implementation in the remaining 3 years of the MF strategy. To ensure greater buy-in and effective partnership, on the part of other government units with a stake in the MF sector, capacity building efforts should also target them. Moreover, the role of the supervisory committee/s should also be reviewed for greater effectiveness.

ENHANCING THE ROLE AND SUPPORTING THE GROWTH OF MFIS

To achieve this objective, three outputs were to be delivered, as highlighted hereunder:

II.A. DEVELOPING SUSTAINABLE MFIS:

Provision of capacity building to MFIs. The lack of institutional and human capacity is considered, in the MF strategy, as one of the key constraints impeding microfinance development in Sudan, Thus, the MFU rightly gave this issue priority in its first year of operation. The most important initiative undertaken by the Unit in this regard was the planning for (training needs assessment questionnaires) and delivery of training to 240 bank employees including senior and middle management from 7 MFIs. Only a few employees of non-bank MFIs, namely from the SDF, have benefitted from training provided by the MFU. The need to target more non-bank MFI for such capacity building efforts is well recognized and the mandate of the newly established SMDF. The training was conducted by Frankfurt School of Finance and Management in collaboration with a local consultant firm. The training covered different topics aimed at providing basic knowledge of MF practice at two levels.

In evaluating its first round of training, the MFU relied on participants' evaluation and feedback from trainees. Some of the shortcomings identified in that evaluation, such as the need to conduct the training in the Arabic language, were taken into consideration in planning for the second round. In the interviews conducted with the MFIs in the course of evaluating the implementation of the strategy, participants considered the training they received to be basic and theoretical. They stated that they would like to see more in-depth technical training in future as well as practical training. The MFU management considered that such basic training was essential in the beginning of the exercise with more in-depth technical training being provided in the second round of training. As such, the proposed second round of training is to cover: a) Training of trainers (TOT), b) training for practitioner bank staff experts, c) preparation of microfinance guiding manuals and specialized training in awareness raising.

Recommendation: While these training activities are certainly needed, it must be said that simply attending training workshop does not necessarily strengthen capacity. This was also echoed in the interviews conducted with MFIs during this exercise of evaluating progress in implementing the strategy. Building capacity requires a conscious effort to share decision making with primary stakeholders over time and engaging them more fully in serving the poor. Its end result must have a lasting local impact in institutional capacity and commitment.

To this end, it is necessary to pinpoint the value-added to the banks benefiting from the training. In general, the MFU/SMDF should target recording the effect of the training provided on the actual development of the MFI’s portfolio vis-à-vis MF activities. Likewise, the bank (MFI) should link its incentive scheme to the application of knowledge, skills and attitudes acquired in the training. For that to take place, it is recommended that training should include the following features:

1. conducted in a participatory manner and complying with adult learning theories and practices
2. linked to real life examples from among the participating organizations
3. include a case study relevant to the topic and should include an output (developed by trainees) to be applied on the trainee’s own institution at the end of the training, whenever possible
4. post-training evaluation to assess applicability in the trainees’ respective organizations in the form of a follow-up *“on-the-job”* training

Training plans should be developed in light of the sector/MFIs’ training needs assessment and in line with current capacities. The MFU/SMDF need to have in place a baseline for the technical capacities and needs expressed by MFIs in order to allow for recording developments made in this area. This will also help the MFU/SMDF in determining how to “best” in serve of the MFIs. Another important aspect is to tie the volume and nature of the MFI training to the expansion of the MFIs’ outreach and/or the quality of portfolio. This should be the end result of the training. In this connection, the MFU/SMDF and the MFIs should agree on a way to link the MF portfolio development to the TA and Training received by the respective MFI; otherwise the MFU/SMDF will only be able to record the activities done without linking these activities to sector development. To that end, a detailed plan could be constructed within the SMDF mandate as it should play a major role in developing benchmarks related to the usefulness of these trainings and how they are benefiting trainees after they get back to their regular working duties.

Another issue related to capacity building is the role of the MFU/SMDF in developing, maintaining, and updating a database to include “well experienced” technical assistance and training service’ providers. This should assist the MFIs to select the right profile for technical assistance.

Establishing key performance indicators. This activity is planned for the medium term in the MF strategy. As such, it is not expected to have been achieved in the short space of time since the establishment of the MFU. Having said that it is pertinent to note at this juncture that the action plan associated with the MF Strategy might have created some confusion in this activity with that stated under “Establishing a Supportive Infrastructure” and given the heading “D: Set Performance Benchmarks and Standards”. It should be clarified, at this juncture, that the two are one and the same. An essential component of a MF supportive infrastructure is the establishment of a common understanding among sector players on how to measure the MFIs performance, and then an agreed upon methodology for presenting and analyzing that information. Otherwise, the validity of information on sector performance will be debatable and stakeholders may arrive at wrong business decisions if erroneous or misleading inputs are provided to them. Thanks to the development of the MF industry worldwide, there are now international standards for reporting on performance that could be adopted by the MFIs in Sudan. This is a cornerstone for setting a valid infrastructure for the sector as will also be conveyed in the recommendation for performance benchmarks and standards listed later under the section "Establishing a Supportive Infrastructure”

MIS/Loan tracking systems. With regards to availing automated Management Information System (MIS)/loan tracking systems for MFIs, accurate, standardized, and comparable information on the financial performance of microfinance providers is imperative for the majority of stakeholders (CBS supervisors, regulators, investors, and clients) to adequately assess risk and returns.

Recommendation: Encouraging MFIs to adopt automated MIS to ensure efficient loan tracking system must be given high priority, as stated in the MF Strategy. This is because MF is characterized by a “large volume of transactions” with a great deal of information to be captured about clients and businesses. So, unless MFIs adopt tested automated MIS, much time and effort will be lost in retrieving and analyzing information on clients including clients’ credit history. The MFU, with the technical assistance of the SMDF, could initiate an effort to capture information on available Arabic software for MF operations by making a technical/cost comparison between the available ones. In this connection, it should be noted that more than one software could be used by MFIs in Sudan, however, the requirement should be that all these software applications should be able to extract and disseminate the relevant information in order to consolidate and arrive at an overall sector performance. Technically speaking, this is easily done as any software would normally have a “data extraction” module that could load data on another commonly used application like excel.

II.B. ENSURING AN EFFECTIVE ROLE OF BANKS IN THE PROVISION OF MF PRODUCTS / SERVICES.

The following activities were planned: a) studying the market demand for MF services (in the short to medium term), and, b) expanding the outreach to target clients/groups (planned during the short to medium terms).
Market studies of the demand for MF Services were conducted in Khartoum state (funded by PlaNet Finance), Northern State (financed by the state itself), Northern Kordofan (IFAD financing) and Southern Kordofan (funded by the state itself). In recognition of the importance of such studies in the expansion of microfinance sector, the MFU obtained permission from the owners of these studies to make them accessible to user MFIs. The issue of easy access to the studies through publication in the Unit's website, could have served that purpose well. However, that remains to be done. The interviews, conducted as part of this Strategy evaluation process, revealed that the data within these Market Studies had not been utilized by the MFIs in the respective states. The reason for non-utilization is not clear as it could be associated to difficulty of accessing the studies, or the language of the studies or simply the lack of information about their existence.

Recommendation: The usefulness of the market studies for MFIs in targeting identified markets, and for developing needed products, as well as for targeting specific clients' groups or type of services, cannot be overemphasized. As such, the MFU should communicate with MFIs to identify the reasons behind them not resorting to the studies in segmenting the targeted markets and developing and/or enhancing products.

The MFU already request MFIs requiring/applying for a license to include a comprehensive market analysis and positioning of the MFI within its business plan. This should be more rigorously applied to new MFIs while those already in operation should be required to do so in the business plan submitted to access wholesale financing from the Central Bank.

II.C. Developing non-bank MFIs

The following activities were stated: a) building on the past experience of the Sudanese Postal Office Savings Fund to regain its legacy as a pioneer institution in facilitating money transfer and micro-saving, and, b) revising both the Humanitarian Act and CBS Article (51) to empower NGOs to function as legislated MFIs.

Experience of the Sudanese Postal Office Savings Fund. The activity on building on the past experience of the Sudanese Postal Office Savings Fund to learn from its legacy as a pioneer institution in facilitating money transfer and micro-saving has not been implemented. The MFU management is of the opinion that the postal experiment was not a successful one. Although it is not clear how this opinion was formed, it remains that important lessons can be drawn from the perceived shortcomings of the postal experiment. In order to take this issue further, the MFU has contacted the "Pensioners Fund" who are the new owners of the Postal Office facility.

Recommendation: As stated in the MF Strategy, the study of the Sudanese Postal Facility and lessons learnt therein, should be conducted in the medium term.

Revision of Humanitarian Act and CBS Article 51. Considerable effort has been exerted by the MFU to revise both the Humanitarian Act and CBS Article (51) to empower NGOs to function as legislated MFIs. But, as discussed earlier, this should not constrain expansion of the MFIs' outreach through work with informal (unregistered) primary groups. MFIs around the world usually work with unregistered groups e.g. the Grameen model of solidarity groups. The MFU exerted a significant effort to coordinate with the Humanitarian Aid Commission (HAC) in order to solve the problem of NGOs engaging in MF. A seven-member committee has been formed to this effect (4 from HAC, 2 from MFU and one from CBS). A draft memo has been prepared for amending the Humanitarian Aid Act (2006) and By-laws to remove restrictions hindering NGOs/CBOs engaging in profit-oriented or commercial activities. The amendment is an attempt to allow CBOs/NGOs to engage in microfinance in a formal manner and the committee prepared a paper on the explanatory note that allows this to take place. All these are positive developments.

Recommendation: The relationship of the MFU with HAC and its consequence for the development of the MF sector will be discussed further in the next chapter.

Establishing a Supportive Infrastructure

As per the MF Strategy, the achievement of this objective require the creation of a supportive information base, launching advocacy for Policy changes, coordination of microfinance activities, setting performance benchmarks and standards and capacity building for MFIs. These will now be considered in the same order.

III.A. Creation of an Operational Supportive Information Base

The following activities were envisaged in the MF Strategy:

An information database on the MF sector. With regards to establishing a supportive information database for MF, it is clear that the MFU has made some efforts, mainly with establishing its own data base which is updated monthly. It includes detailed information on clients (name, amount of loan, type of project, outstanding loans, financing bank/branch, etc.). Each bank monthly submits such information, according to a format provided by the MFU. The database is used by the Unit for preparing its reports and is accessible to its staff only but relevant information can be provided to MFIs upon request. Studies commissioned by the Central Bank on MF in Sudan are available on the MFU's website, www.cbos.gov.sd and experts are encouraged to publish their articles in this website. Moreover, the market surveys conducted in four states in Sudan are to be made available on the Unit's website. However, the database, as conveyed by the MFU, needs further development, particularly in relation to data entry and reporting.

Recommendation: Given its importance of the informative database for development of the MF sector, a further discussion/ recommendation will be included in the next chapter.

Establishing an Information Credit Bureau. The establishment of an Information Credit Bureau (ICB) was scheduled in the short to medium terms. The interviewed MFU partners (MFIs) believed that such bureau would be of great benefit, as the current information on potential clients, availed by the CBS, only covers clients who had received credit from banks, including microfinance clients. It does not include non-bank clients who received credit from NGOs, CBOs and other non-bank financing agencies. The MFU believes that the functions of an ICB could be assigned to the proposed "Takaful' Insurance agency, the establishment of which is still debatable. It is worth-mentioning that the SDF is envisaging the establishment of an ICB and has already nominated and trained staff for this function (trained in Egypt). The SDF has also started to provide information on clients located in the geographical area of its coverage, on request from the newly established Family Bank.

Recommendation: Given the usefulness of providing information on clients, it is recommended the MFU/SMDF promote the establishment of a Credit Information Bureau in the medium term.

III.B. ADVOCACY FOR POLICY CHANGE

According to the MF strategy, advocacy for policy change requires the implementation of one activity in the short run that of effecting the role of the existing MF Organizations Network or establishing a new network to advocate for needed policy changes.

Effecting the role of Micro-finance networks. Currently there are no national networks for organizations engaged in micro-lending. However, there are networks at the state level, namely Khartoum and Gedarif, but those are still in need of much capacity building. The members of these networks have limited experience in handling microfinance, not to mention advocacy for policy change. The Sudan Microfinance Development Facility (SMDF) has made it its priority to build the capacity building of non-bank MFI with the aim of enabling them to create networks strong enough to advocate for policy change.

Recommendation: the SMDF should have a clearly outlined section within its capacity development plans to tackle the issue of networks, their perceived role, and especially their future relation with the SMDF company.

III.C. COORDINATION OF MF ACTIVITIES

The activity planned for implementation in the short run is to study the international models of umbrella/Apex Institutions. Although this was not specifically implemented, it was addressed in the context of establishing the Sudan Microfinance Development Facility (SMDF) as an alternative to the Apex institution.

Recommendation: Given that there seems to be some confusion between the functions of an apex institution/umbrella organization and those of the SMDF, this issue will be addressed in greater detail in the next chapter.

III.D. SETTING PERFORMANCE BENCHMARKS AND STANDARDS FOR NON-BANK MFIS

The main activity planned within the MF Strategy (Action Plan), in the short term, in realizing the fourth output of setting performance benchmarks and standards is: ***Studying the legal requirements for a self-regulatory organization (SRO).*** This was set, in the MF strategy, as a prelude to the actual establishment of the SRO in the medium term. Although no study has been conducted on this issue, the MFU stated that it held consultative meetings to deliberate it. This is expected to be taken up by the newly established SMDF which will focus on enabling non-bank MFIs with progress towards the establishment of the SRO. But before this could take place, the other medium term activity planned, within this context, was the "***setting of benchmarks/performance standards for the sector***". It should be emphasized that this activity is needed for both banks and non-bank MFIs. As such the following recommendation applies:

Recommendation: Given the urgent need for establishing key performance indicators for MFIs, it would be advisable for the MFU/SMDF to immediately move towards achieving this activity. In this regard, it should be noted that the MF industry has already developed a set of internationally approved standards for activity and financial reporting. These standards and even benchmarks are established through international donor assisted initiatives and are posted on the Mix Market website which could be accessed through www.cgap.org

The issue at hand is therefore not building these standards but rather to put them in operation. For that to take place, it is essential to do the following:

1. Provide adequate capacity development in accounting, financial analysis and reporting to MFIs through the SMDF initiatives and other relevant venues.
2. Encouraging third-party performance assessments and internationally recognized ratings of MFIs and adopting the reports prepared as one of the major criteria for facilitating "wholesale" funding to MFIs.
3. Prioritize capacity development and other services to MFIs based on meeting the performance criteria.

These steps would enable sound funding decisions and would help MFIs in analyzing and improving their operations. Additionally, cost-effective methods to measure social performance needs to be established for those MFIs whose key goal is social performance. Regular social performance monitoring could then be included in the performance measurement system.

III.E. PROVISION OF CAPACITY BUILDING PROGRAMS TO MFIS

Designing specialized training programs in MF for bankers

The capacity building programs for MFI employees was among the first activities performed by the MFU in its first year of operation. This was covered in that part of the strategy relating to "Enhancing the role and supporting the growth of MFIs". What is envisioned in this part of the strategy, i.e. "Establishing a supportive infrastructure" are the specialized MF programs to be provided by educational institutions. In this regard, the CBS through its MFU has taken a major step in encouraging such institutions to offer educational programs in the delivery of MF services and has allocated substantial funding for such programs. Important higher level institutions such as the Academy of Banking studies, the Ahfad University and the Sudan College are now in the process of developing their curricula to benefit from the Central Bank's initiative in this regard.

Designing awareness raising campaigns and training courses addressing policy makers and government stakeholders

In addressing this issue, the MFU noted the training it has provided to bank managers, as policy-makers. Extensive public awareness efforts have also been undertaken by the MFU through different communication and lobbying means e.g. monthly consultative fora, coordination meetings, radio and TV programs, newspapers, lobbying and advocacy.

It can be confidently said that the implementation of the MF strategy in Sudan has created a great interest in the sector as a potent tool in poverty reduction. However, there is still a strong lingering perception that MF is a social undertaking that should be offered at little or no cost and for which repayment is not necessary.

Recommendation: There is a tremendous need for greater effort to be exerted in enhancing awareness of the MF sector as a viable financial undertaking that can have a dual economic and social role. To this end, a well planned and carefully thought out advocacy program needs to be in place targeting policy makers as well as beneficiaries of MF services.

Chapter Two: Further Important Considerations in the Evaluation of the MF Strategy Implementation

I. INTRODUCTION

The Microfinance Unit (MFU), has a dual nature in which, on the one hand, it acts as a regulator of the Micro-financial sector (i.e. formal Microfinance Institutions), by virtue of the position as a unit attached to the Central Bank of Sudan (CBS), and on the other hand, its mandate is to serve and develop MFIs, in general, and formal ones (banks), in particular. Its activities are therefore, nation-wide, advocating for sector requirements among various stakeholders, providing and facilitating financial services and, in some cases, facilitating non-financial services and finally targeting multi-sectors of economically active micro-enterpreneurs in Sudan.

Another important issue is the recent start[9] of the Sudan Microfinance Development Facility (SMDF) which is established, under the *Sudan Microfinance Development Facility Project* (see Box in chapter 1 of the report), as a company with balanced representation at the Board level for stakeholders. Moreover, the SMDF could be reasonably foreseein to take the role of an “Apex/umbrella” institution in Sudan with a focus on non-bank MFIs. As such, the relationship between the MFU and the SMDF is a crucial aspect with potential to assist or, on the opposite, hinder the development of the sector; a separate part of the report shall tackle this issues and outline relative recommendations covering the MFU/SMDF proposed roles and cooperation.

In addition to the MFU/SMDF relation; one of the most important needs cited in the strategy was to build an informative infrastructure about the Microfinance sector performance and update the captured information to provide a handy and useful tool for decision makers and relevant stakeholders. In prinicple, microfinance and more precisely microcredit could be defined as “information-based” as opposed to the traditional “collateral-based” lending widely practiced by formal financial institutions in corporate lending. This implies that the amount of data to be captured is large and needs to be updated frequently and with ideally no human errors, all pointing out to the need for an automated system for information capturing, analysis, and dessimination.

Finally, the issue of actually starting to inject loan funds at a number of institutions by the MFU shall be discussed from a view of rationalizing the transactions in a way not to hurt the industry, especially with regards to subsibies computation and allocation.

All these factors should be kept in mind while reviewing the accomplishments of the unit. Besides the factors above, the MFU has a national responsibility of developing sectors and creating jobs positioned as the center theme of its efforts. This factor alone should have its weight in the effort to track implementation of the strategy components, as well as the design of M&E system.

The following sections shall focus on specific aspects, stated above, which are considered to be of critical importance to the development of the MF sector. It will draw on the findings of chapter one, the the desk review and field survey conducted in an effort to draw lessons and point out areas to tackle in the coming years for implementation.

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[9] Actively starting on the third quarter of 2008 as per the interview with SMDF

II. THE RELATIONSHIP BETWEEN THE CENTRAL BANK OF SUDAN (CBS) AND NON-BANK MICROFINANCE INSTITUTIONS

The issue of the relationship between the CBS as represented by the MFU and non-bank MFIs should be carefully tackled as it has important consequences on the expansion of MF services. In more specific terms, the CBS authority over non-bank Microfinance institutions should be clearly defined so as not to interfere with other regulatory/supervisory authorities concerened with these MFIs. This is important because Non-Governmantal organizations (NGOs), Community based Organizations (CBOs) and Self-help Groups (SHG's) have to satisfy their respective supervisory body's requirements. The wisdom here is that the MFU/CBS should practically build its relation with the non-bank MFIs on a win-win basis. It is well known that Microfinance is an activity that should be practiced by a wide array of institutional types to ensure maximum outreach to marginalized and poor communities. As such, the CBS represented by the MFU has a high potential to facilitate the work of non-bank MFIs to the extent that they volunatrily elect to be subject to its standards of performance. Such standards should be minimal and flexible since by definition these MFIs are non-deposit takers (or with little deposits). The MF strategy clearly emphasized the vital role of non-bank MFIs in expanding the MF sector. Moreover, a major perceived incentive for the MFU/CBS is that it will be deepening the financial market as it attracts these MFIs into the more formal set-up. The incentive for non-bank MFIs could be a wider access to financing[10] and a more targeted support to their institutional and capacity development efforts.

II.A. THE RELATION BETWEEN THE MFU AND THE HUMANITARIAN AID COMMISSION

A major development in the implementation of the MF Strategy is the relationship that has been established between the MFU and the Humanitarian Aid Commission (HAC) whose mandate it is to oversee the work of NGOs. This development can have a crucial part to play in the creation of a vibrant MF sector in Sudan. To that end, the MFU has taken the initiative of joining forces with HAC, in an organized fashion, and thereby forming a committee with representation from the CBS (one member), the MFU (2 members) and HAC (4 members). As shown in the previous chapter, the first output from this a committee was a draft memorandum to amend the Humanitarian Aid Act of 2006 and its associated by-laws as well as the preparation of an associated explanatory note allowing NGOs to engage in MF activities.

While all these effforts signal the commitment on the part of the CBS and HAC to support MF development, every precaution should be taken to ensure that these efforts continue to have a positive impact on the sector. In this connection, it is pertinant to note two issues: ***(1) the the committee lacks representation from those same NGOs and CBOs which it is created to serve; (2) MF best practice continuously strives to strike a balance between the need to have some regulation in the MF sector as opposed to the "rush to regulate" the sector, where over-regulation has been shown to hurt the industry.*** As such, the following precautions should be kept in mind while continuing the joint cooperation between the MFU and HAC:

1. The main issue in the Huamanitarian Act that constrained NGOs from actively engaging in MF activities was the clause prohibiting them to engage in any profit-making activities. In this regard, a clear differentiation between profit making and "accumulating surplus" should be made with regards to NGOs' involvement in MF. It is well recognized that the costs associated with service delivery and credit

[10] Based on meeting a specified set of criteria related to performance and reporting

recovery are higher in MF as compared to regular loans. This is in addition to the higher risk profile that the MF clients have. That is why MFIs, in general, and NGOs, in particular, need to earn enough revenue to offset all these costs and at the same time allow for a capitalization margin to expand services and thereby fulfill their social objective.

2. Clear authority lines should be drawn so as not to give the impression to NGOs that they are being subjected to CBS laws and regulations. The role of the committee here should be to facilitate information exchange and problem solving not to impose restrictions. ***But inorder to undertake such a role, it must clearly involve its stkeholders and as such must include representatives of NGOs as members of the committee.***

3. As time passes, the image of the joint committee could be viewed as a sector regulator and a control mechanism rather than a promoter of the sector which is its ultimate purpose. This could very well have an adverse effect on the MF sector as it is well known that the innovativeness in MF services, as well as the effective delivery mechanisms have originated from local communities and civil society actors' (NGOs') initiatives; they provided valuable lessons and models for the banking sector to engage in MF. ***It is pertinent to note here that the microfinance strategic plan proposed that the regulation of NGOs activities should be undertaken by a Self-regulatory Organization (SRO) rather than a governmental body***.

4. There are several models of Self-Regulatory functions that the committee could refer to and use as a guidance to develop the scope of the committee's functions as a complement rather than a substitute to the regulation of the sector. An example of such models is included in the comprehensive study prepared on models of Self regulatory Organizations (SROs) as part of the supporting researches under Egypt's Microfinance Strategy (the report is available at the Sanabel website – Arabic MF gateway). The models provided within that study are international and could provide a solid start for discussion.

III. THE SMDF AS AN APEX ORGANIZATION & ITS RELATION WITH THE MFU

One of the perceived roles of the SMDF is for it to act as an *Apex* organization. This was stated by the SMDF management during the field interview process of the current evaluation of the MF Strategy implementation. In dicussing this issue within the Sudanese context; rather than attempting to duplicate the existing research on best practices Apex Organizations[11], some considerations to be kept in mind are as follows:

1. With regards to the definition of an "Apex" institution, it is referred to by CGAP[12] as *"a second-tier or wholesale organization that channels funding (grants, loans, guarantees) to multiple MFIs in a single country or region. Funding may be provided with or without supporting technical services"*. This definition points to the major role of an apex as a facilitator of access to funds to MFIs, at an institutional level, that can be coupled with technical services but not necessarily so. Moreover, the definition did not prefer one legal shape (NGO, Company, Quasi-governmental) over another. This is left to be determined on a country basis and in light of the existing legal

[11] The SMDF stated that a separate section on apex institutions model was/is being prepared within the SMDF mandate and plans.

[12] www.cgap.org Donor Brief No. 5 July 2002

environment. In the case of Sudan, the perceived “Apex organization” which is currently the SMDF has already been registered as a limited liability company (as per interview with SMDF management). Accordingly, the following recommendations apply:

i. A specific effort should be initiated during the mid-term of the currrent SMDF project to evaluate its services vis-à-vis the MFU services; especially with regards to the role of facilitating access to finance. While the MFU has started channeling funds to MFIs; this is perceived by MFI community as a major role to be undertaken by the SMDF (the apex). The delineation between financing provided to formal MFIs (the banks) through the MFU and that being facilitated by the SMDF to non-bank MFIs should be closely coordinated to ensure that standard performance indicators are applied.

ii. Another important issue that needs to be considered in a mid-term evaluation of the currrent SMDF project, is the ability of the SMDF (given its profit oriented nature) to attract funding from International agencies and the donor community. The answer to this question should guide the decision of maintaining or revising the legal shape of the current Limited Liability Company.

iii. Another major issue for consideration is the need for the MFU itself to more precisely define its role vis-a-vis the existence and development of an Apex organization. This is especially needed if this Apex organization also includes technical services in its scope of work. In carefully considering the functions of each set-up – the MFU and the SMDF – the latter assuming the role of an Apex Organization, MF best practice should be kept in mind. Such best practice stears clearly away from governmental high-handedness and gives preference to total independence which precludes even the presence of government representation in the board of an Apex Organization. This is an important issue to analyze and decide upon towards the mid-term of implementing the current SMDF project. The result of this effort should rationalize the decisions on the future role and size of the MFU and its functions vis-à-vis the SMDF.

2. The Apex Organization should be the logical legacy of the SMDF project, and probably this is the main reason behind establishing it as a limited liability company in order to root it within the existing legal framework from the beginning. However, the *issues of balanced representation, institutional and financial sustainability* should be highlighted in the SMDF detailed plans with regards to the apex institution set-up and operations.

i. *Regarding representation,* the SMDF board includes government representation which can be regarded as natural given that the facility is fully owned by the government. Full government ownership and representation in the board of an Apex organization is not regarded as a positive factor in MF practice. The reason being the possibility of politicizing the organization’s business decisions. The fear is that such politicization could, for example, put pressure on the Apex organization to adopt lenient diligence processes to accelerate disbursement of funds to MFIs. In Sudan, with the overwhelming political commitment to expanding the extension of MF services throughout the country, this is likely to occur with negative consequences on the sustainability of such services. The issue of government ownership (shares) and participation in the board of the Apex should be carefully reviewed towards mid-term. The preferred option would be to have minimum government involvement so as to ensure that the Board decision-making process is NOT materially influenced. In this regard, the Board of the SMDF should have a manual that clearly delineate its tasks, TOR for sub-committees (Technical Services Committee, Fund Raising/Treasury Committee …etc.), understandings and agreements of the Board members on Governance issues (Remuneration and others). The role of the government as represented by the MFU-CBS (or a representative of the CBS if the MFU is dissolved) should focus on ensuring the quality of services provided by the Apex and that the facility is fully supportive of MFIs.

ii. *Regarding institutional sustainability,* it should be based on solid premises preventing governmental over-control, allowing the Apex to deal with multi-players and providing active governance to the MFIs it works with. To this end, the SMDF project should have an exit plan whereby the government (CBS or otherwise) gradually relinquishes its role as the sole or majority owner of the facility. Towards project's mid-term, the SMDF should have a clearer view of the future performance of the company and how it could be sustainable. This should also be accompanied with the financial forecast of the SMDF which should provide a reasonable basis for estimating the company net worth towards the end of the project. Such a financial forecast will also enable the government to practically consider and discuss selling its shares by the end of the project.

iii. *Regarding financial sustainability*, the Apex should have a solid business plan that illustrates its ability to secure its costs and achieve positive yield on its assets beyond the lifetime of the current SMDF project. There are typical revenue sources that are expected here namely; the return on facilitating financing to MFIs (through Mudaraba and/or Musharaka), revenue generated from technical services, revenue generated from special projects like the credit bureau). The success of the SMDF in providing needed services and added-value to the sector will be a major benchmark in deciding on its sustainability and hence; its plans beyond project life.

3. The functions of the Apex organization should be based on practical requirements for the development of the MF sector. Many examples could be provided such as the ownership and maintenance of the database including the Credit Information Bureau, facilitating assessment and rating by internationally recognized institutions, facilitating access to finance based on a clear and transparent criteria, among others. The array of functions and roles of the apex institution is the major guideline for deciding on the details of its governance practices and management structure.

IV. THE CREATION AND OPERATIONALIZATION OF A SUPPORTIVE INFORMATION BASE

The MFU has started on its own initiative has established a database managed by two staff members. The database is a backbone for the sector development and it should be viewed as such. The following features should be considered in the development and sustainability of the database:

1. It should be designed in a user-friendly manner

2. It should be accessible to a wider network (inside and outside Sudan)
3. The access could be for free at the early stages of implementation and actual testing. Then a fee could be established as a source of revenue to maintain and update information
4. The database could include a separate module for credit inquiries; in other words a "Credit Bureau - CB". This will ensure repetitive access to the database in general –if it is linked with the CB- and would support the argument of charging a fee for accessing the database.
5. The question of *"who shall inherit the database?"* should be thought of jointly with the SMDF project management well ahead before the project end date. The database and especially the credit bureau should be entrusted to an independent institution that is protected by law and is at the same time subject to prudential regulations that guarantee its accountability and ensure "client protection" aspects of information exchange, besides not imposing excessive charges on inquiries.
6. In light of the amount of data generated by MFIs, an automated data exchange routine should be established, to the extent possible between the MFU and the operating MFIs in Sudan (Banks and non-bank) to capture portfolio major indicators in a timely and user-friendly manner.

The inputs of the database as maintained by the department/technical staff of the MFU will also be of critical importance to the future monitoring of the MF Strategy Implementation This is is needed for the following reasons:

a) The data capturing function is the primary step to perform a set of analysis on the information gathered (growth in portfolio, outreach to specific groups like Female Heads of Households, portfolio quality indicators mainly portfolio at risk (PAR), operating cost ratio and loan officers' productivity, besides other relevant indicators). Analyzing the information captured would allow the MFU to draw lessons from implementation and perhaps re-direct the financial and technical resources of the MFU to achieve better impact.
b) The data analysis will provide many possibilities of cross-linking the achievements of the MFU to the major objectives set forth in the strategy, and correlate to other indicators that the CBS sees vital to monitor

V. MOTIVATION OF BANKS TO ACTIVELY ENGAGE IN MF OPERATIONS

The previous chapter has clearly shown that the engagement of banks in MF operations is still poor with many still handling these operations in the same traditional manner (desk rather than field work). This means that banks engaged in MF operations are either not adequately aware of the operational feasibility of the activity, or are not willing to change their corporate culture and embark materially on offering MF services.

The MFU has, in many occassions, stressed the importance of the businessplan, in its requirement for new banks to obtain a license and/or for those banks who wish to benefit from the CBS wholesale financing. Moreover, the MFU, has put in place a reasonable research data base [the market studies conducted in 4 states] covering information needed to start an effective business planning exercise for participating and potential partners. There is, therefore every reason to expect banks involved (or those with potential to be involved) in MF operations to have an informative Business Plan in place with a strong section on the analysis of the bank's vision and strategic orientation vis-à-vis microfinance. The business plan should cover the *market segmentation, bank's competitive edge(s), marketing strategy, branding, and sales strategy*; all unfolded in the plan for services' extension and expansion (including a detailed financial plan). The answer to the these issues in business planning will help to shed light on the serioussness of the bank in taking the MF activity and assist the MFU in rationalizing the selection of its implementing partners.

Besides the strategic level of buy-in by the bank's decision makers, it is a fact that getting a bank to operate MF program according to best practices requires much effort to convince the operational departments at the bank with the merits of MF. Primarily, the staff involved in MF operations should be treated in a different manner regarding working hours (at least 70% of time in the field). The other important operational issue is the incentive system applied to MF operational staff which should be different from the rest of the units. In best practices MF field officers and management staff receive the major portion of their remuneration as a direct function of their "service expansion", "client maintenance" and "quality of portfolio". The incentive schemes are more based on the "number" of transactions as opposed to the "volume of portfolio". This is because the average MF transaction is significantly lower than regular credit for the bank. This may create a negative incentive for the operational staff to expand MF transactions at the account of their regular transactions, especially if they are treated the same from the remuneration system of the bank they work for. Incentive schemes for staff should also inclulde non-financial incentives (like awards, nomination to exchange visits, recognition by public figures, …etc.).

The bottom line here is that as long as the banks, as well as their employees involved in MF operations, do not perceive a tangibe benefit of embarking on MF, they will still be reluctant to boost outreach. To solve this issue, the MFU and the SMDF should dedicate considerable effort and time to come up with a set of practical incentive mechanisms at the MFI institutional levels to motivate active involvement and service expansion. One important recommendation that could be examined in this respect is the possibility of a clear incentive scheme to be included in the regulations of the Central Bank for those banks that are engaged in MF operations. At the individual MFI level, the MFU/SMDF should follow-up properly on ensuring that the MFIs are adopting a reasonable and fair incentive scheme for its MF staff that is built on the parameters of service expansion (new and renewed clients), client retention and portfolio quality.

Other insights for vitalizing and expanding banks' portfolio in MF could be found in the experience of some major Middle East banks in establishing a MF specific product within their existing structure. Examples of these that could be cited are "Banque du Caire" and Bank Misr in Egypt. It worth noting that both downscaling processes started with a heavy intervention at the level of the Board in order to guarantee their buy-in to the new product. The second very important factor is to appoint a "champion" for the MF activities within the bank. This champion should have the access to, and credibility with the Board in order to be able to facilitate any problems and satisfy any requirements for the MF product within the bank organizational hierarchy. Following that is a carefully designed orientation program with MF best practices to the top and mid-level management of the banks. Normally, this set of activities should result in a Vision and Mission statement for the banks that are willing to engage in MF activities. Then the whole effort of developing the staff capacities and operationalize MF within the bank becomes much more smoother. In summary, the MFU with the technical cooperation of the SMDF should design a substantial intervention aiming at orienting the Boards and top level managers of targeted banks with MF practices and requirements, and accordingly ask each bank to nominate a "credible" champion who has direct connection with the top level management and Board to lead the MF activity and be the focal point between the bank and the MFU in the future.

V.A. THE PROFIT MARGIN CEILING APPLIED TO MF OPERATIONS (MURABAHA)

The policy of applying a ceiling on the profit margin of Murabaha Micro-loans should be carefully reconsidered with the aim of balancing between the associated pros and cons. The following points are meant to highlight potential areas for maximizing the benefit of funds/subsidies in support of the MF sector and to minimize, as much as possible, the side effects that are likely to occur.

1. It is a practice that the MF industry received and is receiving until now subsidies to expand; even many of the well-known names in the industry like Grameen Foundation[13] have built their financial/capital base largely from grants. The major source of funding that have started this foundation and enabled it to re-finance MFIs on a global scale comprised around 95% restricted and/or partially restricted grant financing. However, the foundation uses its granted capital to leverage its resources and increase access for serious MFIs to institutional credit. The schemes designed by Grameen foundation to re-finance MFIs are built on market performance rates. This applies for direct lending, as well as fees for issuing a guarantee to a local bank to avail local funds to the MFI. As such, the grants offered to Grameen are used to leverage its resources and expand coverage rather than passing them over to MFIs or to end-user borrowers. A lesson that we have to keep in mind when deciding on future funding to MFIs in Sudan.
2. It is not an accepted practice in sound MF to interfere in the interest rate (in Sudan's case the profit margin or cost of finance) setting policy of a MF institution, even when the objective is to subsidize the provision of financial services to the economically active poor. This is for many reasons, some of which are:
   - → Setting ceilings on profit margin/cost of finance will not provide real incentive for MFIs to embark on MF activities, especially given MF high labor costs
   - → Any subsidy that is announced and known shall promote an image of charity underlying the whole operations and thus, may negatively affect the ability of the MFIs to recover loans from the end-borrower
   - → Hindering the ability of the MFI to realize attractive returns on its MF portfolio will accordingly lead to problems; both at the levels of Governance and Management. At the governance level, some of the Board members shall see that the whole MF activity is included to comply with the political will and thereby loosing support and ownership. At the operational side, the MFI would not be able to get enough revenue to recruit and maintain a good staff caliber, nor will it be able to provide its staff with decent incentives and accordingly escape slagging performance and potential abuse of resources.

All the above reasons could have contributed to the lagging performance of banks in achieving the 12% of the portfolio that should target MF sector. The situation is further aggrevated by asking MFIs not to charge 5% of the 10% and seek its re-imbursement from the Ministry of Finance.[14] It worth mentioning here that according to a recent study on the

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[13] Grameen Foundation Financial Statements 2007 -2008

[14] Findings of field survey conducted as part of the evaluation of implementation of MF Strategy.

MF demand in Khartoum districts revealed that the major reason for not applying for credit is the lack of information on such schemes and not the costs associated with the loan.

The conclusion here is that any support to the MF sector should not result in hindering the will and ability of MFIs to expand its services. Some of the options to re-direct the intended subsidy could be one-of or a combination of the following:

→ Decrease the share of the CBS in the Musharaka agreements made with MFIs. To act as an incentive the decrease in CBS share (or altogether forgoing its share as in 'Qard hassun') in the Musharaka agreement should be made in relation to good portfolio quality and expansion indicators and not ahead of that. If the MFI then sees itself making a profit, it will be motivated to embark on more MF operations.

→ Finance capacity development initiatives (while emphasizing cost sharing principle)

→ Designing specialized Business Development and Advisory services (BDAS) to the end-borrowers through qualified existing serviecs providers

→ Finance the development of a functional Credit Bureau (CB) and the establishment of a needed self-reguatory organization (SRO)

Another option to be considered here is to base the rationale of pricing on a scientific base of a proper costing exercise for each participating MFIs; based on interationally recognized costing methodology "Activity Based Costing" which is adopted by MFIs worldwide. Then the allowable range of service charges could be set in light of the associated costs and market competitiveness position. This could be the fair way to argue whether a specific service charge is excessive or not.

The presence of the SMDF advisors is a present opportunity to capitalize on and a separate study could be done in order to identify how to best channel sector subsidies without demotivating MFIs from expanding their services to the targeted groups.

V.B CBS/MFU INITIATIVE TO PROVIDE WHOLESALE FINANCE TO BANKS

The decision to allocate funds to MFIs was not originally planned in the vision of the sector; yet it signals the Central Bank's strong support to the expansion of MF services, namely access to credit to the vast majority of Sudanese economically active poor. Moreover, criteria for selecting institutions to qualify for receiving funds from the CBS/MFU were developed by the MFU and applied to interested banks. While setting eligibility criteria is the first step towards objectively selecting MFIs to be financed, the following issues should be considered:

1. The condition that the MFI match the CBS fund by contributing 50% from its resources, is highly desirable as it signifies the endorsement of MF operations by the MFI's top level management. Moreover, the MFU requested banks, benefiting from the financial support, to establish separate microfinance units/branches and to develop strategies for their microfinance operations. Nevertheless, the field review, conducted in the process of the current evaluation, showed that the commitment of the participating bank still needs to be translated into change away from the traditional mode of lending in MF operations. To address this concern, transfer of funds, from CBS to MFIs, should be tied to carefully prepared business plans along the following lines:
   i) The business plan should clearly show that MF operations are to be treated as a separate revenue/cost center from the on-set. Moreover, the staff allocation to MF operations, as well as the staff time for work on the MF portfolio should be very clear within the business plan. In some cases, banks would like to start offering MF as a new product while using the same management capacity and labor force

of the bank, until the volume of the portfolio (and revenue generated) allows for hiring separate staff and establishing a separate unit or cost/revenue center. If that is the case, it should be clearly stated to show when and how MF operations will be expanded.

ii) The business plan should include a detailed cash flow for the portfolio identifying the expected rates of loan disbursement and expected collection of loans, thereby outlining how the bank intends to use the portfolio of allocated funds.

iii) MFI/banks applying for funding should identify the different types of loans to be offered (i.e. working capital loans of repayment period (tenor) less than one year versus loans financing fixed assets, agricultural activities and others for which the tenor exceeds one year), as well as measures taken to ensure proper client follow-up and loan monitoring functions. Such measures should include the allocation of an appropriate number of staff to follow-up on clients and clearly showing the progression of these staff numbers as the portfolio builds-up.

iv) The calculation and expression of portfolio at risk indicators should be different for loans with more than one year tenor. Using the standard aging of the portfolio (1-30, 31-60, 61-90, 91-120) may not be appropriate for loans of longer tenor, or for loans with bullet and/or balloon repayments (where the principal loan amount is paid in one installment at the end of the loan tenor or the principal loan amount plus interest are paid at the end of the loan tenor). The portfolio reports should segregate the "longer" term loans and report on it separately with appropriate aging brackets for unpaid installments.

2. MFIs, benefitting from CBS resources, should be requested to provide the MFU with detailed cash flows. This will allow the MFU to periodically monitor (recommended every three months) implementation of the business plan. This should also form the basis upon which future funds disbursements are made to the MFI. Another action that could be followed by the MFU in its quest to maximize the output from its earmarked funds (maximum number of economically active poor with access to MF operations), is to request the participating MFI to utilize its own resources first. The MFU can then transfer the amounts required for on-lending, based on increments of cash needed as the portfolio builds-up.

3. Special attention should be given to reviewing the cost structure of the MF products to ensure that the bank is actually recovering its costs if not achieving a real positive return on the capital invested in the MF operations. This is a very important point as losses will not encourage the bank to continue in MF operations, let alone expand in them. It is also important because it allows the MFU to accumulate experience in the cost containment (structure and amount) measures being implemented by banks offering MF services. Such experience will place the MFU in a better position to evaluate the impact on MF operations of CBS policy imposing a 10% ceiling (range of 8%-12%) on Murabaha transactions.

Chapter 3: Conclusion & Summary of Recommendations

CONCLUSION

This report is a culmination of an extensive evaluation process of progress in implementation of the MF Strategy. The evaluation recognized, from the beginning, that it is still too early to quantify the impact of policies undertaken in the implementing the Strategy. Accordingly, the evaluation focused on reviewing the activities of the MFU, to identify areas of strengths and weaknesses in implementation, and to make recommendations on the way forward so as to ensure steady progress in achieving the objectives of the MF Strategy. The evaluation process was also seen as an opportunity to review the Strategy itself to assess whether any revisions were needed on the basis of actual implementation in its one and a half year of operation.

The first part of the report recognizes the tremendous efforts that have been exerted by the MFU since its establishment early in 2007. It also recognizes the considerable progress that has been achieved in moving forward towards an expanded MF sector. Having said that, it is recognized that the Strategy implementation is still in its early stages and much work remains to be done towards achieving the primary goal of the MF Strategy - the establishment of a self-sustaining MF sector with expanded outreach to the majority of the economically active poor in Sudan.

The challenges ahead can be summarized as follows: **Firstly**, changing the perception among both banks and policy makers so as to recognize the viability of microfinance, not only as a social undertaking, but also as a sustainable financial tool that can also be a profitable activity. In this respect, unification of the messages that address the target client and promote a real understanding of the role of microfinance, should be undertaken as a collective effort by both government and non-government stakeholders. The MFU/CBS cannot do it on its own but must sensitize and work closely with its partners (government institutions and MFIs) to complement, support and strengthen its efforts in laying the foundation for a sustainable MF industry in Sudan;

Secondly, motivating banks to more effectively engage in microfinance and so change their traditional approach to such services. In this respect, incentives should be linked with performance, achievement of targets and plans. Such performance will necessarily include Reduction in operation costs to be more in line with the 10% profit margin (charged on Murabaha transactions); Diversification of MF products based on the needs of clients, identified through MF demand market studies; Expansion of outreach by the adoption of well known best practice in the delivery of micro-financial services; Adoption of microfinance technical packages, including Management Information Systems, Computerized loan tracking systems etc., required for efficient and effective MF operations. But prior to that, there is a need for a unification of the definition of the targeted client, among MFIs as well as policy makers, to effectively increase their access to microfinance services. **Thirdly**, the challenge remains of increasing the number of Sudanese who are technically and practically skilled and enabled to efficiently and effectively manage microfinance operations and disseminate information on best practice. Capacity building efforts being undertaken will need to be intensified with a focus on training of trainers as well as strengthening local MF specialized organizations. The role of the MFU and SMDF in this respect is critical. Complimentary capacity building efforts aimed at the micro-entrepreneur in the form of business development services will also need to be developed and expanded.

Fourthly, the Field Survey as well as the M&E planning exercise, both undertaken as part of the current evaluation, brought to the forefront the need for a careful review of the structure and capabilities of the MFU as the driving force for progress in developing the sector. The

MFU should capitalize on the presence of the advisory capacity within the SMDF project in order to arrive at the roles and complementarities between the Unit and the SMDF in its perceived form as the potential apex institution for MF in Sudan. By the same token, the SMDF project should, jointly with project stakeholders (non-bank MFIs- NGOs), revisit the SMDF performance through a mid-term evaluation with a focused purpose of evaluating the value added by the project as well as validating the suitability of its current legal structure.

Finally and most importantly, it cannot be overstressed that microfinance is an effective poverty alleviation tool but it is effective when undertaken within an overall package of poverty reduction policies. Tremendous public mobilization has been effected by the adoption of the MF Strategy, however, the concern remains that such efforts will be undermined by the need for complimentary efforts in reducing the burden on micro-entrepreneurs from a multiplicy of other factors. Among the most important of these factors are those arising from excessive taxes and governmental harassment as well as lack of human resource development services (basic services of education, health and water).

Lastly and sincerely, the evaluation process and recommendations emanating from it are meant to assist in making future activities, undertaken as part of the strategy implementation for development of the MF sector, more effective in achieving the desired goals. In no way do they undermine the great efforts undertaken so far. They are an effort at enhancing the impact of these efforts.

SUMMARY OF RECOMMENDATIONS AND RELATED ACTIONS:

The table below summarizes the key recommendations emmanating from the process of evaluating the implementation of the MF Strategy, almost two years after its adoption. The table focuses on the actions that have been partly or incompletely undertaken or those which need to be reviewed for greater effectiveness and progress towards achieving the goals of the MF Strategy.

Recommendation	***Related Actions***
CREATING A CONDUCIVE LEGAL AND POLICY FRAMEWORK	
Carefully design a set of practical incentive mechanisms at the MFI institutional levels to motivate active involvement and service expansion.	Examine the possibility of a clear incentive scheme to be included in the regulations of the Central Bank for those banks engaged in MF operations (e.g. decreased tax bracket for MFI/banks).
Re-direct subsidies to finance development of the MF sector	Possible actions for consideration: • Decrease the share of the CBS in the Musharaka agreements to those MFIs meeting a preset quality of portfolio indicator and expansion targets. • Finance capacity development initiatives (while emphasizing cost sharing principle). • Design specialized Business Development and Advisory services to the end-borrowers through qualified existing service providers. • Support the development of a functional Credit Bureau and the establishment of a self-regulatory organization (SRO).
Review CBS-MFU Guidelines for Wholesale Financing to MFIs.	• The MFU should ensure the buy-in of the bank's top level management to the targets included in the business plan. • Transfer of funds should be tied to to carefully prepared business plans (as detailed within text of evaluation) • Future fund transfers based on results of periodical monitoring (every 3 months) to assess their performance.
Accumulate experience/knowledge on cost containment (structure and amount) measures adopted by MFIs for coverage of costs and progress towards acheiving positive returns on capital invested in MF operations.	• Review the cost structure of MF products on offer by participating banks. • Based on the accumulated knowledge, review the policy of setting a 10% ceiling (range +_2) on cost of finance on Murabaha transactions of MFI banks.
Review of CBS regulatory policies to cater for MFIs as different institutions to normal commercial banks.	CBS policy to take into account MFI's different risk profile, volatility, and lending technology.
A continued need for re-assessing, in a structured manner, the policy of directing 12% of portfolio.	Revise the policy directive of allocating 12% of portfolio to MF in a manner that guarantees consultation with its clients (banks) at the highest level

	(Board of Directors and top management).
Encourage wholesale financing from banks to non-bank MF providers with the aim of expanding their outreach.	Prioritize capacity building by SMDF to potential non-bank MFIs. MFU to coordinate closely with SMDF to create linkages between enabled organizations and banks.
Encourage MF product diversification, especially savings products that are attractive to both MFIs and clients.	• Study and disseminate, through practical interaction, successful local experiences in diversification of MF products (e.g. SDF and PASED) to banks and other MFIs; • Organize a workshop specifically targeting "Product Diversification" in which various players who have MF product initiatives share their experiences.
Further encourage the adoption of alternative collaterals.	Practical capacity development and information exchange regarding the following aspects of MF operations: → Delinquency management (paperwork and field operations) → Peer pressure and community pressure techniques to emphasize repayments → Internal Control Policies and Procedures in MF best practices → Exchange fora with prior successful experiences in similar communities and countries.
Promote the establishment of a Fund for hedging credit risk in the provision of microfinance.	Review the proposal for a solidarity fund to define and take into consideration the aspects that are of concern to the Insurance Supervisory Board and other stakeholders.
Promote micro-insurance as a hedging mechanism for microfinance.	Review the agreements governing MFIs joining the insurance scheme to ensure compensation terms and conditions are conducive to the expansion of MF services. Details of issues to be reviewed are to be found in the text of the evaluation report.
The Huamanitarian Aid Commission (HAC) should not replace the role of the SRO.	Careful review of the composition and mandate of the joint MFU/HAC committee.
The MFU of CBS should be strengthened to further improve its implementation in the remaining 3 years of the MF strategy.	• Underake a review of the MFU set-up and conduct an assessment its needs with the aim of reviewing the organizational structure, personnel capabilities and material resources most appropriate for the effective implementation of the MF strategy and for conducting a comprehensive M&E work plan. • Capacity building and greater awareness targetting partner government units. • Review for greater effectiveness the role and mandate of the supervisory committee/s.

	• Review the role of the MFU vis-à-vis the SMDF.
ENHANCING THE ROLE AND SUPPORTING THE GROWTH OF MFIS	
Further develop MFIs' capacities (SMDF & MFU)	• Design trainings based on needs assessment and in line with current capacities. • Ensure trainings are oriented towards practical application (details in the text). • Record the effect of the training provided on the actual development of the MFI's portfolio vis-à-vis MF activities. • Banks (MFIs) to link their incentive scheme to the application of knowledge, skills and attitudes acquired in trainings. • Develop, maintain, and regularly update a database that includes "well experienced" technical assistance and training service' providers.
Establish and apply key performance indicators for MFIs from existing internationally approved standards for activity and financial reporting.	• Provide adequate capacity development in accounting, financial analysis and reporting to MFIs through the SMDF initiatives and other relevant venues • Encourage third-party performance assessments and internationally recognized ratings of MFIs and adopting the reports prepared as one of the major criteria for facilitating "wholesale" funding to MFIs • Prioritize capacity development and other services to MFIs based on meeting the performance criteria. • Provide capacity development in cost-effective methods to measure social performance for those MFIs whose key goal is social performance.
Encourage MFIs to adopt automated MIS to ensure efficient loan tracking system (MFU & SMDF).	Provision of technical assistance Initiate effort to capture information on available Arabic software for MF operations and assist in making a technical/cost comparison between the available ones while ensuring "data extraction" modules load onto other commonly used applications like excel.
Better utilize the market studies and research of the MF market in Sudan.	• Identify the reasons for MFIs not resorting to the available market studies in segmenting the targeted markets and developing and/or enhancing products. • More rigorous application of the requirement for comprehensive market analysis and positioning of the MFI within business plans of MFIs requesting

	an operational license and those benefitting from CBS resources.
Ensure the existence of an informative Business Plan (BP) for MF Operations.	The BP to include the following: • Analysis of the bank's vision and strategic orientation vis-à-vis microfinance. • Coverage of: the market segmentation, bank's competitive edge(s), marketing strategy, branding, and sales strategy; all translated into a detailed financial plan for services' extension and expansion. • Coverage of the incentive system applied to MF operational staff based on "service expansion", "client maintenance" and "portfolio quality".
ESTABLISHING A SUPPORTIVE INFRASTRUCTURE	
Develop and upgrade the MF information database that is currently in place (MFU/SMDF).	• Database to be designed in a user-friendly manner and frequently updated to ensure timly information. • Make database accessible to a wider network (inside and outside Sudan) • The database could include a separate module for credit inquiries; in other words a "Credit Bureau - CB". • The question of *"who shall inherit the database?"* should be thought of jointly with the SMDF project management well ahead before the project end date. • Establish an automated data exchange routine between the MFU and the MFIs operating in Sudan (Banks and non-bank).
Promote the establishment of a Credit Information Bureau.	The credit bureau should be entrusted to an independent institution that is protected by law and is at the same time subject to prudential regulations that guarantee its accountability and ensure "client protection" aspects of information exchange, besides not imposing excessive charges on inquiries.
Promote the establishment of a Self Regulatory Organization in the medium term	
Promote the establishment of a National Network of MFIs (SMDF).	Provide capacity building targetting the development of networks and highlighting the membership potential benefits to MFIs.
Towards the SMDF project mid term; perform an evaluation study to assess the SMDF value-addition and future role.	A specific effort should be initiated during the mid-term of the currrent SMDF project to evaluate its services vis-à-vis the MFU services; especially with regards to the role of facilitating access to finance.
Government ownership (shares) and level of involvement in the board of the Apex institution to be	Review to be incorporated in the mid-term evaluation of SMDF project.

carefully reviewed.	
Ensure the quality of services provided by the SMDF as an Apex Organization that promotes the development of MFIs.	Effective role of supervision/steering committee for the MF strategy in conjunction with that undertaken by the board of directors of the SMDF.
Enhance awareness of the MF sector as a viable financial undertaking that can have a dual economic and social role.	Carry out a well planned and carefully thought out advocacy program targeting policy makers as well as beneficiaries of MF services.

Annexes

Annex 1. Analysis of MFIs Operations (2008)

The data collected from banks interviewed in the course of the evaluation process focused on their MF activities in the years 2006-2008, i.e. before and after joining the CBS MF project. These are depicted in Table 4: List of peole interviewed. MFIs joined the CBS MF experimental project at different intervals. The first to join was the Framer's Commercial Bank (1/7/2007) and the last was the Real Estate Commercial Bank (June 2008). Since the experimental program is about one year old, the analysis will focus on the activities of the year 2008 with the aim of giving some indication of micro-credit services offered vis-à-vis the intended objectives and policies. The findings of this analysis are summarized as follows:

Murabaha is still the Dominant Mode of Finance

Micro-loans classified by mode of finance showed that an average of 97% of total loans were offered on Murabaha terms (Table (1) below). Under such terms, the MFIs have to adjust their costs to ensure that they generate adequate profits (or at least cover their costs) from the predetermined 10% Murabaha profit margin. As shown in the body of the text of chapter 1, most MFIs reported that the 10% profit margin imposed by the CBS does not cover their cost of offering micro loans on Murabaha terms. The MF Strategy had recommended various means by which MFIs could improve their portfolio and so counter the effect of the low 10% on their earnings. Among these recommendations was for the MFIs to exhibit offer loans on other Islamic modes of finance, and "examine the addition of new microfinance services in compliance with Islamic Sharia Law".

Table 1:Murabaha percentage in 7 MFIs, 2008 (up to end September)

No	Bank Name	Amount of loans	No of Murabahas	% of Murabaha
1	Agricultural Bank of Sudan	2744	2744	100%
2	Social Development Foundation	5630	5569	99%
3	Real Estate Commercial Bank	24	23	96%
4	Industrial Development Bank	390	383	98%
5	Savings and Social Develop. Bank	11193	11193	100%
6	Family Bank	265	231	87%
7	Farmer's Commercial Bank	1810	1559	86%
	Total	**22056**	**21702**	**97%**

Source: Computed from table (5) compiled from the MFI stated there in

However, the flexibility of MFIs to comply with this recommendation, is, to a great extent, undermined by the continued use of traditional lending procedures that are not conducive to micro financing, such as shortage of staff and the desk-work type of operations (clients coming to the bank, instead of bank going to clients). Adopting Musharaka mode of finance, for example, requires close follow-up in the field. Mudaraba requires good trust in clients. This can only be realized through close links with target clients and adequate filed follow up, as well as adoption of repeated loans. The experience of ADRA (INGO) MF project in Omdurman Locality showed that an MFI may start by a Murabaha and provide repeated loans and later shift to Mudaraba after trust is built in clients of good performance. Such an approach requires maintenance of direct links with clients in the field. MF is known to be a labor-intensive field so more effort will need to be exerted by MFIs to move closer to target clients. This will allow them to adopt a range of financing modes while improving their repayment rates.

MICRO-LOANS ARE CONCENTRATED IN URBAN AREAS

The geographical coverage of MF operations is illustrated in table 2 below. The percentage of rural transactions, compared to total micro lending transactions, varies considerably from one MFI to the other: a zero percent for the Family Bank, 4% for the SSDB, 5% for the Industrial Development Bank, 17% for the Real Estate Commercial Bank, 30% for the SDF, 70% for the Framer's Commercial Bank and 100% for the Agricultural bank. The average percentage is approx. 28%. This shows that except for the two agriculture oriented banks, MFIs are far from achieving the CBS directive for channeling 70% of their MF loans to rural areas.[15]

Table 2: MF Operations by Geographical Coverage in 2008 (up to end September)

No	MFI	No of enterprises	No of projects per location		
			Urban	Rural	Semi-urban
1	Real Estate Commercial Bank	24	5	4	15
2	Industrial Development Bank	390	76	19	295
3	Social Development Foundation	5630	3941	1689	-
4	Savings and Social Development Bank	11193	7275	449	3469
5	Family Bank	265	265	-	-
6	Agricultural Bank of Sudan	2744	-	2744	-
7	Farmer's Commercial Bank	1810	546	1264	-
	Total	**22056**	**12108**	**6169**	**3779**

Source: Compiled from indicated MFI

MICRO-LOANS ACCORDING TO TYPE OF ECONOMIC ACTIVITY/ SUB-SECTOR

Table 3 shows that, in 2008, the following distribution of micro-loans according to economic activity: farming constitutes 36% of total transactions, petty trade 30%, services 22% and 12% for other activities. Petty trade and services together constitute 52% of total, which is in line with international MF practices. The ABS which is the biggest and oldest bank (1959) in Sudan, operating with more than 90 branches, accounted for 70% of farming activities in 2008 (up to end September).

The CBS-MFU has directed MFIs participating in its MF Pilot project to focus on certain types of activities and economic sectors according to each MFI's known area of specialization. In the case of ABS, the financed activity falls within an ambitious project, submitted by the ABS to the CBS, aiming at enhancing the varieties of orchard trees (such as

15 CBS Circular No 18/2007

dates palm and citrus fruits) in 4 states of Sudan (Northern state, River Nile, Sinnar and Blue Nile). The seedlings are to be imported from Saudi Arabia (dates palm) and South Africa (citrus fruits). Although this project could be considered as a positive contribution to the achievement of the National Agricultural Revival Program objectives, yet it does not lend itself to funding through microfinance. The following reservations could be cited in this respect: a) the repayment period in MF is usually less than 12 months and this project repayment starts after 3 years, b) the SDG 10,000 ceiling allows farmers to cultivate 1.75 feddans only instead of 2-5 feddans, as originally planned and, c) the reimbursement of 5% of Murabaha profit margin to farmers of good performance (reported to be incorporated in the partnership agreement signed by the ABS and CBS-MFU), makes it doubtful as to whether the ABS will meet its operation cost (reported by ABS to be at around 36%).

Table 3: Operations according to type of activity (2008 up to end September)

#	MFI	No of enterprises	Enterprises by type						
			Farm ing	**Animal Product-ion**	**Poultry**	**Process-ing**	**Services**	**Trade**	**Other**
1	Real Estate Commercial Bank	24	3	-	-	-	3	2	16*
2	Industrial Development Bank	390	-	-	-	390	-	-	-
3	Social Development Foundation	5630	169	-	113	169	2252	2927	-
4	Family Bank	265	1	6	9	21	109	81	38
5	Agricultural Bank of Sudan	2744	2744	-	-	-	-	-	
6	Farmer's Commercial Bank	1810	982	-	-	32	16	243	537**
	Total	**10863**	**3899**	**6**	**122**	**612**	**2380**	**3253**	**591**

* Home maintenance/additions
** including transport and handicrafts
<u>Note</u>: SSDB figures are not included due to lack of breakdown

ANNEX 2: THE MICROFINANCE UNIT OF THE CENTRAL BANK OF SUDAN

The MF Unit started its operations in March 2007, as a semi-autonomous body, within the sector of Financial Institutions and Systems of the CBS. It reports to the Assistant Governor of the sector or directly to the Governor of the Central Bank while also coordinating with other CBS Departments (e.g. circulars, inspection etc.). The Terms of Reference of the Unit's manager and the strategy itself form the mandate under which the MFU operates. The Unit is manned by six staff members (a manager, deputy, 3 department heads and a secretary), assisted by 7 trainees/volunteers, most of whom are fresh graduates. In addition, the unit is in the process of recruiting a technical advisor with regional expertise in Microfinance.

The work of the Unit is also supervised by a "Higher Supervisory Committee" that was formed in July 2007 to "provide overall guidance and direction to the microfinance unit, including the periodic revision and supervision of the implementation of the Action Plan associated with the Microfinance Strategy". The committee members, who work on a voluntary basis, are nominated by the MFU, in consultation with the Assistant Governor of the Financial Institutions and Systems sector. The committee, as per its Terms of Reference, consists of 5-8 members with the majority being from the NGO sector and nominated to ensure gender and ethnic diversity within the committee. The committee holds its meetings on quarterly basis but is called for adhoc meetings, if the need arises.

MF supervisory bodies have also been established by the CBS in several states. Their membership includes the CBS branch in the state, the banks, the locality, the State Ministry of Finance, the Social and Cultural Affairs Ministry, the NGOs and the CBOs. The MFU has also established focal points in different states, where the CBS has offices. The designated CBS officers, in respective states, are entrusted with the task of disseminating information on MF, after they had received necessary training in this respect.

Annex 3: Interviews with Main Partners in Implementation of MF Strategy

The evaluation process of the implementation of the MF Strategy included semi-structured interviews conducted with the main government ministries regarded as primary partners in implementation of the strategy, namely the Ministry of Social Welfare, Women and Child Affairs (MSWWCA) and the Ministry of Finance and National Economy (MOFNE). The interviews were conducted with the focal points in these ministries as conveyed by the MFU and who are mainly concerned with poverty-reduction policies.

The Ministry of Social Welfare, Women and Child Affairs

The Ministry of Social Welfare, Women and Child Affairs (MSWWCA) has recently established a Poverty Center to handle all poverty-related issues. Within this Center, a Microfinance Unit has recently been established with the main objective of complementing the CBS-MFU endeavors. Through a six-member joint committee (three from each of MSWWCA and MFU) the Poverty Center and the CBS-MFU coordinate their activities and assess progress of the microfinance project. The senior official interviewed at the Ministry indicated that close link that has been established with the CBS-MFU, in addition to the continuous efforts exerted by the Ministry in propagating the "social banking" concepts, portray the Ministry's adoption of the MF Strategy. The official also relayed that the Unit passes all MF information and reports to the Ministry's Poverty Center and also provides any information on request. The only issue on which the Ministry seems to lack information is the SMDF. Given the role that the SMDF is expected to play vis-à-vis the capacity building of the MSWWCA constituencies, namely local CBOs engaged in income development and poverty reduction programs, it will be important that the MSWWCA is also kept abreast of the Facility.

The Poverty Center believes that one of its main functions is to support and work through civil society organizations. It intends to organize groups, contribute to institution-building and capacity building of these groups in order to promote their capacity in small business and microfinance activities. Networking, the Center's Manger believes, is a crucial concern in this respect. The outreach of banks, the manager believes, could be expanded when they work with community organizations such as savings and credit associations.

The Center's Manager pointed out that the Ministry had established poverty centers in the different states. One of the functions of these centers is to train beneficiaries on how to establish and run viable small enterprises. The Ministry has a training unit (the "Strategic Center for Community Rehabilitation") that conducts training in small business management, following the ILO's start-your-business and improve-your-business packages (SYB and IYB). A "Council for Community Development" has also been established in the State ministries and its representatives meet every three months to deliberate on community development and poverty-related issues. The Ministry's "Social Information" department undertakes advocacy and awareness raising and could play a significant role in disseminating microfinance information.

When asked about whether the adoption of the Microfinance Strategy had led to increased awareness, among policy makers, of the viability and self-sustaining nature of the MF sector, the Center's Manager stated that this has not been satisfactorily achieved. He maintained that there is a conceptual problem because some policy makers still view the microfinance concept as that of support provided to poor productive families. He also conveyed his belief that there is still a problem related to the conceptual definition of the targeted group in the delivery of MF services and that this has resulted in a number of constraints adversely limiting the access of the poor to financial services. The social collateral, he believes, has not yet been used by banks to extend microcredit to the poor. The funds allocated by banks to microfinance are still low due to limited awareness, understanding of concepts and constraints related to adopted procedures. The Center's manager believes that the ability of banks to reach out to the poor was constrained by the lack of an adequate number of branches in the rural areas, where the majority of poor reside. He added that it was difficult to convince banks to extend credit to establish or enhance the social services that the poor need. Hence, microfinance could play a significant role in this respect.

The Zakat chamber is under the stewardship of the Ministry and in this respect, it was noted that although no clear-cut recommendations have yet been drawn to specifically determine the role of Zakat in developing the MF sector, the Chamber took some initiatives in this direction. For example, the Chamber contributed to the capital of the Family Bank and has initiated community mobilization towards enhancing productive capacities, in the rural areas. The example cited was the organizing of people in Sinnar state into agricultural cooperative societies to which the Chamber donated a tractor to each of these societies.

One of the recommendations of the Microfinance Strategy was to evaluate the past experience of the SSDB (also under the stewardship of the Ministry) in extending credit to small producers. However, the MSWWCA conveyed that such evaluation had not been conducted and that all experiences should be evaluated to learn from them.

THE MINISTRY OF FINANCE AND NATIONAL ECONOMY (MOFNE)

The adoption of the Microfinance Strategy, the interviewed MOFNE senior official stated, is demonstrated by a number of measures and activities. These being: a) the Ministry's approval of the contribution to the SMDF project of $10 million dollars from the Multi-Donor Trust Fund (MDTF) which is administered by the World Bank; b) the Minister of MOFNE addressed the International Microfinance Consultative Forum, organized in Sudan by the CBS-MFU in conjunction with the UNDP, in November 2007. Moreover, the recommendations of the Poverty Reduction Strategy, currently being prepared by the Ministry (described as a policy paper), included the facilitation of access to finance by the poor. Moreover, the Ministry has a seat (currently occupied by the interviewed MOFNE official who is the office manager of the State Minister responsible for the formulation of the PRSP) in the board of the SMDF. The Ministry official is also a member of the CBS "Higher MF Supervisory Committee". The MFU-CBS coordinates with the Ministry and is regularly providing data, information and reports related to its MF activities.

No specific awareness raising efforts, targeting the policy makers at the Ministry of Finance, have been conducted in relation to the potential of MF. However, it is reported that the Ministry official took part in the MFU awareness sessions addressing bankers. Moreover, it was noted that the Ministry lacked knowledge of the specific recommendations of the MF Strategy, particularly the recommendations related to the evaluation studies of the ABS and SSDB activities, as well as that related to building upon the experience of the Sudan Postal Office Saving Fund for the mobilization of micro-savings. As such, the Ministry official could not comment on the feasibility and usefulness of the recommendation concerning the Postal Office experience.

OTHER TABLES

Table 4: List of peole interviewed

No	Name and Designation	Institution / Agency
1	Ishrag Dirar, Manager	MFU-CBS
2	Yasir Jamie, Deputy Manager	MFU-CBS
3	Sami Awadelseed, Officer	MFU-CBS
4	Elmufti Ismaeel, Manager	MF Unit, Industrial Development Bank
5	Nawal Majzoub	MF Unit, SSDB
6	Manal Awad, Deputy Manager	Amal MF Program, SDF
7	Aiyda Awad, Accountant	Amal MF Program, SDF
8	Usama Mohammed Birair	Amal MF Program, SDF
9	Ghada Abdulrahman	Amal MF Program, SDF
10	Anwar Babikir	Amal MF Program, SDF
11	Yousif Abubakr	Amal MF Program, SDF
12	Fathiya Othman Sulaiman, manager	Omdurman Branch, Amal MF Program, SDF
13	Nadir Eisa, Manager	MF Unit, Farmer's Commercial Bank
14	Ibrahim Musa, Deputy Manager	MF Unit, Farmer's Commercial Bank
15	Salaheldin Nazlawi, Deputy General Manager	Family Bank
16	Bahaadien Aabdeen, Manager	Main Branch, Family Bank
17	Dr Ismaeel Shabbo, Head	Investment Department, Real Estate Commercial bank
18	Umayma Mohammed Ismaeel, Manager	MF Unit, Real Estate Commercial bank
19	Omer Awad Abdulrahman	Investment Department, Real Estate Commercial bank
20	Omer Babikir Higazi, Manager	MF Unit, ABS
21	Naila Basheer Sulaiman,	Planning Section, MF Unit, ABS
22	Awadiya Fadlalmoula	MF Unit, ABS
23	Dr Mohammed Saad Nasr, Microfinance specialist	SMDF
24	Ibrahim Mohammed Ibrahim, Manager	Poverty Center, MSWWCA
25	Seifeldin Abdelrahim, Deputy Manager	Poverty Center, MSWWCA
26	Manal Sheikheldin	Poverty Center, MSWWCA
27	Mekki Mohammed Abdelrahim, Manager	Front Office for the State Minister of Finance
28	Siddeeg Elobaid, Deputy Manager	Front Office for the State Minister of Finance

Table 5: Analysis of MF operations

MFI	Year	No of clients	Mode of finance				Geographical coverage			Microenterprises by type						
			Murabaha	Musharaka	Mudaraba	Others	Urban	Rural	Semi-urban	Farming	Anim.	Poultry	Processing	Services	Trade	Others
Real Estate Commercial Bank	2006	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	2007	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	2008	24	23	-	-	1	5	4	15	3	-	-	-	3	2	16
Industrial Development Bank	2006	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	2007	3	1	-	2	-	-	1	2	-	-	-	3	-	-	-
	2008	390	383	2	4	1	76	19	295	-	-	-	390	-	-	-
Social Development Foundation	2006	724					430	312	-	-	-	-	-	297	445	-
	2007	1699	X	-	-	X	1189	510	-	50	33	-	50	543	1023	-
	2008	5630	5569	-	-	61	3941	1689	-	169	-	113	169	2252	2927	-
Savings and Social Development Bank	2006	12283	12283	-	-	-	7983	493	3807	-	-	-	-	-	-	-
	2007	8783	8783	-	-	-	5708	3532	2722	-	-	-	-	-	-	-
	2008	11193	11193	-	-	-	7275	449	3469	-	-		-	-	-	-
Family Bank	2006	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	2007	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	2008	265	231	32	1	-	265	-	-	1	6	9	21	109	81	38
Agricultural Bank of Sudan	2006															
	2007															
	2008	2744*	2744			600	-	2744	-	2744	-	-	-	-	-	-
Farmer's Commercial Bank	2006	330	296	-	-	34	107	223	-	133	-	-	4	3	51	139
	2007	607	590	5	-	12	162	445	-	336	-	-	15	1	82	173
	2008	1810	1559	12	1	238	546	1264	-	982	-	-	32	16	243	537

*Finance extended by the ABS, within the microfinance project, was in the form of Murabaha extended to farmers engaged in the "horticultural activity", 600 of whom received both Murabaha and Mugawala (contracting)

Table 6: Status of implementation of the 12% portfolio allocated to MF (SDG '000')

No	Name of Bank	Volume of MF	Total Amount of Loans	% of MF
1	Agricultural Bank of Sudan	78,465	134,965	58%
2	Savings and Social Development Bank	107,818	217,208	50%
3	Nilein Bank	2,404	115,162	2%
4	Faisal Islamic Bank	719	235,437	0.3%
5	Sudanese French Bank	56	375,346	0.01%
6	National Bank (Alahli)	1,943	166,668	1%
7	Blue Nile-Mashreq Bank	12	101,776	0.01%
8	Altadamon Islamic Bank	1,380	109,219	1%
9	Islamic Cooperative Dvlpt. Bank	6,937	341,442	2%
10	Albaraka Bank	1,641	228,467	1%
11	Export Development Bank	1,490	176,889	1%
12	Khartoum Bank	75	1,133	0.01%
13	Saudi-Sudanese Bank	1,490	187,038	1%
14	Workers National Bank	4,225	71,294	6%
15	Animal Resources Bank	3,329	224,618	2%
16	Alshamal Islamic Bank	6,007	231,788	3%
17	Farmer's Commercial Bank	25,816	298,568	9%
18	Ivory Bank	120	6,164	2%
19	Omdurman National Bank	2,676	3,660,160	0.001%
20	Africa Bank for Trade and Development	0	13,725	0%
21	Byblous Bank	0	116,242	0%
22	Sudanese Egyptian Bank	0	136,385	0%
23	Abu-Dhabi National Bank	0	47,992	0%
24	Real Estate Commercial Bank	671	104,975	1%
25	United Capital Bank	0	207,927	0%
26	Aljazeera Jordanian Bank	0	0	0%
27	Assalam Bank	0	329,820	0%
28	Family Bank	4,953	4,953	100%
29	Financial Investment Bank	0	7,506	0%
30	Industrial Development Bank	7,510	178,631	4%
31	Sudanese Islamic Bank	4,323	233,712	2%
	Total	**264,062**	**9,397,106**	**3%**

Outstanding balance as on 31st August, 2008
Source: MFU-CBS

Table 7: Deatils of the MFU-CBS wholesale finance to MFIs

No	MFI Name	CBOS allocation (SDG Million)	Outstanding loans (SDG Million)	No of clients	Repayment (SDG Million)	% of implementation*
1	Agricultural Bank of Sudan	34	19.7	2,639	0	41%
2	Animal Resources Development Bank	7	1.7	303	0.2	27%
3	Social Development Foundation	5	4.9	5,459	1.7	94%
4	Farmer's Commercial Bank	25	12.4	5,302	1.3	47%
5	Workers National Bank	3	2.3	337	0.6	88%
6	Industrial Development Bank	10	7.4	3,769	0.5	75%
7	Savings and Social Development Bank	15	8.4	2,243	0.7	54%
8	Islamic Cooperative Development Bank	1	0.8	148	0.1	96%
9	Real Estate Commercial Bank	15	0.57	1,203	0.08	3%
	Total/Average	115	58.5	21,303	5.4	45%

* % of Amount spent out of MF allocated fund

Source: CBOS – MFU, monthly report, September 2008