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LEGAL ASPECTS IMPACTING THE FINANCING OF MICRO AND SMALL ENTERPRISES IN SUDAN¹

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(Translated Version)

February 2006

¹ Paper Prepared for UNICONS Consultancy Ltd. Khartoum, as part of the Project “*Formulation of a Vision for the Development and Expansion of the Microfinance Sector in Sudan*” sponsored by the Central Bank of Sudan.

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Abstract

The Small and Micro Enterprise (MSE) sector represents a major part of economic activities in Sudan. Yet the legal and regulatory framework is believed to be one of the major barriers to the entry of such enterprises into the market and into the formal sector. Laws that facilitate easy entry into the market will encourage the formalization process and enable the sector to act as a driver of economic growth and poverty reduction. The expansion of the sector is also dependent on the formal financing that is available to it which in its turn is governed by a non-accommodating legal and regulatory framework. Financing by the banking sector is regulated and supervised by the Central Bank of Sudan and as such the laws and regulations of the Central Bank have an important impact. Another important supplier of credit to the MSE sector are the Non-Governmental organizations whose activities also regulated by a legal framework.

These are the major elements that are being considered in this study which reviews the current laws and regulations governing the MSE sector and its financing. The aim is to lay the ground for informed recommendations and action oriented reforms to integrate micro-finance into the formal financial sector and encourage its expansion. Special attention is paid to the role and effect of contracts under the various modes of Islamic finance.

Preliminary recommendations being made by the paper include: (a) The presence of strong and continuous political will in accordance with the dictates of the Interim National Constitution for 2005. (b) Laying out a national strategy for small and micro financing based on studies and experiences accumulated in the Sudan and abroad.(c) The revision of the poverty plan to accommodate the guiding directives enshrined in the Interim Constitution. (d) The revision of the existing laws to incorporate, financing of small and micro projects, in the objects of the concerned government ministries, concerned governmental institutions, and Sudanese and international non governmental organizations. (e) The organization of financing of small and micro projects by passing legislation with the object of procuring coordination between all the Stakeholders on the national level. This may be realized by establishing a national organ for small and micro financing in which all Stakeholders are represented.

1. Introduction

Poverty represents one of the most serious conflicts and challenges that the world has to face particularly in continents like Africa, Asia, and Latin America, Unquestionably in recent decades; poverty has become the prime concern that can not be underestimated by rich countries in view of its negatives ramifications even on the rich countries themselves. The impact of climatic conditions on poor countries, the economic liberalization policies, and globalization have all led to a sharp decrease in the prices of agricultural products in the rural areas. Consequently, there has been a huge wave of urbanization, thus a large number of people living under extreme drastic conditions with basically no or minimal job opportunities. The high rate of unemployment and lack of education have lead to alarming poverty levels in both rural and suburbs areas. A number of means and methods have been adapted by the both the local and international community to combat poverty including state, banks, micro-finance institutions, United Nations agencies and NGOs. Studies have proven that financing of small scale and micro enterprises (MSE) has become one of the most important tools to alleviate poverty. The importance of the financing tool lies in the fact that the success of the operation depends entirely on having direct contact with the poor strata and attempting to recognize, asses and determine their level of productivity. This access eventually raises the awareness of this community and help integrating them into the economy.

In every nation-state, the legal and regulatory frameworks play a critical role in encouraging or impeding small and micro entrepreneurs to enter the market and be incorporated in the formal sector. Laws that facilitate easy entry into the market will encourage the formalization process and enable the sector to act as a driver of economic growth and poverty reduction. Hence, formal financing which is governed by the legal and regulatory framework is a necessity in the expansion of MSEs. On the other hand, NGOs which are regarded as main creditors to the MSEs are also subject to a legal framework

On the light of these facts, this study aims at reviewing the legal aspects of financing small and micro projects in Sudan by first identifying legislations governing all financial transactions and mechanisms for financing the various economic activities. Such mechanisms include, but are not limited to, companies, partnerships, business names, licenses and securities.

In financing economic activities based on different financing mechanisms (Islamic or traditional), the banking sector, has to abide by the policies and regulations of the Central Bank of Sudan. Consequently, this study details such policies and regulations with the objective of understanding their ramifications on the financing of MSEs.

Given that Non Governmental Organizations (NGOs) play a critical role in encouraging and financing small and micro projects, it becomes imperative to study the legislation that governs their work. This is being done with the aim of determining whether the legislation is encouraging the establishment, financing and sustainability of such projects.

The success and sustainability of any financial undertaking depends, first and foremost, on the success of the economic activity benefiting from this financing and its ability repay the loan plus the profit margin set by the financing institution. Economic activities are subject to both visible and invisible risks which may undermine the ability of the beneficiaries to honor their financial obligation. It is, thus, rational for financial institutions to obtain

guarantees that adequately safeguard their interests as well as those of their depositors. The study gives due attention to the guarantee system and its suitability to the financing of small and micro- enterprises.

The experiences of other countries and those of multilateral organizations in the financing of MSEs are briefly examined in an attempt to identify the areas of common ground with the Sudanese experience. The results will set broad guidelines on how to either benefit from positive achievements or avoid mistakes committed when applying them to the Sudanese experience.

Based on the above exposure of legal aspects affecting the microfinance sector, the paper makes preliminary recommendations for further consideration.

2. The Hierarchy of Legislations Governing Civil Transactions in the Sudan

The hierarchy of legislations governing civil transactions in the Sudan is dominated by the Interim National Constitution of the Republic of the Sudan 2005 (INCRP) followed by the 1984 Civil Transactions Act (CTA). Other legislations governing mechanisms of economic activity include the 'Companies Act 1925' (CA), the 'Business Names Registration Act 1931' (BNRA), the 'Registration of Partnerships 1933' (RP) and the 'License Act 1922' (LA).

2.1. The Interim National Constitution of the Republic of the Sudan 2005(INCRP):

The INCRP is the supreme law in the country and all other constitutions and laws at the state level must comply with it. It is worth noting that this constitution differs from others in that it stipulates a number of principles and guidelines for the management of the national economy, that aim primarily at eradicating poverty.

Article 10 of chapter 2 of the constitution reads as follows:

"The national economy:

1-The overarching aims of economic development shall be poverty eradication, attainment of the Millennium Development Goals, guaranteeing the equitable distribution of the nation's wealth, redressing income disparities, and achieving decent living standards for all citizens.

2- The State shall develop and manage the national economy with the objective of achieving prosperity by adopting policies aimed at increasing production and creating a competitive self-reliant economy that is based on the free market approach.

3- The State shall enhance regional economic integration. "

It is amply clear from this article and its provisions, that it refers to comprehensive economic development objectives represented in poverty eradication. This signifies that government institutions, namely the socio-economic ones, must in compliance with the constitution, formulate the strategies, legislations, policies and mechanisms that are necessary for achieving the goal of eradicating poverty.

In addition, Article (12) (1) of the constitution which is focused on social justice stipulates the following points:

The State is to implement the strategies and policies that guarantee social justice among all the citizens of the Sudan by securing opportunities for earning a living, for employment, for the promotion of social solidarity and co-operation, and the encouragement of charitable activities.

In return for the delivery of such services by the State, Article 23 paragraph (C) of the interim constitution stipulates that citizens must preserve public funds, public properties and must honor their legal and financial obligations towards the State.

The new interim constitution, in Article 43, gives the citizen the right to ownership and possession while conferring constitutional protection on this right by prohibiting the confiscation of private property except by the law or for the public good and after being fully and justly compensated. The article also prohibits the confiscation of private funds except under judicial decree.

For the purposes of this study, articles pertaining to the role of the Central Bank of Sudan in leading and regulating the banking sector must be reviewed. In this regard, it is to be noted that paragraph 8 of article 202 of the constitution stipulates that "*All financial institutions shall be subject to regulatory and prudential standards for Islamic and conventional finance, as set by the Central Bank of Sudan*".

Moreover, Article 202 of the constitution recognizes the vital role played by the Central Bank of Sudan in developing the banking sector and its impact on the whole economy through developing and implementing appropriate strategies, policies and mechanisms that eventually lead to economic growth and social justice.

2.2. The Civil Transactions Act (CTA) 1984:

The CTA 1984 is a law of general application basically aimed at "Islamizing" the particular laws governing civil transactions, that is, ensuring that they are compatible with the Islamic Law (Sharia). Consequently, this legislation which is comprised of 22 chapters and 819 articles has abrogated a number of laws governing civil transactions such as sale contract acts. It is to be noted that the civil transactions Act 1984 has devoted chapter seven to deal with the definition of companies in accordance with the Islamic Law (Sharia). Accordingly three types of companies are stipulated as follows: (a) The enterprise company; (b) The partnership; (c) The speculation company

Although article 247 of the CTA stipulates that a company, from the date of its establishment, can have a unique legal personality, the law does not stipulate that the company's liability is limited as it is by virtue of the 1925 Companies' Act.

2.3. The 1925 Companies' Act (CA)

The act currently being implemented in Sudan was first issued in 1925. Although a number of amendments have been introduced, it has remained consistent with the concept of the companies act stipulated by the English law and that is applicable in many parts of the world. Despite the different initiatives to update it, the substantial differences over its legal and jurisdictional concepts and compatibility with Islamic Law (Sharia) have impeded the

formulation of a modern companies' act in accordance with the existing laws being applied worldwide.

The Act stipulates the possibility of establishing and registering three types of companies as follows

- a) The public limited liability company
- b) The private limited liability company
- c) Registering a branch of a foreign company in Sudan

Given that this study is concerned with the financing of MSEs, focus is on the private company with limited liability. In doing so, we shall consider the legal requirements for establishing and registering such companies; the minimum requirements for its capital by virtue of the existing law; the different procedures; and the cost of registration in brief.

Article 4 of the 1925 Companies' act stipulates that two or more individuals, not exceeding fifty, are entitled to establish a private limited liability company. This implies that the responsibility of its members/shareholders is limited by virtue of its memorandum articles of association to the amount actually not paid from the total start up capital of the company (In case it has not been paid in full)

Article 5 of the Act requires that the articles of association include the term "limited" at the end of the company's name, while stipulating that the articles of association should contain the location of the registered company's offices; its objectives; that company member have limited liability. In addition, Article 5 of the Act stipulates that the company must specify the amount of registered capital, as well as dividing the paid-up capital into specific shares with limited value. The minimum capital requirement for registration of a private limited company currently stands at five million Sudanese. All the company's shareholders must sign the Articles of Association and none of the signatories is allowed to contribute less than one share.

The establishment and registration of a private limited liability company is subject to a number of procedures requiring legal expertise. Hence, this implies that any individual intending to establish a private company with limited liability must first seek the services of a legal attorney or a legal advisor to carry out this job. It should also be noted that the cost of registration of this process, at the time of this study is fifty thousand Sudanese Dinars. This includes registration fees to the commercial Registrar General based in the Ministry of Justice and the capital tax as well as other stamps and duties. Thus, although private limited liability companies by virtue of their many potential benefits, are the most suitable for people with limited income intending to start a small or micro enterprise, they are by however too complex for the real needs *of the* Micro and small enterprise sector. A large number of individuals and traders tend to resort to less costly and complex mechanisms for establishing and registering their economic entity. This raises a number of questions as regards the viability of the 1931 Business Names Registration Act

2.4. The Business Names Registration Act (BNRA) 1931

Article (3) defines the business name as the name or title for any activity to be practiced whether in the form of a partnership or others. The term business describes any profession, activity or craft which is identified and described under the term trade and which is conducted by any association or partnership composed of two or more people working

collectively to practice profit generating activities. The act clearly stipulates that the business name must not include the real names of the person or people practicing the said activity under the respective business name.

Article (6) (1) clearly prohibits any trading organization or person, to whom the law is applicable, from practicing the specific business before obtaining the legal registration. The registration is carried out by virtue of article (6) (2) of the act after submitting a model statement that includes the business name, the general nature of the activities, the main office and any other sub-branches or offices where the said activity is practised. It also stipulates that in the case when prior written approval from the competent authority is required, a copy of the approval must be submitted. It also stipulates that in the event that registration concerns an individual, this individual's name must be mentioned in full in addition to his residence and any other activities being practiced by him/her. The law equally stipulates any procedural details relating to the registration; continuation of practice and penalties including fines and imprisonment of those who do not abide by the law. At the time of preparing this study, the cost of registering business name stands at fifteen thousand five hundred Sudanese Dinars. (SD-15,500)

2.5. The Partnerships Registration Act (PRA) 1933

Article 2 of the 1933 PRA defines 'partnerships' as a partnership between two persons or more joining to practice any business with the aim of sharing the profits between themselves. The term business is defined by the law as being any trade, industry or profession.

It is equally observed that article 4 of the act stipulates that companies or institutions registered as limited or non limited liability companies are not bound by the provisions of this law. Moreover, any partnership with a capital not exceeding one million Sudanese Dinars is not covered by this law.

Article 5 of the act, notwithstanding the exceptions stated in article (4), stipulates registration under the act of any partnership practicing in any town or area where this law is applicable or in any area identified by the Minister of Justice in accordance with the provisions of article 3 of the act. The registration is carried out by submitting a statement to the registrar of 'partnerships' that includes the partnership's name and the nature of its activities as well as the location of its main offices.

If the newly established business requires prior written approval from the competent authority and the granting of a license to carry out that activity or part of it, a copy of that approval endorsed by all partners in the venture has to be submitted to the registrar. The statement to be submitted to the registrar must include the business names; names of partners and their places of residence. In the case when the company's names are not composed of the real names of all partners, it has to be clearly stated whether it has been already registered under the 1931 Registration Act or its registration is still being processed. The required data include, among others, the duration of the partnership if it was for a limited duration and the commencement of this partnership. In the case of limited duration, additional data must be submitted that includes a statement indicating that the partnership is of limited duration, the names of partners with limited liability, the amount paid by each partner with limited liability as well as stating the amount that has been actually paid from the total amount. Moreover, the partnership has the right to register the

original version or an approved copy of the partnership agreement and to state the amount of capital being utilized in the activity.

Article five requires the partnership to submit, within one month, any changes in the data supplied in the original registration while Article (9) of the same act entitles any person to have access to the data relating to the partnership at the registration office. It is to be noted that article (10) of the act stipulates that registered partnerships must keep regular documentation and books "*All partners in a registered trade-based partnership have to ensure that the company has regular accounting books*". In addition to other details relating to the partnership and partners' rights, the Act stipulates various penalties such as fines and imprisonment for those who do not abide by the law.

Moreover, the current cost of registration of a partnership stands at fifteen thousand Sudanese Dinars (15,000).

2.6. The Company and Partnership: the Legal Personality, Limited Liability and the Partnership Contract

While reviewing above the 1925 Companies Act, it was explained that private companies registered by virtue of the law enjoy a legal personality and limited liability. This implies that in the event that not all the capital has been paid up at the time of establishment and registration, the company's liability is only limited to the amount that has not been paid of the share capital. The definition of legal personality is that the company is totally independent from the individuals, the subscribers and members of the company to the extent that it allows any subscriber in the company, even if he/she owns most of its shares, to sue the company without regard to the relationship to the company. Therefore, personal funds and assets of shareholders are kept totally separate from those of the company. So that when the company makes a profit, each shareholder earns his/her share of the profit according to ownership of company shares. And when the company makes a loss, exceeding the total value of its assets, the repayment of such debts is paid from the value of the remaining shares, if any, and losses incurred are born by the creditors. The law for the establishment and registration of private companies with limited liability provides for full protection of the shareholders personal funds which remain secure from legal prosecution by creditors in the event that the company incurs losses or undergoes liquidation.

However, in the case of partnerships and according to the law's rules and the CTA 1984, the situation is totally different. Here every member in the company is deemed to represent it and all acts performed by this member are considered binding to the company. The partners' funds and assets are mixed with those of the partnership to the extent that the creditors are entitled to take legal action against the partnership and the personal funds of the partners for repayment of their debts. Moreover, the general rules underlying the PRA ensure that the resignation of any one of the company's members, his/her retirement or death - all lead to the liquidation of the company and the termination of its existence.

Careful study of the articles establishing the company (partnership) under the CTA 1984 reveals that the law considers the company to be in possession of a legal personality from the time of its establishment but does not stipulate that the company's liability is limited. On the contrary, the 1933 PRA stipulates that the partnership can be limited. But, the law did not confer any legal personality on this kind of partnership. The current legislation in

force is the Partnerships Act and not the special texts relating to the company under the 1984 Civil Transactions Act.

In practice, partners mostly resort to the signing of a special partnership agreement between themselves. Such an agreement identifies the contribution made by each partner in the partnership fund, his/her share in the profits, the obligations and rights of each partner in the partnership, the powers and competencies that he/she enjoys. The aim of such an agreement is to protect the funds of the partnership and those of the shareholders as well as the rights of others.

2.7. The Licenses Act 1922 (LA)

A number of amendments were introduced to the 1922 LA, the latest being in 2000. The competent authority for issuing licenses are the localities in the different states of the Sudan and these are also responsible for setting model licenses and permissions by virtue of the rules of this Act. The locality also defines and fixes, after approval by of the Minister of Finance for the state, the fees to be paid for various locality licenses and their renewal. Article 6 of the Act stipulates that any license issued by virtue of the 1922 LA shall be valid for one year from the date of issuance and must be renewed at least one before expiry. Article 5 of the Act authorizes the respective Governor (Wali) of the State or any other competent personality to deprive any person convicted in a crime from practicing trade in an area under his/her jurisdiction or competency. Despite the fact that the Act concentrates on the trader's licenses, it also focuses on issuing different licenses for providing services and practicing different crafts and professions.

2.8. The Khartoum Stock Exchange Act 1994 (KSEA)

Although the functioning of the KSEA is not related to the topic of this study, it is being briefly covered here because of its great impact on the whole economy.

Article 10 of the KSEA 1994 states that membership in the market as being as follows: the Bank of Sudan; officially licensed banks; specialized financing institutions; public registered companies and licensed representatives under the rules and regulations of the Act. In addition any other public entities and local authorities registered in the market's registry as well as any other governmental entity with a legal personality and submitting shares for subscription. The objective of the Act is to organize and supervise the issuance of securities, their purchase and their sale. Article 9 stipulates different provisions which are all focused on banknotes and securities.

3. The 2005 Provisional Decree for the Regulation of Humanitarian Voluntary Activities

By virtue of a provisional decree signed by the President of the Republic on the 4th of August 2005, the Humanitarian Voluntary Act for the year 2005 was issued. Despite its presentation to the National Assembly, it has not yet been endorsed. According to the Article (109) of the Sudan Interim National Constitution for the year 2005,, the National Legislative Body, represented by both the National and States' Assemblies, must submit the interim decree when they are convened. Its approval with no further amendments directly puts it in effect as a law. However, there are two situations where it is not passed as a law: its rejection by the National Assembly or the expiration of the parliamentary sessions

without endorsement. Although, the Act benefits from the absolute authority granted by the law, still it is equally subject to either expiration or validation. As the Provisional Decree has the power of law during the preparation of this study, it will be examined according to its current status.

The Act defines “Voluntary Action” as any type of voluntary, charitable, or humanitarian activity which is both non-governmental and non-profitable executed by civil society organization, NGOs, international financing institutions, or any of their implementing partners. The activities should embrace cultural, developmental, sponsoring, service, or banking elements. Listing “development” as a main element in voluntary action has not been reflected in reality. The Humanitarian Aid Commission (HAC) has shifted the body into an “emergency unit” that mainly deals with alleviating disaster impact, rebuilding and rehabilitation. Article (22) outlining HAC’s responsibilities as follows:

- 1- Being a “highly specialized emergency unit, the commission shall have the following responsibilities:
 - In collaboration with the competent authorities, the commission should take the initiative and leadership in identifying areas of humanitarian needs aiming in fighting both natural and man-made disasters.
 - Supervising relief and rehabilitation operations (the Act did not include any article specifying the objectives for which the commission has been established).
 - Raising the awareness and enhancing concepts related to areas of rehabilitation and resettlement as part of the humanitarian aid process.
 - Assist in guiding humanitarian missions nationally and internationally
 - Ensure the availability of strategic relief reserves, in case of emergency.
 - Mobilizing local and international efforts in emergency preparedness and rehabilitation areas, in partnership with specialized agencies
- 2- In order to implement any humanitarian activity, reference to the ministry should always be considered at any given circumstances.

When reviewing the above mentioned specializations, one can observe the focus on combating disasters and relief activities rather than establishing a foundation for the development process through securing means of living, providing job opportunities, and fighting poverty; thus achieving social justice. The Act distinguishes between civil society organizations and the national charitable organizations. The Act also defines the civil society organizations as being the organizations, unions, associations and non-governmental organizations or semi governmental national organizations working in the fields of humanitarian voluntary action and which have been registered by virtue of this Act.

Regarding local charitable foundations, these should have humanitarian agenda, possess a reliable financing portfolio, sustainable enough to implement its activities, and raises funds from legitimate sources. Nevertheless, the Act prohibits these foundations from raising any local or international funds. Moreover, the Act does not grant to them legal personality as it did for the civil society organizations (CBOs).

The reader of the Provisional Decree will also notice that it contains a number of typing errors and the drafting seems to be quite weak. It is unable to specify the humanitarian aid requirements reflected in the absence of any reference to the overall objectives. Besides,

there is an apparent confusion between the aims and powers. The reader can easily deduce that the drafter of the Act lacks the required knowledge about the humanitarian objective and socioeconomic multi benefits that can result from the voluntary work at the local level. The fact that the Act emphasized more on establishing and supervising consortium rather than defining their objectives, suggests that the main purpose is to stop the negative practices by NGOs during the period of the previous legislations.

4. The Banking Sector and the Islamic and Traditional Modes of Financing

4.1 The Banking System: -

The activities of the banking system are governed by the 2003 Act for the Organization of Banking Sector and the 2002 Bank of Sudan Act that was amended in accordance with the provisions of the interim constitution of the Sudan in the year 2005.

4.1.1. The 2003 Act for the Organization of the Banking Sector

The activities of the banking sector are governed in the first place by the 2003 Act for the organization of Banking Sector where article 3 of the act stipulates that its rulings take precedence over any other. The Act which is comprised of 60 articles covering all the different banking activities has been very well formulated. We shall limit our coverage in this study to the articles that have an impact on the microfinance sector.

The Act defines the bank as any company registered by virtue of the provisions of the 1925 companies Act or legally established institution or any foreign bank authorized to practice by virtue of this Act. The banking activity includes opening different types of bank accounts, accepting deposits, carrying out transfers, opening letters of credit, issuing letters of guarantee, paying and collecting checks, certificates and any other valuable bank notes or securities. This being in addition to dealing in foreign currency, investing and providing financing to the customers and any other banking activities stipulated by the Central Bank of Sudan on condition that they do not contradict with the principles of the Islamic Law (Sharia). The Act defines financing as being the utilization of money in accordance with the Islamic modes. On the other hand, the Act defines a loan as being the possession of money or other material on condition that it shall be repaid in quantity and quality to the lender at the end of the loan period.

Article 5 of the Act stipulates that anyone interested in undertaking banking activities or part of it in the Sudan must first obtain a written license issued by virtue of the provisions of the 2002 Bank of Sudan Act amended 2005 and the Act for the organization of banking activities . The provisions of this Act are applicable to all banks and financial institutions that are authorized to practice all or part of the banking activities in Sudan without exception to a foreign bank or agency. Article 6 of the Bank of Sudan Act gives existing banks and financial institutions, at the time of issuance of this Act, the authority to restructure their institutions in order to comply with the provisions of the Act.

By virtue of the provisions of article 8 of this Act, the Bank of Sudan has the responsibility of supervising and monitoring all banks and financial institutions. The same Act gives the Governor of the Bank of Sudan, or any individual authorized by him, the authority to issue instructions and directives to any individual practicing all or part of the banking activities.

The concerned individual must comply with these instructions and their implementation. The Act established, by virtue of article 15, an independent part-time body named the Higher Sharia Supervisory Board for Banks and Financial Institutions whose responsibilities cover, among others, the issuance of Islamic Rulings (Fatwa), recommendations and consultations to unify the Islamic base, principles and the rulings and interpretations upon which the financial and banking activities are built. The Higher Authority also follows up on the policies and performance of the Bank of Sudan as well as reviews the activities of banks and financial institutions with a view to streamline them in accordance with the rulings of the Islamic Law (Sharia). In addition, the Authority is charged with working with the competent authorities in the various financial institutions to lay down the basis for the various Islamic financial transactions. Article 21 of the Act stipulates that the Islamic Fatwa issued by this body in any banking dispute is binding to the Bank of Sudan and to the financial institution/s involved in the dispute and must be implemented unless an injunction has been submitted before any tribunal by other parties.

4.1.2. Supervision of Banking Operations and Transactions

The Bank of Sudan, by virtue of article 41 of the Act, practices a supervisory and regulatory role over banking operations and has the authority to fix the maximum or minimum profit margin for financing. It must be stated here that the Central Bank of Sudan policies for the year 2006 and in compliance with the state policy regarding poverty reduction, drew attention to the importance of microfinance and re-iterated the need for the banking sector to be more active in this regard and to comply with the requirement to allocate at least 10% of their total financing to social development and to the vulnerable groups in the society. Moreover, the 2006 Financing Policies of the Central Bank clearly state the need for the formulation of policies supportive of the development and expansion of microfinance as an effective mechanism for social support, poverty reduction and rural development. The policies also call for developing the necessary supervision and monitoring mechanisms for the financing of small and micro enterprises. In this connection, it is to be noted that article 41 authorizes the Bank of Sudan to issue directives to all banks in Sudan as regards the required level of guarantees against credit granted and the finance ceiling that any bank is allowed to grant to any company, joint-venture, group of individuals or individual. The directives include the ceiling of guarantees and undertakings that can be granted to these projects together with the profit margin and the conditions associated with the granting of a loan in terms of guarantees or the undertakings can be granted.

4.1.2. (a) The Central Bank Of Sudan Act 2002 amended 2005: -

The Interim National Constitution of the Sudan 2005 has stipulated the introduction of a basic change in the banking system by using a dual banking system. The constitution stipulates that the Central Bank of Sudan (CBOS) remains responsible for formulating and implementing monetary policy and that all banking institutions must abide by the regulations and directives issued by the CBOS. The constitution equally stipulates the establishment of a two window banking system consisting of an Islamic system in northern Sudan and a traditional one in southern Sudan. The Bank of Southern Sudan (BOSS) is to be established as a branch of the CBOS to carry out, among other missions, the regulation of the traditional banking operations.

The 2005 amendment covers 9 articles of the 63 articles of the Act. It is to be noted that the new article 6 in this amendment consists of the same objectives stipulated in paragraph [C] of the cancelled article 6. This article stipulated the responsibility of the CBOS as being the organization, supervision and monitoring of the banking system together with its development and promotion of its efficiency with the objective of achieving equitable socio-economic development.

The establishment of the dual banking system has meant the replacement of paragraph (f) of article 6 of the Act by a new paragraph in the same article which is paragraph (i). The provisions of this paragraph stipulate that the CBOS, while discharging its responsibilities and practicing its mandate in terms of supervising and monitoring the banking system, must abide by the principles of Islamic Law (Sharia) and the traditional banking system norms.

Within the context of the CBOS relations with the other banks, article 36 of the Act authorizes the CBOS to identify and declare to the other banks and the other non banking institutions approved by it from time to time the profit margin and how it is to be distributed in the different transactions. It also displays the different formulas and the partner's contribution in the capital of any partnership and any other measures that control and serve the public interest in this respect such as opening letters of credit, providing guarantees and undertakings.

Article 38 of the act regarding the restriction of financing levels authorizes, periodically, the Governor of the Bank to fix the ceiling of financing investment transactions granted by the different banks to cover different economic activities. The Central Bank must fix the ceiling of total financing intended for investment activities financed by any bank and which are due to be paid at any time.

Article 43 of the act authorizes the Governor or any person mandated by him to issue instructions and directives to any bank or any person practicing all or some of the banking activities. The concerned bank or entity has to abide by such instructions and implement them.

This act mandates the Central Bank of Sudan to practice power of supervision on the banking system by virtue of article 44 of the act which also stipulates that the central bank shall act as a government bank and a financial representative for the government.

4.1.2. (b) Conclusions:

It is to be concluded from a reading of (i) the 2003 Act for organizing banking activities and (ii) the 2002 Bank of Sudan act amended 2005 as well as (iii) the Central Bank of Sudan policies for 2006 that a great role is played by the banking system in financing operations in general, and microfinance in particular. This is evidenced through three axes; the first is that the two above mentioned acts and the policies of the Central Bank are all aimed at redistributing the available financing by banks to the different economic sectors - mainly the highly prioritized sectors - with a view to developing such sectors. The second axis is that of providing and organizing liquidity in the different banks through the mandating of specific reserve levels as well as coordinating between the different financing modes and the nature and terms of deposits within anyone bank. Through the third axis the Bank of Sudan obliges the banks to obtain sufficient guarantees when granting any financing to any company, partnership, group of individuals or individual.

4.2. Islamic Modes of Financing

4.2.1 The MUSHARAKA or Partnership Mode

Musharaka or partnership have the same significance in the Arabic language and the Islamic jurisprudence where the company is defined as a contract signed between two or more people provided that the company's capital and its profits are shared between its members. It has been equally defined as being a contract according to which two people or more shall commit themselves to invest in one financial project by contributing money or labour and then share the profits/loss emanating from that project. This definition is applicable to the company that is in a partnership agreement and which can be classified into different forms based on financial or in kind contributions. Accordingly, there can be a company whose capital is exclusively based on its labour force in addition to enterprises whose capital is primarily based on their integrity and commitment.

Following the norms practiced in the Sudanese banking system, the financing of a company comes from the bank itself and its customer through a financial contribution in kind to complete the ratio of 100% as stipulated by the companies' act. This money should be invested within a certain period of time under their joint administration or that of a third party. They shall, together, share the profits and the losses.

If one of the partners is interested in possessing or buying his partner's share in the partnership company, all at once, based on the going rate, that partner shall be granted priority to any third party. However, if he/she wishes to buy higher partner's share in instalments the transaction shall be called a diminishing partnership for the one who is intending to disengage gradually from the contract. The same operation shall be named an incremental partnership for the individual who is disengaging gradually and progressively from the partnership and possessing the shares. It is also legal to sell the shares to a non-partner who can acquire the full ownership of the shares alone or in partnership with another person.

The partnership contract is used in local trade and import transactions. In case of multiplicity of currencies in the partnership it is possible to use one of such currencies. The contribution in kind to the operation shall be assessed on contract basis and shall be assigned to the total of the partnership capital. Such a value shall be considered as a partial contribution at the time of liquidating the whole transaction.

Any partner has the right to request the partner in charge of the management and the administration operations to provide a guarantee against any source of trespass or misconduct that might cause any losses in the partner's contribution in the capital. The profits shall be distributed to the partners after paying all the expenditure items in accordance with a ratio agreed upon between the partners. It is possible to give the managing partner an incentive in case the profits were above a certain level.

Liquidation of the partnership

The partnership is liquidated by the end of its term or at the end of the objectives for which it has been established. At such a time all the existing assets and liabilities resulting from the partnership including any goods shall be sold to repay the different obligations. The

profit shall be fixed and divided. In case of loss, all the partners shall bear the consequences of any losses, trespass or any sort of misconduct according to each partner's share in the partnership capital.

In case of a diminishing partnership, the agreement shall end up by selling the shares to any of the partners at any time. The partners' satisfaction is a paramount requirement to decide the liquidation of the partnership even before the specified date as a result of the expiry of the agreement.

The means and ways for liquidating the partnership operations:

The partnership is liquidated by selling the assets and liabilities and sharing the profits or bearing the losses. In case some assets remain they must be sold at the going rate. Each partner is entitled to receiving his share from the existing or remaining assets and liabilities. The ratios of contribution in the partnership can be divided into a number of equal shares sold to the individuals in the partnership. In case of medium and long term partnership ,it is possible to reassess the assets and liabilities periodically.

The rights, obligations and conditions should be drafted in a contract signed by both parties and witnessed. In such a contract the two parties shall fix the partnership's capital and the ratios of contribution and shall state the field of activity in which the capital shall be utilized as well as the partnership's terms, the ratios for dividing the profits and all necessary measures or conditions for selling and Mudarba purposes as well as the type of required reports , specifications ,fines, and accounts to be opened and managed .

The Bank of Sudan Finance Policy 2006 regarding the Musharaka Formula 2006:

Every bank is authorized to fix the contribution levels and the management margins.

4.2.2 The Murabaha and The Murabaha by order of the Purchaser.

The Murabaha contract consists of selling a certain commodity at cost value plus an agreed upon mark-up. The contract is defined as a "Murabaha Contract" when the product being sold was owned by the seller before the purchaser placed the order under the Murabaha contract.

The contract is defined as "Murabaha" contract by order of the purchaser" if the product is not owned by the seller at the time the purchaser placed his order and if the product is obtained upon demand by the customer to sell it to the person placing the purchase order. The following scenario takes place when the Murabaha is intended for the customer (or the one who places the order):

"The purchaser demands the supplier to buy a certain commodity according to certain specifications and quantities at an agreed upon price or within a certain cash limit. The purchaser promises the supplier that whenever he/she buys the specific product from the supplier, he/she (the purchaser) will do so with an agreed upon makeup of profit. Consequently if the supplier agrees on this offer he shall promise to sell this product to him. The supplier, after obtaining the initial consent to buy the specific product for him/her first, shall offer it to the purchaser in the light of the previous initial agreement. A contract shall be signed between the two parties to sell the product by virtue of a Murabaha contract for the benefit of the purchaser according to which a certain margin of profit shall be determined together with a forward dated repayment agreement as well as guarantees to be

provided. In case of default of payment no additional margin of profit shall be added .The contract shall be issued and signed by both parties. Given that the purchaser has the right to change his mind and not buy that specific product even when the supplier has already obtained that product, the supplier must take the necessary precautions by making sure of the seriousness of the purchaser and the possibility of selling the product elsewhere in that event.

The first down payment which is part of the sale price is to be paid at the time of signing the contract to sell. The remaining instalments are to be paid at agreed upon terms and times. In the event of default in payment and lack of commitment to the terms of payments, no additional amount is added to the instalments in return for extension or new schedule of payment.

A sufficient guarantee must be provided by the purchaser for honouring his obligations. This guarantee can be in the form of the product that has been bought from the supplier based on the mutual consent of both parties. The purchaser is not obliged to make payment from the cost of the product being sold to him unless it was in itself a guarantee to repay his financial obligations and provided that it was agreed not to release that product without paying a specific sum of money.

The obligation to sell the product at a loss shall not be influenced by any losses that have to be incurred because the fact that once the Murabaha contract has been concluded, the ownership of the product is transferred to the purchaser and the ownership of the cost is transferred to the buyer. In the event that the creditor or purchaser delays payments in accordance with his/her obligations despite his ability to do so and if such a delay creates unjustifiable loss to the seller (supplier), the supplier (seller) has the right to sue the purchaser to force him/her to pay even when the debt was guaranteed by virtue of the mortgage.

The bank gives due consideration to the purchaser who expedites the payment before the due date and consideration is also given in cases of insolvency. It is not legal within the context of the "Murabaha by order of the purchaser" that the product be owned by the purchaser at the time of agreement on the Murabaha contract or even if the product was thought to be partly owned. The same applies in the case of joint ownership, companies and business names that are owned by the purchaser or in the case of companies belonging to him/her only if the doubt of possible ownership has been ruled out. The Murabaha contract and the Murabaha by order of the purchaser can not be a means for carrying out the sale of the product in order to return it to its first owner by using the bank as a mediator in the selling and buying processes. It is to prohibited to undertake fictitious selling by Murabaha in order to obtain liquidity only. The supplier must keep a record in terms of an invoice to show the goods being the subject of the Murabaha for the costumer have been bought for the specific purpose of the contract between him and the first owner. The costumer must in his/her turn issue a statement indicating the receipt of the product from the bank's representative. An account for the Murabaha transaction is opened into which the instalments shall be paid.

The Bank of Sudan Finance policies 2006 concerning the implementation of the Murabaha Mode of Financing:

Banks must abide by the following in their financing using Murabaha mode:

- 1/ the share of financing by Murabaha should not exceed 30% (as an indicator) of total financing by any one bank at any time.
- 2/ implementing a margin of profit of 10% annually as an indicator for local and foreign transactions
- 3/ the financing should be carried out in accordance with the Murabaha guide issued by the Bank of Sudan. The Murabaha shall be considered as being fictitious in case this guide has not been respected.

4.2.3 The Mudaraba Contract

Mudaraba is a form of partnership where the investor (actor) uses the capital of any given business entity to generate profit through investing and using this money for a specific period of time. It is depicted as follows: the capital (money) owner lends the actor on the basis that a certain business activity will be established. If there is profit resulting, then it is divided between them according to a previous agreement, and if there is a loss not caused by the actor's misconduct, then the initially invested money is only liable for return. There are three kinds of Mudaraba:

- (a) *Absolute Mudaraba*: where the actor (investor) is not confined to any restriction on how to spend the money
- (b) *Limited Mudaraba*: where the actor (investor) is restricted to use the money based on the agreement, that is, only commodities, prices, and certain time.
- (c) *Joint Mudaraba*: where the actor (investor): where an actor/s can speculate with a number of individuals' money at the same time. The initial investment is not considered as a liability to the investor. If losses occur as a result of a the investor's intentional misconduct, then the creditors have the right to for an action and at the same time are not obliged to pay the investors any rewards. The investors can seek guarantees not to allow this to happen.

The Mudaraba term ends either with the expiration of its period if temporary, or by its termination if both sides agreed, or by its eventual failure. When a financial institution carries out liquidation of any speculation, by the end of its term, the assets and liabilities are liquidated to assess and amount the profit.

The Bank Of Sudan Financing Policies 2006 Concerning The Mudaraba Mode of Financing:

Every bank has the right to determine the Mudaraba share in the profits in case the financing was granted on the basis of the limited Mudaraba mode of financing. It is observed that it is not allowed to conduct financing through the absolute speculation formula.

4.2.4 The Sa'lam (Salaf) Borrowing Mode:

The Sa'lam (Salaf) or borrowing is a form of purchase whereby the price is paid immediately, and called the Sa'lam capital. The delivery of products should then be forward-dated. The seller is known as the deliverer and the purchaser is known as the "delivered to". The Sa'lam or borrowing contract provides liquidity for producers and manufacturers to cater for their current needs. Negotiations can take place in order to conclude limited borrowing contracts ending or when the operation is in the form of contracts covering a specific period time and specific cost change. The contract fixes the products' quantity, quality, specifications and price as well as the date and place of delivery of the backdated products. It is not necessary that the products belong to the receiver who

might have produced them as a result of utilizing the Sa'lam capital. It is possible to expedite the delivery of the product before the specified dates. It is equally possible to replace it and use the going price on the date of delivery of the product. In case of default of delivery of the product or its alternative or if the receiver of the product (the purchaser) was not accepting the long waiting time and the possibility that he can not wait for another period of time for the product to be delivered, he has the right to get refunded. Both parties to the contract are entitled to apply the principle of good treatment (IHSAN) in their transactions. In other words they have to do every thing to put an end to any kind of resentment that one party might feel when the delivery date is due in case the prices were reduced by more than one third of the price according to the type of product and the surrounding conditions regarding the transaction. It is not possible to add a penalty clause and impose it on the purchaser in case of delay of delivery of the product to the receiver. However, the purchaser (the seller the owner) has the right to seek a suitable guarantee. In case the delivery was to be done at different portions, it is possible to ask for the delivery of all the other portions in case of default of delivery on time.

The Bank Of Sudan Policy for The Implementation Of The Sa'lam formula 2006:

The above-mentioned policy did not mention the implementation of the Sa'lam in name however it stipulated the following for resources utilization:" Financing all the sectors and activities except the prohibited sectors and that is by using any one of the Islamic modes of financing except the absolute Mudaraba mode. It is for this reason that the Sa'lam formula is part and parcel of the allowable modes of financing. The policy equally mentions that the Bank encourages the use of financing modes other than the *MURABAHA (purchase)*, *MUSHARAKAH (partnership)* and *MURABAHA (speculation)* in addition to the contracting, entrepreneurship and manufacture contracts.

4.2.5 The Lease and Ownership Contract (Ownership by Lease)

The Lease and Ownership Contract (Ownership by Lease) is a kind of contract based on doing a certain business and eventually selling the leased premises. For example the bank shall buy and own the assets and liabilities such as the buildings, the equipments, the machines or any other devices and apparatus with a view to ultimately transferring their ownership to the concerned parties by way of lease ending with ownership. In other words the assets and liabilities leased by the customer shall not belong to the bank at the end of the lease contract, as it is the case in the lease operate contract. However, the ownership shall be transferred to the leasing customer.

Practically the ownership of the premises and its business shall be transferred to the customer at the end of the lease contract in the following two ways:

*A lease contract starting with a promise to donate the leased premises at the end of the lease contract after paying all the specified installments by virtue of a separate contract.

*Or through a lease contract starting with a promise to sell the leased premises at the end of a stated period against the full payment of all the costs by virtue of a separate contract and according to a price that takes into account the fact that the lease cost was already included in the cost and the ordinary profit. The total cost of the operation shall be calculated on the basis of the cost of the assets and liabilities in addition to the profit during that period.

Implementation Measures and Procedures: Following a request made by the customer, the bank shall get the specified equipment based on a lease contract with a total lease value covering the cost of buying the assets and liabilities in addition to a margin of profit for a

certain period of time. The means and ways for repaying the lease (the total volume of installments, their number their dates, the currency and the place of paying the installments shall be determined). The bank shall promise to transfer the ownership of the assets and liabilities to the customer by the date of repaying the lease in full. The provisions governing the lease contract shall be applicable at the expiry of the contract duration and the repayment. The bank shall transfer the ownership of the assets to the customer by virtue of a donation or a separate sale contract.

The 2006 Bank Of Sudan Financing Policy Regarding the Own and Lease Contract:

The policy allows the use of all the Islamic accepted modes of financing except the absolute Mudaraba. The bank has equally encouraged the use of other financing modes such as the entrepreneurship, contracting and manufacturing.

4.2.6 The Manufacturing (Al-Istisna'a): Contract

The manufacturing contract is signed between the purchaser (customer) and the manufacturer or the supplier (buyer) who shall manufacture a certain product following a request made by the purchaser and according to his specifications. The manufacturer shall sell his product to the customer according to the price agreed upon. This contract is based on selling a specific product that has to be produced and whose raw materials have to be supplied by the manufacturer. However, in case the manufacturing materials are going to be supplied by the manufacturer, the contract will be a lease contract. The product to be manufactured has to be specified and described with certain specifications that distinguish it from other products similar to it for the fact that this kind of contracts is based on selling a product that did not exist at the time of contracting. The statement and specification should cover the type of the product, its quality, its value, volume, dimensions and characteristics.

Identifying And Fixing The Price And The Modalities Of Payment: In case the customer asks the bank to manufacture a certain product and if the bank needs a manufacturer to carry out this job, the bank shall sign a contract with the manufacturer on the basis that the bank is another contracting manufacturing agency existing independently from the previous contract signed with the customer. The implementation Steps are as follows:

Following a request submitted by the customer to the bank for manufacturing a certain product and on the basis of the feasibility study and the approval of the project, both parties must sign a manufacturing contract where the specifications, the conditions and the obligations are stated. In most cases the bank signs a manufacturing contract with a certain manufacturer with the full knowledge of the customer to manufacture a certain product. The contract shall determine the delivery date by the bank to the customer. It is to be mentioned here that the manufacture price in this case shall be less than the price stated in the contract between the customer and the bank. The bank has to pay the cost of manufacturing to the manufacturer. After completing the manufacture processes, the bank shall see the product according to the specifications and deliver it to the customer in order to implement and execute the first manufacturing contract signed between them and accordingly it shall receive the price of the product according to the provisions of the contract. The necessary guarantees shall have to be maintained in order to preserve the banks' rights in case of default of payment.

The 2006 Bank Of Sudan Policies Regarding The Implementation Of The Manufacturing Mode of Financing:

The policies stipulate the following: The Central Bank of Sudan encourages the use of other Islamic modes of financing such as the contracting and manufacturing.

4.2.7 The Contracting (Entrepreneurship) Contract Mode

The entrepreneurship contracting mode has been defined as a contract according to which one of the two parties shall undertake to manufacture a certain product or carry out certain jobs against a certain value that the other party undertakes to pay. The manufacturing materials can be provided by any one of the two parties. It is equally possible to assign the implementation of certain jobs to another contractor other than the original contractor who shall be in charge of the efficient implementation of the contract between the original contractor and the bank under the supervision of the contracting party. The work governed by the contract has to be sufficiently identified and defined. There shall also be an agreement on the different alternatives or the amount of money that has to be paid for each of the contracting parties for each stage completed. There should also be an agreement on the modalities of payment. The alternative or the equivalence in case of selecting a subcontractor shall have to be less than the alternative or the equivalence stated in the contract signed between the bank and the customer.

The Implementation Steps:

The customer has to make a demand to the bank to manufacture a certain product explaining the type of the contracting mode that he is interested in as well as its cost, the modalities of payment and with a feasibility study. After approving the transaction and signing the contract, in most cases the bank shall assign the job to another subcontractor in order to carry out the job in accordance with the stated conditions under the full supervision of the customer but with a separate contract. The contractor shall be paid in accordance with the payment schedules, the reports or the achievement certificates as stated in the contract. The contract shall have to consist of the following: the specifications, the conditions and the standards . Once the manufacturer has finished his job he will have to deliver the product to the bank which will deliver it to the customer who will have to pay the price. The necessary appropriate guarantees have to be supplied by the contractor to ensure good performance levels and compliance with the contract conditions.

The Bank Of Sudan Policies Regarding The Implementation Of The Contracting Mode :

The Bank's policy is to encourage the implementation of other Islamic modes of financing such as the contracting and manufacturing modes.

4.3. The Procedures Required for Submitting an Application by the Customer and its Approval by the Bank

The customer's application:

- The customer must submit his written application to the bank (either in a form prepared and designed by the bank or in a letter written by the customer where he expresses his intentions and the type of financing required (contract or mode that he is seeking together with the kind of products or particular commodity that he would like the bank to buy or the service that he would like to obtain) together with the cost and his contribution in the modalities, the stages and the terms of payment and all necessary agreement for each stage.

Items to be enclosed with the customer's application: -

- The customer has to submit with his application copies of certain official documents such as the certificate of company's registration or the business name or the articles of association, the commercial license and the taxation certificate from the competent authorities together with the land certificates that prove his/her ownership of the land. He/she also has to sometimes submit a technical and economic feasibility study for the transaction accompanied with the audited budget.

Studying the customer's application and issuing recommendations thereof:

- The competent official in the specific department shall study the customer's request and make sure that the information supplied is true and sufficient and that the customer's experience in the specified field and his ability to meet his previous obligations in dealing with the banking system is intact. The official also has to make sure that the transaction is not prohibited and it is in compliance with the Central Bank policies. He/she also has to make sure that the required financing is available at the bank and that the commodity or the product, if used as a guarantee is easily resaleable if the need arises. He/she also has to make sure that the profit shall be reasonable and feasible in the context of the technical, economic and social framework. The official then makes the appropriate recommendation for acceptance of the application or seek to amend it in certain aspects or reject the application while suggesting other alternative possible options or may express the bank's regret for the time being. This is sent to the competent authority within the bank who then makes a decision on the basis of this recommendation and inform the customer.
- In case of approval both, parties to the transaction must sign the contract that covers the conditions and obligations as well as the payment modalities and the dispute settlement and the means and the ways to liquidate the transaction and all necessary procedures.

4.4. The Central Bank of Sudan (CBOS) Financing Policies for 2006

These are instructions and directives issued by the Central Bank of Sudan for the year 2006 concerning the Bank's financing, banking and supervision policies (with a focus on policies that affect microfinance).

1-the Bank of Sudan has issued a circular letter regarding the Central Bank of Sudan policies 2006 dated the 3rd of December 2005 covering 5 axes as follows: (i) monetary policies; (ii) financing policies; (iii) foreign exchange policies; (iv) banking and supervision policies; (v) the banking system in southern Sudan

2- In the second axis the directives cover financing policies, paragraph 4 reads "there shall be an inter-banking market as stipulated by the paragraph 8 as follows: any group of banks shall have the right to establish a financing purse to finance different economic activities namely agriculture, industry, exports, social development, Mudarbamedical, diagnostic and clinical equipment provided that the CBOS is informed before the implementation process takes place.

3- Paragraph (5) of the second axis under the title 'utilization of the resources' stipulates that within the context of the free market mechanisms the CBOS encourages the banks to use their resources as follows:

(a) – Financing all sector and activities except those prohibited by the law through any of the Islamic modes of financing except the absolute speculation modes.

(b) - In compliance with the policy of the State regarding poverty alleviation the CBOS draws the attention of the banks to the importance of microfinance and encourages them to provide financing for the social development sectors within a minimum of 10 percent of total financing at any time.

4- The decree stated, in paragraph (6) of the second axis, under the title “the banks have to respect the following elements” when implementing the different modes of financing such as Murabaha (purchase), Musharaka (partnership) , Mudaraba (speculations) and any other mode such as (contracting, manufacturing). Such contracts have been mentioned in the different modes of financing.

5- Paragraph (8) of the second axis dealt with measures and general directives demanding the banks to abide by the principles and the best implementation of the Central Bank’s circular letters and instructions regarding the principles and measures for approving bank financing and other general banking measures .

6- Under the fourth axis with the title “supervision and banking policies”, paragraph (2) entitled expanding the infrastructure of banking services, point (h) indicates the necessity of developing the supervision measures concerning the financing of small and medium scale enterprises.

4.5. The Basis for Earning Profits in Trade

Profit is earned either in money or in terms of labor or guarantee. Concerning the earning of profit money, this happens on the basis that the profit is a mechanism for increasing the capital of its owner. For this reason, the owner of the capital deserves the profit in the case of the speculation. Concerning the earning of profit as a result of labor for example, the speculator deserves the profit as a result of his labor for the effort he exerts to help increase the capital of his partner (on condition the he doesn’t show any sort of misconduct or trespass on the speculation fund). With regards to the Islamic point of view on profit, it is considered to be a kind of increasing one's funds by investing the money in activities which is the main element of movement of capital in response to the desire to exert effort to increase one's funds because frozen money cannot increase except through labor except by labor.

5. Guarantees and Repayment

As previously mentioned, the banking sector laws and BOS regulations and polices require banks to have. sufficient and easily liquidated guarantees from borrowers. As a rule, any business activity is vulnerable to risks of various kinds that ultimately lead to affecting its performances, thus its ability to repay its finances. The owner him/herself might be subject to financial and health risks that in turn affect his ability to repay. Hence, based on these legislations, banks inevitably demand enough guarantees and securities to meet any cases of payment defaults.

Undoubtedly, the guarantees are demanded to serve the interests of the lending bank while providing the customer with the required finance to develop his/her business.. Guarantees are classified into: Personal and Real Securities.

5.1 Personal Guarantees

It is termed "personal" as it is based on the person's integrity to honor that certain debt. However, it is not only limited to "individuals", as others can be involved through being responsible towards serving the debt based on a 'surety ship' contract as stipulated by article 484 of the 1984 Civil Transactions Act (CTA).

In reference to article 493 (2), the creditor has the right to claim the debt from either the debtor or the surety. In case there are many debtors, the creditor has to approach each debtor separately as stipulated in article (498) (1)

In case one of the surety is insolvent he can be covered by another one. The debt has to be honored on due course of time. In case the indebted individual or the surety dies before the debt is due, it is to be deducted from his/her inheritance (497). Article 487 of the 1984 CTA requires the debtor to remain bound to his/her debt in collaboration with the sureties.

Practically, the debtor must be legally qualified and enjoys good reputation among banks and other business entities. Looking at the financial burden the surety shares with the debtor, usually both parties have a lot in common, including business partnership, kinship or, strong friendship.

Personal guarantees can be provided through a group or an association to its members on rotational basis in order to ensure getting the needed finance. Hence these bodies can play a major role in pressuring its defaulting members to pay their arrears. Since personal guarantees depend mainly on personal relations, it is logical that they are not dominantly prevalent.

5.2 Real Securities

The real security usually comes in the form of property, (land or building) but could also be in any other form. The 1984 Civil Transaction Act (CTA) provides for two types of guarantees: mortgage and pledge. There is a third type called the "the floating charge" where the company mortgages all or part of its assets to raise finance without affecting the status of usage of the assets.

5.21 The Mortgage

Articles (727) of the CTA defines mortgage as "a contract in which the creditor acquires real right on an immovable property allotted for the payment of a debt, and whereby the creditor shall have a priority over the ordinary creditors and the successive creditors ranking in the register, to recover his debt from the proceeds of sale of the mortgaged property in whatever hands it may pass..

It appears that the mortgage is a kind of real estate mortgage, only applicable to a real estate, without affecting its original possession status. The act prohibits any division for the fact that the mortgaged real estate is a guarantee for all the debt and not part of it. If the mortgager paid part of the debt, the whole real estate entity shall remain under mortgage as a guarantee for repaying the remaining part of the debt. Usually the prevailing interpretation for the meaning of a real estate is land, yet that does not exclude all other entities that are within the land including buildings and other facilities. The act stipulates that the mortgage should be registered at the registrar general of lands to have legal effect against third parties.

The 1984 CTA requires the mortgager to be the owner of the mortgaged real estate and have the full legal authority. The mortgage includes the accessories of the mortgaged real estate in terms of buildings, trees, real estate items and any new buildings built on it after the signing of the contract. The Act equally stipulates that there must be a tangible debt against the mortgage or a promised debt. The beneficiary from the mortgager has the right to use, manage and benefit from the real estate item or owning it by the force of law if the debtor did not meet his obligation. In order to guarantee the rights of the creditor, the act holds the mortgager responsible of the mortgage physical integrity up to the date of honoring his obligation or the debt. It equally gives the creditor the right to preserve his right by expressing his objection to any kind of misuse or loss of any item in the mortgaged, the real estate or the buildings, the trees or the facilities existing on it. The act includes other texts regarding the details that guarantee the rights of those debtors and the creditors

The mortgage contract consists of agreed-upon conditions between the debtor and the creditor. Such conditions include, among others, the value of the secured debt, its nature and the reason for which it has been made, the date of repayment, the priority of mortgage which is , in most cases, a first mortgage on the real estate ensuring that the creditor will have priority compared to any other creditors in case of other debts to be covered by the same real estate. Concerning the mortgaged real estate, the mortgage contract has to clearly indicate the real estate registration certificate because it contains information regarding the real estate area, the buildings on it, and the real estate classification. The registration certificate must be recent and reflect the actual legal status of the real estate and whether it is free of any encumbrance or not. The cautious creditor always asks for mortgage of the real estate that exceeds the value of the debt or the loan to provide a reasonable margin allowing him to fully insure that he will get a complete guarantee in case the value of the real estate has decreased or that of the buildings built on it.

The mortgagee shall cover his debt from the value of the mortgaged real estate in case of default of repayment by the mortgager at the time when the debt is due according to the debt classification. In case the real estate does not cover the debt the beneficiary has to cover the remaining debt.

5.22 The Pledge

Article (766) of the 1984 CTA defines pledge as "a contract whereby the creditor or receiver retains possession of the property as a security for the debt until satisfied partly or in full, in priority of all other creditors". It has been given this title because it is based on a liability or a right as guarantee for a debt or a loan. The property can be either in the hands of the creditor himself or in the hands of any other reliable third party or in the hands of the guarantor who is trusted by the pledger and the pledgee. This name has been given because it is based on the possession of an asset used as a guarantee against a certain debt or loan. The pledged property shall either be kept by the creditor, the indebted person, or a third party trusted by the two sides, and it should be conveniently deliverable (if money) or easily liquidated (if property). Furthermore, it must be delivered a specific date previously agreed on when the pledge took effect.

In order for possession to be complete and binding, it has to be accepted by the creditor and the guarantor. The grantor has the right to renounce the pledged property before the delivery time. The pledged property can not be divisible in order to guarantee the

repayment of a certain debt. In other words, it has to remain all as a guarantee for all or part of the debt.

The pledger can not take any action on the pledged property either by selling, lease or donation without the prior approval of the pledgee. The pledger has to guarantee the safety and security of the pledge. He/she can not carry out any action that undermines its safety or security or impede the pledge beneficiary to practice his rights. The pledgee has the right to sue the pledger until he repays his debts.

There are different ways to transfer the ownership of the property depending on the nature of the pledged property which could be a fund or a right as it has been mentioned. In the case of commodities, the ownership can be physically transferred to the beneficiary of the pledge by giving him/her the store keys. The goods can be transported by air or sea based on certain cargo documents. The ownership of the share can be transferred to the pledgee once he receives such documentation for that. The ownership of circulated shares can be transferred through the Khartoum stock exchange market once the market has been informed of the pledge of such shares in order to guarantee the repayment of the debt. As for the transfer of insurance policies ownership this can be done once it has been stipulated in the contract. It is the creditor benefiting from the pledge that has to receive it in order to recover the amount of the loan in case of default of payment.

5.3 Negotiable Instruments and Guarantees

The negotiable instruments are subject to the 1917 Bills of Exchange Act (BA) which is one of the oldest Sudanese laws derived from the British Law. The bills include bills of exchange, promissory notes and cheques.

The 1917 BA defines cheques as a documented order signed by the drawer that is not subject to conditions, addressed to a bank ordering it to pay a certain sum of money on a specific date, and payable to an explicit individual or whom, is representing him/her.

The section of the study, however, will be confined to the cheques as there is a prevailing perception that it represents a financial guarantee. Following the modification introduced to the 1991 Criminal Code by virtue of article (179), rendered cheques not honoured as being a crime punishable by the law.

Negotiable instruments are considered as commercial methods of payment which are governed by civil transactions laws. The 1917 Bills of Exchange Act stipulated the required procedures to be followed in case of cheque not being honoured that is protesting for default payment "protesto" action. In addition, the Bills of Exchange Act specified each party's obligations together with the legal consequences of emanating from them. These regulations are within the competence of civil, not criminal courts.

The 1991 amendment in the criminal laws undertaken to render the cheque bouncing as a punishable crime by the law, came as a result of the government's will to preserve the funds of public institutions and nationalized bodies as it noticed the increased illegal dealings resulting from the weakness of the existing law. A large number of individuals issued high value cheques against received commodities without having sufficient funds to cover the requested amount. Even worse, some of them used to submit cheques under false names to various institutions from different banks. And because of the lengthy civil courts' legal

procedures of collecting the value of bounced cheques, large number of institutions and nationalized bodies incurred huge losses as their debts lost their value given the long period of time. Ultimately, the cheques lost its reliability as a negotiable instrument prior to changes in the 1991 criminal law.

Hence, this led the government to introduce article (179) in the 1991 Penal Act where point (1) stipulates the following:

“S/he who issues a bank cheque to honor a certain obligation for a certain value of money and if the cheque returns to the drawer (R.D.), s/he shall be committing the crime of issuing an uncover able cheque for any one of the following reasons”

- *the drawer has no account at the bank at the time of issuing the cheque*
- *the drawer has no sufficient credit in his account with his full knowledge*
- *the drawer has stopped the cheque without reasonable justifications*
- *the drawer, knowingly, issued the cheque in an unreasonable way given his full knowledge of that.*

Point (2) on the same article stipulates that any person committing the crime of issuing a cheque without provision, shall be penalized by either five years imprisonment or fined, or both.

By virtue of article (198) of the 1991 Penal Act, if the cheque drawer was fined or had to pay compensation, the court has to apply a repayment modality by confiscating, mortgaging real estates, or selling any available assets.

In case of execution, the same article stipulates civil procedures to be followed. And since, most sentenced individuals have no real estates or visible funds that can be sold (sometimes they tend to hide them), the study will be concerned with the articles that necessitate collecting the value of the cheque based on the civil procedures.

Article (198) read with article (243) of the 1983 Civil Procedures Act stipulates arresting the drawer until repayment of the debt. In addition, according to article (244) of the same Act the debtor should not be released unless: the amount is paid completely or the creditor drops the debt through a written a concession, or if the debtor presents sufficient evidence according to which he/she is declared insolvent. .

Tracing back the historical legal precedents, it has been proven that the process is quite exhausting in terms of time reaching sometimes two years and in terms of monetary value, costing large sums of money in legal procedures. If the debtor eventually proves his/her insolvency, the creditor will be with virtually no guarantee in addition to the financial losses incurred from the lengthy legal procedures. Hence, the cheque should not be considered a safe guarantee.

6. The Experiences of Different Countries and International Organizations

This part of the study aims at providing an analytical resume of the rich experiences of all organizations and institutions engaged in the field of small and micro financing in an endeavor to draw the lessons which could help us in identifying the issues and framing of recommendations.

Reading the studies and reports written on this subject, including the studies written on the Sudanese experience, reveals the following:

1. The absence of a definition of small and micro projects and consequently the absence of an indication of the size of financing required.
2. The absence of a definition of the targeted groups.
3. The multiplicity of institutions and organizations active in the field of small and micro financing, and the absence of coordination between them.

We shall deal briefly with each one of these observations in the following pages:

6.1. The Absence of a Definition for Small and Micro Finance

The studies written on small and micro projects enumerate the types of projects financed and their total financing without defining them or indicating the size of financing. It is needless to add that the definition of the projects is closely related to their cost. The absence of a definition may be due to their diversity both in their types and their sectors from one State to another or from one community to another. It may also be due to the lack of reliable statistics on these projects, their types, cost and the respective needs of each and every community or group.

It should be observed that the determination of the types of these projects, and their cost is closely related to the community in which these projects are financed in view of its needs, its composition and its ability to benefit from these projects. Such an endeavor requires the organization of the targeted groups and building their productive capacities through training to guarantee the success and sustainability of these projects in the different parts of the Sudan.

6.2. The Absence of a Definition of the Targeted Groups.

Perusal of the studies and papers written on micro financing are devoid of a definition of the targeted groups. We have already indicated that the object of this financing is the eradication of poverty and the realization of social development. The absence of a definition of the targeted groups or communities may be due to the varied definitions of poverty given by the World Bank and the specialized organizations of the United Nations. Furthermore, each State has its own definition of poverty. While accepting the very general international criteria for the definition of poverty, the issue is certainly more complicated by the fact that poverty is always a relative phenomenon varying from one country to another and from one community to another. A more precise definition will certainly help in determining the neediest groups as a first priority moving to the less needy groups as a second priority.

The studies reveal that there are certain very poor and needy groups and communities amongst whom it is unthinkable even to consider micro financing before raising their awareness and organizing and training them to appreciate the necessity of becoming

productive. On the other hand some other poor groups and communities possess the necessary awareness, the ability to get organized and the necessary agricultural and artisan skills but lack the necessary training and financing. The best example is presented by the “productive families”.

We do not need to emphasize that the success of any national action must be based on proper planning and organization. The success and sustainability of such action makes it imperative to precede the said planning and organization by appropriate surveys of each and every community or group for the purpose of classifying them and offering each and every group or community the appropriate product. Such a classification on the national and State levels will help the different Stakeholders in determining the communities and groups in which a particular Stakeholder, governmental or other, may operate with maximum efficiency and success.

6.3. The Multiplicity of Institutions and Organizations Active in the Field of Small and Micro financing, and the Absence of Coordination.

The studies reveal an evident multiplicity of Stakeholders. These include ministries, departments and government institutions concerned with social care and development banks and in particular the specialized ones. United Nations specialized agencies like the UNDP and IFAD, Voluntary governmental, non governmental and charitable organizations. While these studies indicate in some detail the successes, failures and constraints facing each and every one of the Stakeholders, they do not indicate the existence of a body or organ capable of effectively coordinating between all of them, for the purpose of consolidating and developing micro finance.

It has also been observed that although the studies enumerate the success registered by some countries in this field, such studies lack a close analysis of the reasons leading to such success. Success has always been attributed to the good management of the Stakeholder concerned. It is needless to add that such analysis, added to good management, will make it possible to extend successful experiences on an institutional basis to other communities and groups by the appropriate Stakeholder.

Despite accumulated experiences during the past few decades, the studies still hesitate between two options, namely, the creation of a central national institution specialized in micro financing, and the creation of national institution to coordinate between the various Stakeholders. The second option confines the role of the said institution to the consolidation of micro financing and setting of appropriate success rating criteria to measure the success registered by each and every Stakeholder.

It should, however, be noted that the studies indicate that while the first option may be the most appropriate in certain cases, the same studies seem to encourage the second option. It is said that it ensures stability of all Stakeholders and provides them with the opportunity to develop their present activities by benefiting from their previous experience. The supporters of this option argue that working under the umbrella of a centralized institution will leave no room for initiative or creativity. It could also hamper the gradual integration of micro financing in the economic system.

In view of the vast area of the Sudan, the spread of poverty, the diversity of its peoples, communities and economic activities, and the multiplicity of the Stakeholders, the second option seems to be the most appropriate for the Sudan.

7. Conclusions and Recommendations

7.1 Conclusions

It has been explained in the opening paragraphs of this paper that the Interim National Constitution of the Sudan 2005 has explicitly stipulated that poverty eradication is one of the most important objectives of economic development. In fact, the constitution puts a heavy responsibility on the state whereby the state has to lay the required strategies, legislations, polices and mechanisms and to come up with different means and ways to develop the mechanisms that help in eradicating poverty. It is undoubtedly true that financing of micro and small enterprises is one of the most important mechanisms that ensure decent jobs and productive means for earning a living while achieving social development.

We have also presented in the first part of this study the legislation relating to the financial transactions and the mechanisms put in place to finance the different economic activities such as the companies business names licenses and securities. It can be concluded from this presentation that the modalities provided by the financial services market do not suit the financing of MSEs in the Sudan. This might be attributed to: (a) The laws governing civil transactions being adapted to the financing of medium and large projects and as such not appropriate for the financing of small and micro projects; and (b) the fact that existing financing mechanisms require the provision of large capital, guarantees and expertise that are not available to small and micro entrepreneurs.

The paper has also detailed the laws governing the activities of the Central Bank of Sudan, these being the 2003 Act for organizing banking activities and the 2002 Bank of Sudan Act amended 2005. From this exposure and taking into consideration the 2006 Financing Policies of the Central Bank, it is clear that the Central Bank can play a pioneering role in financing social development, improving the capacities of the vulnerable sectors specifically by expanding the base for the provision of banking services in support of the development of microfinance for poverty alleviation. It is also clear that the two laws mentioned above lay out the legal foundation for financing MSEs through the banking system but provided that the policies of the Central Bank in support of this direction are respected and implemented.

Islamisation of the economic system in Sudan and the prohibition of Riba (usury) have resulted in the banking system adopting Islamic modes of financing. Some of these Islamic modes, such as the lease and own contract and *MURABAHA* contracts, can provide appropriate tools for financing micro and small enterprises and services and respond to the needs of the targeted sectors and groups. In this connection, specialized banks are quite familiar with the constraints of the beneficiaries and they should be encouraged to respond to these constraints by making these two modes even more responsive to the needs of micro financing. It remains to be seen whether such actions by specialized banks can be made effective through the Islamic financing modes now being implemented in the northern part of the country.

The Central Bank of Sudan, specialized banks, Ministers and specialized governmental departments, and institutions in the field of poverty eradication social welfare and development together with the local and international NGOs in the Sudan have, during the past decades, exerted much effort in providing financing for small and micro enterprises.. However, we observe that each body works in isolation in the absence of specific legislation to streamline this kind of financing on the national level. The best evidence for this is the Act for organizing Voluntary Activity for the year 2005 which does not make any reference to the financing of MSEs and has been severely criticized as we have explained in the previous text of this study. It is worth mentioning that all the studies on this subject matter, specifically those on the experience of Sudan, clearly indicate that these voluntary agencies (Non-Governmental Organizations) working in the area of microfinance enjoy rich experiences accumulated through decades. Such experience is valuable in formulating and drafting the basic framework and the legal instruments that help to spread this kind of financing, support and reinforce it at the national level. And, this can take place by coordinating their efforts and extending the experiences to all agencies working in this field.

In reference to the law, it is crucial to state that organizing is not enough to support and develop the microfinance. What is required is to establish a legal institutional framework laying out the measures, norms and the necessary standards that will consolidate the small scale enterprises and allow for their sustainability. In order for any legislation to be successful and effective, it has to be feasible and must emanate from the immediate and expected national needs, in the long and medium term. The success of financing should foster the healthy development of all the other organs working in the field of small scale financing with its different types and objectives as well as regulations and policies that govern them by involving all stakeholders effectively in all the different stages of law drafting. Moreover, the law has to be evaluative to accommodate all difference initiatives and creative ideas to be able to cope with the new developments in the financial and servicing market in all the different areas in the Sudan

7.2 Recommendations

In the past previous pages we identified the legal institutional and organizational gaps in the field of financing small scale enterprises, based on the literature and the readings we had about this subject inside and outside the Sudan. We equally tried to contribute to displaying the negative ramifications of these gaps as well as the expected positive results in case they were well implemented. Despite the fact that an evaluation of outcomes and formulation of final recommendations requires joint efforts exerted by all the stakeholders involved in the field of developing the financing of micro and small enterprises together with experts in this field, we shall try to present the following initial recommendations:

- 1- The prevalence of a strong political will in compliance with the directives of the Interim National Constitution of the Sudan 2005.
- 2- Laying out a national strategy for financing micro and small enterprises by benefiting from the different studies and experiences available in the Sudan and abroad.
- 3- Reviewing the poverty eradication plan in relation to the guiding principles that has been identified by the Interim National Constitution of the Sudan.

- 4- Reviewing all the legislations with a view of including the objectives of the different specialized governmental institutions and international NGOs within the context of providing financing to the small scale and micro enterprises.
- 5- Organizing the work in the field of small scale and micro-enterprises by drafting a legislation whose objective is to establish coordination between the different bodies working in the field of financing small scale and micro-enterprises at the national level. This can be carried out by establishing a national authority for small scale and micro-financing where all the specialized bodies shall be represented.

7.3 Specific Recommendations Emanating from Workshop Discussions

- 1- Based on the Interim National Constitution of the Republic of the Sudan 2005, there should be prevalence of political determination to eradicate poverty and spread social justice.
- 2- Draft new regulations and laws for establishing a "central unit" responsible for the coordination between the various stakeholders in the MF sector.
- 3- Revise the Voluntary and Humanitarian Action Law in the Sudan for the Year 2005 to include elements addressing MF and support and develop its bodies and unions in order to catalyze the process.

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