A Vision for the Development and Expansion of the Microfinance Sector in Sudan

PREPARED BY

UNICONS CONSULTANCY LTD.
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Acknowledgement

Having been commissioned by the Central Bank of Sudan, Unicons Consultancy Ltd. is proud to be presenting this document encompassing a vision for the development and expansion of the microfinance sector in Sudan. The vision is presented in the form of a strategy and five year action plan that aims at firmly positioning the microfinance sector in Sudan within the wider framework for poverty alleviation and economic and financial development.

The document is the result of intensive and extensive consultations in workshops, roundtable meetings as well as small group meetings. It has benefited from the views and expertise of many more practitioners and experts than those mentioned in the document. We wish to acknowledge their diligence and enthusiasm in participating in the many discussions that took place and to thank them for their enormous contribution to the strategy in its present form.

Particular acknowledgement and thanks goes to EQI and its consultants who were extensively involved in the formulation process in all its stages and whose input was most valuable.

The document has also greatly benefited from comments received from Magdi Amin and Samuel Maimbo of the WB, Martin Hoffmann of CGAP and Aditya Narain of the IMF. Their comments no doubt enriched the document and ensured that it took into consideration internationally established best practice.

Abda Y. El-Mahdi
Managing Director
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THE GOVERNOR'S NOTE

Microfinance has become one of the most powerful mechanisms for tackling poverty in different parts of the world. It is with this in mind that Sudanese banks have embraced microfinance as a means of allowing them to play an important social role. Other institutions are also embracing microfinance including a large number of social programs, local and international NGOs and charitable and governmental social funds. However, despite the efforts put forth by the Central Bank of Sudan, in particular, and banks, in general, to facilitate financing for small-scale producers, professionals and small income households, access to the needed finance by these categories remains weak. This is mostly attributable to the absence of a clear and comprehensive microfinance vision that is shared by government and non-government stakeholders in Sudan.

In recognition of the important role that microfinance can play in reducing poverty and in realizing the benefits of peace, the Central Bank of Sudan has undertaken an initiative to formulate a National Vision for developing and expanding the microfinance sector in Sudan. The aim of such a vision is to create an enabling environment for the industry so that the microfinance sector can grow both socially and economically. With this in mind and based on the Central Bank's policy to consult with local and international expertise and to benefit from successful international and regional experiences in the pursuit of its microfinance initiative, that this project was assigned to Unicons Consultancy Ltd. The project which was implemented in several stages adopted a widespread consultative approach that brought together the different stakeholders in the formulation of the vision enclosed in this booklet.

It is our belief that this vision has been successful in defining the framework for the needed strategy by presenting the concept of microfinance and its application in the case of Sudan while taking into consideration the experiences of other countries. This document highlights the essential goals of the vision which are: Firstly, the formulation of more effective policies to support and facilitate the provision of a wider range of financial services that are easily accessible, that meet the demands of clients and that are suitably priced. Secondly, the establishment of a framework for policy-making and legislation that creates an economic environment conducive to growth and development and that ensures the commitment of government, civil society and the private sector to the alleviation of poverty. Thirdly, it specifies the actions to be taken and the role of each of the stakeholders in supporting the development of microfinance institutions and in creating the necessary supportive infrastructure.

Although the vision is based on the findings of a comprehensive survey of the microfinance sector in north Sudan, it could well serve as a model for the formulation of a similar project in the south. In this regard, there are on-going efforts, after the establishment of the Bank of Southern Sudan, to develop a similar and complimentary strategy, specifically geared to the situation in the Southern States and that will serve as an extension of the vision.

In conclusion, it is our hope that this vision will act as a road map for all stakeholders involved in the development of the microfinance sector in Sudan. It is also our hope that this strategy will contribute to efficient prioritizing of resources and to a review of the efficacy of current laws and to the adoption of institutional reforms in accordance with the time frame defined in the work-plan.

Our thanks goes to Unicons Consultancy Ltd. for effectively completing the stated task and for all their efforts in this regard.

With Allah's blessing,

Dr. Sabir Hassan
Governor, Central Bank of Sudan

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List of Abbreviations

ABS	Agricultural Bank of Sudan
AIBF	Accion International Bridge Fund
BDS	Business Development Services
CBS	Central Bank of Sudan
CBO	Community Based Organization
CGAP	The Consultative Group to Assist the Poor
CPA	Comprehensive Peace Agreement
EAP	Economically Active Poor
FHHs	Female Heads of Household
FSS	Financial Self-Sufficiency
GEP	Graduates Employment Project
IDPs	Internally-Displaced Persons
ICB	Information Credit Bureau
IDP	Internally Displaced People
IMF	International Monetary Fund
MFIs	Microfinance Institutions
MF	Microfinance
MIS	Management Information Systems
MOFNE	Ministry of Finance and National Economy
MON	Microfinance Organizations Network
MSEs	Micro and Small Enterprises
NGO	Non-Governmental Organization
NPF	National Pensioners' Fund
OSS	Operational Self-Sufficiency
PASED	Port-Sudan Association for Small Enterprises Development
PAR	Portfolio at Risk
SAP	Structural Adjustment Program
SD	Sudanese Dinar
SDF	Social Development Foundation
SHG	Self Help Groups
SRO	Self Regulatory Organizations
SSDB	Savings and Social Development Bank
TOT	Training of Trainers
WB	World Bank

Preface

The "Formulation of a Vision for the Development and Expansion of the Microfinance Sector in Sudan" is a project commissioned by the Central Bank of Sudan (CBS) in recognition of the important role that a vibrant microfinance (MF) sector can play in the economic development of the country, particularly in terms of poverty reduction. In commissioning the work, the Central Bank has chosen UNICONS Consultancy Ltd (Unicons), a Sudanese Consultancy firm, to undertake the formulation of the strategy. While playing the lead role in the implementation of the project, Unicons has collaborated with Environmental Quality International (EQI), one of the leading firms in microfinance, and environmental and management consulting in the Middle East and North Africa. The team spirit created in implementing the project combined Sudanese expertise with regional and international experience, ensuring that maximum benefit was made from adopting best practices, and adapting regional success stories to the Sudanese context.

The primary objective of the project is to formulate a strategic framework that would enable the MF sector to play a lead role in:

a) *Supporting sustainable livelihoods by alleviating poverty and building assets that can minimize vulnerability and exclusion.*

b) *Augmenting productive investment for job creation.*

c) *Contributing to financial development by integrating informal microfinance into the formal sector.*

In order to achieve its primary objective, the project sets out to formulate a strategy for more effective policies that support the delivery of a wide range of financial services that are convenient, flexible and reasonably priced. Such a framework would locate microfinance interventions within the broader approach of poverty alleviation and financial development – enabling the poor to access financial services that are not only limited to credit but also include savings, cash transfers and insurance. The formulation process adopted a comprehensive consultative approach that emphasized the need for (and supported the development of) coordinated actions between various stakeholders, including banks, non-government organizations and the private sector. The consultative process that was set in motion took into consideration the views, challenges and priorities of various MF stakeholders (governmental bodies, financial intermediaries, NGOs and the donor community) with the aim of reaching a consensus on the priority actions and policies that needed to be adopted in favor of this important sector.

The first stage of project implementation focused on providing a full understanding of the status of the microfinance sector in Sudan, mainly from the supply side. A survey of the microfinance sector was conducted to provide an information database for the background research that was undertaken to identify challenges and constraints to the sector's development, effectiveness and expansion. A more limited exploration of the demand side sampled clients (micro and small entrepreneurs), with the aim of incorporating their evaluation of services provided by the various microfinance institutions. The major study which emanated from the results of this survey, entitled "Situational Analysis of the Status of Microfinance in Sudan", gave a thorough and technical analysis of the status quo of the sector, identified sector problems, and provided recommendations for resolving these problems based on local success stories and the international experience in this field. To complement this study and provide a comprehensive overview of the status of the sector, two other studies were also prepared. The first study discussed the impact of macroeconomic policies on microfinance while the second detailed legal aspects impacting on the financing of small and micro-enterprises in Sudan.

The second stage focused on the consultative process whereby various stakeholders were engaged in the formulation of the vision for microfinance in Sudan. This participatory process has ensured legitimacy for the vision, as well as commitment by the various stakeholders to supporting it. Most importantly it has sensitized policy makers, at different levels, to the need for coordinated action in support of the sector. The first activity in the consultative process was a two-day workshop, organized by UNICONS on 28^{th} February and 1^{st} March, 2006. ***The workshop "The Microfinance Sector in Sudan: Much Room for Improvement"*** brought together almost two hundred MF practitioners, experts and other stakeholders (including the private sector relevant ministries, the banking sector, national and international NGOs, social funds, multilateral development organizations) to discuss the results of the three studies mentioned above.

The workshop discussions were successful in raising awareness of the main issues that needed consideration in developing the sector. Consensus was reached on what constituted the main constraints to expanding financial services to the economically active poor and recommendations for eliminating these constraints were adopted. Those discussions and recommendations were carefully studied by the UNICONS team to identify those requiring further in depth discussion and dialogue. Five main issues were identified as such and these formed the subject matter for the second phase of the consultative process.

The identified topics covered the following:

1. How to supply the market with a broad range of financial services.

2. The role of formal financial institutions in servicing the economically active poor.

3. Collaterals, guarantees & recourse.

4. How can regulation (non-prudential) of the microfinance sector enhance the performance of the sector and mobilize resources for its growth.

5. The capacity building needs of banks and other microfinance institutions for servicing the MSE sector in a sustainable manner.

Five issue papers on each of the aforementioned topics were prepared by a select number of experts and discussed in a series of roundtables. Each of the five roundtables brought together MF practitioners and experts, representatives from various banks, NGOs, CBOs, ministries, donors and MFI networks. ***The roundtable discussions and reports*** that ensued from them formed the basic material for the formulation of the strategy and accompanying policy briefs.

The document, in hand now, presents the outcome of the consultative process in the form of a comprehensive strategy designed to transform the microfinance sector into a demand driven financially sustainable vibrant sector. It outlines the roles of each of the relevant stakeholders and makes specific recommendations to be implemented over a five year period. The main part of the document is structured in the following manner: In the first section, consideration is first given to microfinance in the global context before going on to the Sudanese context where it identifies the main players and outlines the major constraints to the development and expansion of the microfinance sector in Sudan. The second section details the recommendations for creating a conducive legal and regulatory policy framework giving due consideration to the regulatory role of the Central Bank of Sudan as well as to other policy reforms to be implemented by various relevant stakeholders. The third section focuses on enhancing the role and supporting the growth of microfinance institutions – both banks and non-banks. Emphasis is made here on promoting financial sustainability and the institutional requirement for achieving that. The fourth section discusses the establishment of supportive infrastructure in terms of creating the needed umbrella agency and self regulatory organization in support of the sector as well as detailing the advocacy and capacity building efforts to be undertaken. The final section outlines the action plan which translates the recommendations made in the body of the strategy into specific actions/measures to be undertaken in accordance with priority levels and time frames for implementation in the short (1 year), medium (2-3 years) and long term (4-5 years).

Executive Summary

INTRODUCTION

The demand for microfinance services in Sudan far outstrips the supply which remains exceptionally small covering only about 1%-3% of the potential market. This can be attributed to a number of factors, but most importantly, the lack of a clear policy direction for MFIs and absence of coordination between them. This has resulted in an underserved market that is NOT being offered a sufficient range of demand-driven microfinance products. A microfinance sector offering financial services such as micro loans, repeated and larger loans, consumption loans, savings, deposits, money transfers, insurance and adopting acknowledged performance measurement indicators does not really exist in Sudan. Accordingly, there is a need for a comprehensive strategy to support MFIs, including banks, to provide non-conventional products and services to a broad based constituency of poor women and men. Such a strategy must include the setting of standards of performance for the industry as a crucial element in the sound development and sustainability of the sector. However, supportive microfinance policies cannot succeed in isolation and the sustainability of the sector will also be dependant on overall country level structures such as payment systems, accounting and legal systems.

The "Formulation of a Vision for the Development and Expansion of the Microfinance Sector in Sudan" is a project commissioned by the Central Bank of Sudan (CBS) in recognition of the important role that a vibrant microfinance (MF) sector can play in the economic development of the country, particularly in terms of poverty reduction.

This document presents the Vision which is the outcome of a long consultative process that has entailed round table discussions, workshops, and extensive desktop and field research. Much effort has been made to involve the majority of stakeholders in the formulation of the vision to transform the microfinance sector into a demand driven financially sustainable vibrant sector within the Sudanese context. These stakeholders included CBS staff and government officials from the relevant ministries, bank employees and other MF practitioners including NGOs and CBOs. Also consulted in the formulation process were the donors represented by international organizations having a major role in Sudan. An integral part of the vision is an action plan outlining the roles of the relevant stakeholders and recommending specific interventions to be implemented over a five year period.

THE VISION AND GUIDING PRINCIPLES

The main aim of the projected strategy is to facilitate sustained access to financial services for the economically active poor (EAP) in rural, semi-urban, and urban areas by expanding and developing the microfinance sector in a cost effective, gender sensitive and sustainable manner. The EAP are the targeted clients and they refer to the small and micro entrepreneurs and the women and men who work for very low wages. Those two groups are by definition excluded from accessing formal financial services.

The primary objective of the vision is to develop a framework for more effective policies supporting the delivery of a diverse range of financial services that are widely available, client responsive and reasonably priced. Such a framework would have the twin objective of (1) Locating microfinance as an essential intervention within the broader approach to poverty alleviation and socio-economic development – enabling the micro-enterprise sector to access financial services that are not limited to credit but also include savings, cash transfers and insurance; and (2) Developing a microfinance industry that is institutionally and financially sustainable, and integrated within the broader formal financial sector.

CROSS CUTTING AREAS OF INTERVENTION

The vision has been developed within a framework that focuses on three cross cutting areas of intervention that are considered to be crucial in enhancing the role of the microfinance sector in Sudan. These areas are the policy environment, the institutional and regulatory framework, and the supporting infrastructure. The recommendations made are translated into a comprehensive action plan that sets out specific actions/measures to be undertaken in accordance with priority levels and time frames for implementation in the short (1 year), medium (2-3 years) and long term (4-5 years).

CREATING A CONDUCIVE LEGAL AND POLICY FRAMEWORK

To promote inclusive financial systems and support the growth and development of the financial sector at the bottom of the market

A. Reviewing the Banking Law and CBS Policy

Current credit policies are not attractive to bank engagement in micro finance. Accordingly, the Central Bank of Sudan is encouraged to adopt more flexible, balanced monetary and pricing policies that would encourage banks to provide microfinance services without compromising international standards of banking safety. Moreover, and while lessons could be drawn from the experiences of existing specialized banks, in particular the Savings & Social Development Bank and the Agricultural Bank the fact remains that there is a need to restructure the existing specialized system with a view to reforming it. Although the creation of a new bank for the poor by the government is considered in the strategy, reforming the existing financial system is given priority and regarded as being more efficient in the short to medium term.

To reach its full potential, the microfinance industry must include a variety of financial intermediaries to serve the specific demands of a broad spectrum of clients through innovative approaches and technologies. It also means that the industry must be able to enter the arena of licensed, prudentially supervised financial intermediation and that regulations and procedures be carefully crafted to allow for this development. To this end, rational licensing of new MFIs and descaling of existing banks to serve as specialized banks will be important. The Central Bank will also need to be equipped to monitor the operations and performance of the different MFIs, whether banks or NGOs and to set guidelines determining when to exercise prudential regulation.

In addition, developing linkages between banks and non bank MFIs under a carefully designed pilot linkage project, to be launched as an initiative of CBS, is recommended as a means to broadening the depth and breadth of outreach of microfinance services.

Finally, reviewing the Banking law and CBS Policy should include a re-evaluation of the effectiveness of directed credit which has so far not proven of significant value to the industry, given the banks' inability to meet the micro-sector lending targets. This will be crucial to providing policy support for implementation of the strategy.

B. Diversifying the Range of MF Services and Products

Some of the Islamic modes of financing, e.g. Murabaha and Salam, are considered by many to be unsuitable for micro-financing as they are relatively expensive and limited to the production cycle. This especially affects farmers who constitute a major proportion of the targeted micro entrepreneurs, depriving them from realizing potential gains at market maturity. Moreover, the currently practiced Islamic mode for deposit taking (on a non-interest bearing basis) does not encourage savings which is an essential component of a healthy MF sector.

It is, therefore, recommended that other modes of financing, such as Musharaka, be encouraged and that banks improve their capacities to, more widely, apply this modality of profit sharing and to develop other innovative and non-traditional modalities in line with clients' needs, while observing the essence of the Islamic financing regulations.

In addition, it is proposed that a specific "savings and investment" scheme for micro savers be designed. Under the "savings and investment" scheme a formal financial institution would initiate a fund that invests in one or more project. The funds are collected from micro savers and pooled to be re-invested without predetermining the return on investments.

C. Examining Alternative Collateral Mechanisms

The limited access to financial services by small farm, non-farm micro-entrepreneurs and especially women entrepreneurs is attributed, among other factors, to the absence of a legal, policy and regulatory framework for collaterals and guarantees appropriate for microfinance. Greater flexibility will need to be exercised in the definition of what type of collateral constitutes an acceptable securitization in the case of microfinance with due consideration being given to non-conventional collaterals. The strategy recommends a pilot project whereby the provision of non-conventional/social collateral including endorsement by grassroots organizations and solidarity groups, personal guarantee and community guarantee funds are developed and tested for adoption as an acceptable and practical form of collateral. This is considered as one of the main elements of the strategy leading to the institutionalization and expansion of a sustainable and gender sensitive microfinance system.

Moreover, small producers and merchants in rural areas and in the fringes of urban towns own unregistered real estate that can serve as collateral for obtaining the much needed financing. It is, therefore, recommended that the issue of land reforms and registration be addressed as an important component of the strategy to develop the microfinance sector. The Land Commission stipulated in the Comprehensive Peace Agreement (CPA) will have a critical role to play in this regard.

Guarantees are particularly useful for borrowers who do not have sufficient collateral, such as land or other assets. This directly proposes the establishment of credit guarantee schemes with the purpose of sharing credit risk with banks. The strategy recommends three mechanisms to be further explored for implementation: Community Repayment Guarantee Fund, MFI maintained Credit Guarantee Fund, and Joint Guarantee Scheme.

The strategy also emphasizes the role of Zakat funds in enhancing the performance of the MF industry in Sudan. The fact that MF objectives also constitute those of the Zakat, makes it rational to strategically integrate, in a complimentary manner, these funds in the MF industry. Zakat funds, currently utilized to finance collective investments that benefit the poor, could be implemented in partnership with specialized MF banks or directly by working with CBOs and SHGs to provide financing for essential infrastructure, health, transportation, roads, and other public services.

A recommended solution for the limitation on securing adequate guarantee is to promote micro-insurance as security back-up for micro-financing. It is recommended that new insurance funds within clients' unions and networks should be established in the form of solidarity funds, which could further be supported by Zakat funds and social insurance initiatives. Formal private insurance companies should be encouraged to support such mechanisms, both financially and operationally, by creating the right incentives especially those leading to greater profitability.

D. Establishing A Specialized MF Department in CBS

The strategy strongly recommends establishing a centralized Microfinance department/Unit within the Central Bank which will be responsible for regulating, supervising and formulating policies in support of microfinance activities, in accordance with prevailing legal mandates. The department is to specialize in enacting the role of the Central Bank in all issues related to this strategy. It also recommends strong representation of the specialized department in the regional offices of the Central Bank to cater for rural microfinance. The department should have a clear mandate and business plan as well as detailed accounts for the services it will offer and cost recovery techniques to ensure sustainability. It must be adequately funded and staffed by officials who are highly trained in the provision of MF services to enable it to fully carry out its mandate.

ENHANCING THE ROLE AND SUPPORTING THE GROWTH OF MFIS

To `Develop and provide an institutional and regulatory framework that is supportive of market oriented approaches in the delivery of broad based financial services.

A. Development of Financially Sustainable MFIs

In order to achieve the microfinance double bottom-line of combining banking with social goals, strong institutions need to be developed to provide the needed financial services to the economically active poor in a sustainable manner. These institutions need to be able to attract savings, recycle them into loans and provide other financial services needed by the targeted groups.

Besides promoting efficiency and self-sufficiency, sustainability goals for an MFI also have other benefits that include attracting external financial investment, satisfying Central Bank reporting requirements and building trust among its clients and supporting institutions (including donors).

In order to develop sustainable MFIs, efficient management must be ensured through training that emphasizes the use of diagnostic and management tools that measure the capital adequacy, asset quality, management, earnings and liquidity. In addition, performance monitoring through the use of a computerized loan tracking system backed by staff and customer incentives is an integral part of sound MF operations. Such Management Information Systems bring out problems at loan officer and branch levels and serve as early warning mechanisms for unsatisfactory performance.

B. Effecting the Role of Banks in Provision of MF Services

The huge demand/supply gap in microfinance in Sudan can be narrowed by creating a better understanding of the demand side. Firstly by ensuring better targeting of credit worthy, economically active clients, and secondly by broadening the supply side to reach more home based and start-up enterprises. A detailed study focusing on mapping the un-served or underserved markets, defining the clients and studying their needs is needed. This would allow MFIs to design methods of outreach and follow-up that are tailored to the needs of the designated target group (unemployed graduates, women, IDPs, productive families etc.) and that provide a solid definition of the target group for microfinance or a set of unified eligibility criteria across banks.

Furthermore, the strategy focuses on expanding outreach as a crucial element in enhancing the growth of MFIs. This is to be achieved by firstly, using less costly and more innovative approaches to facilitate delivery of services as well as reviewing and making more flexible requirements for bank branches such as security standards, working hours, daily clearing of accounts or limitations on location. Secondly, creating linkages between banks and NGOs & CBOs particularly in the remote rural areas where banks have difficulty reaching the poor. Thirdly, pricing microfinance products on the basis of adequate costing with the aim of stimulating their supply. This will require conducting a thorough analysis of cost elements and structure, as well as relation to the price that would ultimately balance between supply and demand.

C. Developing the Non-Banks MFIs

The strategy stresses the vital role of non-bank MFIs in expanding the microfinance sector in Sudan. For example, the experience of the Sudanese Postal Office can act as an important guideline and a serious effort should be made in regaining its legacy as a pioneer institution in facilitating money transfers and savings behavior. By doing so, a wider geographical coverage will be achieved in various states and also in rural areas. Moreover, the role of NGOs and CBOs, in the delivery of microfinance services, can be enhanced by appropriate reforms and amendments to the laws governing such institutions. These laws being the Humanitarian Aid Act governing NGOs and the 1999 Cooperative Law governing CBOs.

ESTABLISHING A SUPPORTIVE INFRASTRUCTURE

To provide financial institutions with the required human, financial, capital and information resources to offer effective and sustainable services

A. Creating a Supportive Information Base

The creation of a database within CBS is a necessary requirement to inform policy making. It is recommended that data be collected and published on the microfinance activities of licensed banks, NGOs, CBOs and the donor community - a process that will entail monitoring the development of the microfinance sector over time. Such a database could be established and maintained by the recommended MF department within the Central Bank.

To overcome the challenge facing MFIs as a result of lack of information on the credit history of the client, an Information Credit Bureau (ICB) should be established. It is recognized that the establishment of such bureaus would require conducting some institutional and legal interventions that can be summarized in a call for setting up a Credit Record Apparatus and utilizing the accumulated experience of the Central Bureau of Statistics.

B. Supporting the Establishment of a Microfinance Network

International experience shows that a network of MFIs is the entity most suited for advocating policy and legal changes for the growth and development of the sector. To facilitate this process, there is a clear need for intensifying awareness raising campaigns on the MF industry and credit worthiness of the poor, in addition to training programs that focus on policy issues for government officials at all levels as well as for banks, second-tier institutions and other.

Establishing an Umbrella Organization/Apex Institution is a further step to improve coordination among the different MFIs and between MFIs and other microfinance stakeholders at both the Federal and State levels. The Apex institution should play an important role in exposing MFIs to new ideas and experiences and sharing of opportunities that would help them continuously refine strategies and operations. It should work in close coordination with CBS to ensure that the needs and concerns of the banking sector are also addressed.

C. Establishing a Self Regulatory Organization

Prudential regulation and supervision is clearly needed for microfinance but a balance must be struck on when and how to exercise such powers. The strategy, therefore, recommends that when MFIs do not pose any systemic risk to the financial system, such regulation and supervision be delegated to a system of self-regulation. In such a case, CBS should limit its responsibility to solely registering MFIs, especially if they do not capture savings, and to ensuring that all microfinance initiatives are registered regardless of their source of funding or legal type.

Establishing a self regulatory body that has the responsibility of setting performance standards, norms, definitions and credit rating criteria (in consultation with CBS) will provide guidance and strategic support to microfinance institutions. This will enable the MF industry to attract and raise capital and resources from the donor community. The legal shape that the SRO should take has to be a result of a detailed study that would take into consideration internationally accepted experiences. The capacity of such an institution should be adequately assessed and supported so as to ultimately function as a financing intermediary and benefit from technical assistance provided by microfinance initiatives such as those associated with the IMF and the World Bank.

D. Building the Capacity of MFIs

A major pillar of the Microfinance Strategy focuses on improving the efficiency of MFIs by building both financial and managerial capacities. Financial capacity building is needed to improve MFIs' absorptive capacity and ability to attract greater funds, increase the number of loans disbursed and encourage savings and expand their clientele base etc. Managerial capacity building, on the other hand, should primarily focus on the institutional and human resources aspects of the MFI - in terms of networking and partnership for training, skill development, information management systems and so on.

Capacity building should include training and education, documentation of best practices and ideas as well as strategies, and tools to reach the un-served and underserved market segments. Such efforts must necessarily aim at the training of trainers in order to expand the capacity building exercise. Workshops and seminars together with the greater involvement of the media should be targeted to create the awareness needed for the suitability and viability of microfinance not only as a potent poverty alleviation tool but also as a potentially profitable business.

Conclusion

The strategy has identified the specific recommendations that, if adopted, will go a long way towards increasing access to diversified demand-driven financial services to the economically active poor women and men. The major components of the strategy can be described as follows:

- Building on the existing system and/or developing a ***Reformed Financial System*** for the poor with solid infrastructure and efficient financial intermediaries that have the required outreach to meet the financial needs of the poor;

- Creating an ideal ***legislative and regulatory framework*** that enhances the performance of the MF industry;

- Adopting mechanisms that support ***transparency*** among microfinance lending institutions.

- Applying "***best practices"*** and setting distinct performance standards for the sector;

- Creating an efficient information network that includes access to reliable, up-to-date, market information on the financial needs of the poor and MSEs and on gender and geographical imbalances.

The strategy is accompanied by an action plan that specifies responsibilities assigned to the relevant stakeholders, as well as priority levels of each activity to be implemented in the short, medium and long term. They are actions to be undertaken, not only by CBS as the leader and regulator of formal financial intermediaries, but also by other relevant government entities as well as non-government stakeholders. The role of the donor community is to support the strategy in terms of availing technical and financial assistance. Commitment at all levels is a corner-stone for the success of this strategy.

The strategy presented here is comprehensive attempting to encompass all aspects needed to increase the depth and breadth of outreach of financial intermediaries as well as to diversify their products to be more responsive to the needs of micro-entrepreneurs. It must be stressed, however, that the MF sector is only one of the tools for combating poverty. Therefore, the success of the MF strategy is largely dependent on integrating it within the overall strategy for the reduction and eventual elimination of poverty in the country. It must be supported by macro policies that focus on creating an enabling environment and a favorable business climate that fosters investment opportunities for small and micro-entrepreneurs and farmers.

I. Introduction

A. MICROFINANCE IN THE GLOBAL CONTEXT

Microfinance first appeared in the 1980's, with growing debates on the viability and effectiveness of subsidized, state-delivered credit to poor farmers. In the mid-1980's the 'subsidized targeted credit model' - supported by many donors - was the object of steady criticism, because most programs accumulated large loan losses, and required frequent recapitalization to continue operation. It became more and more evident that market-based solutions were required. This led to a new approach that considered microfinance as an integral part of the overall financial system. Emphasis shifted from the top-down rapid disbursement of subsidized loans to target populations toward the building up of local sustainable institutions to serve the poor.

Microfinance activities are usually characterized by: Small loans, typically for working capital; Informal appraisal of borrowers and investments; Access to repeat and larger loans based on debt capacity and repayment performance; Streamlined loan disbursement and monitoring; and Securing savings products.

Microfinance clients are typically self-employed and low-income entrepreneurs. They are often traders, street vendors, service providers (such as hairdressers, small restaurant operators, artisans and other small cottage industries), and they usually generate income from more than one activity.

The first, and most famous, pioneer community microfinance institution (MFI) was the Grameen Bank of Bangladesh[1], which became a model for many countries. As of December 2005, Grameen Bank had five million poor landless clients (94 percent of them women).[2] Various MFIs have been established around the world since, mainly in the developing countries of Latin America, Asia and Africa.

The formal financial system has begun changing its approach, moving away from subsidized credit to the poor to a more market-oriented banking approach. One example is provided by Bank Rakyat in Indonesia. This state-owned rural bank moved away from providing subsidized credit to adopting an institutional approach that operated on market principles. The most salient feature of this approach is reliance on savings as a main source of funding, and the establishment of an effective incentive system to motivate potential savers and bank staff. Local non-governmental organizations (NGOs) also started to look for a more long term approach that took them away from the unsustainable subsidy-based income-generating approach to community development.

To give an idea of the magnitude of MFI activities, one may refer to a survey conducted by the World Bank in 1995. The survey showed that there were 1,000 institutions that provided microfinance services, each reaching at least 1,000 clients. By September 1995, approximately US$7 billion in loans had been provided to more than 13 million individuals and groups. In addition, more than US$19 billion had been mobilized in 45 million active deposit accounts.[3] Nevertheless, much still remains to be done. The Consultative Group to Assist the Poor (CGAP) estimates that of the three billion poor people of working age who could be making use of these services, about 500 million - one sixth - currently have access to formal financial services. Without permanent access to

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1 Grameen Bank Project started in 1976 in Bangladesh and was transformed in 1983 into a formal bank under a law issued to establish it. (http://www.grameen-info.org)

2 Grameen Official Website. http://www.grameen-info.org

3 Johnson, S. and B. Rogaly. 1997. Microfinance and Poverty Reduction. Oxfam, Oxford

institutional microfinance, most poor households continue to rely on meager self-finance or informal sources of microfinance, which are both costly and risky thereby limiting their ability to actively participate in and benefit from income generating activities.

It is now widely accepted that it will require a whole range of institutions, not just traditional NGO microfinance institutions, to reach the estimated three billion poor people who could use financial services. Microfinance institutions have played a key role in the development of microfinance and will need to continue to do so. But what is really needed – to reach both further and deeper - is a whole range of institutions that serve poor people and to innovate to reach more and more poor people.[1]

The objective of microfinance is to cover critical gaps in formal financial systems in order to address a specific aspect of the problem of poverty – access to financial instruments -- in a manner sensitive to the needs of the worst off and consistent with gender equity. Microfinance does not aim at, nor can it address, all dimensions of the complex and cumulative micro-deprivations that trap people in poverty, including lack of access to basic services and infrastructure, inadequate skills, low productivity, limited market penetration, lack of access to power, seasonality, vulnerability to crisis, and gender related disabilities. Rather, it is only one of many instruments, which may do little by itself. However, when microfinance forms part of a broader national anti-poverty policy, it is possible to liberate its full potential to derive steadily increasing benefits for the poorer sections of the population.

Microfinance can be a critical element of an effective poverty reduction strategy. It is the access to financial services that can help enable the poor to increase income and smooth consumption flows, and thus expanding their asset base and reduce their vulnerability to the external shocks that are a part of their daily existence. Experiences have revealed that the availability of financial services acts as a buffer against sudden emergencies, business risk, and seasonal slumps that can push a family into destitution. More and better financial services specifically geared towards low-income groups can help poor households to move from everyday survival to planning for the future, investing in better nutrition, improved living conditions, and children's health and education.

Women, who are more vulnerable to the negative impact of poverty, on the other hand, can benefit extensively from the services and goods provided via the microfinance industry. Many microfinance programs target women in particular, largely due to their (generally) higher repayment rates. In the field of microfinance today, much focus has been made on women who constitute 70 percent of the 1.3 billion people living in poverty. Although women perform a great proportion of the world's work, they tend to reap fewer rewards from it than men. Furthermore, the poorer the household, the more likely it is to rely on women's earnings as an important source of income. Female entrepreneurs are more likely to be widows, female heads of households, or younger, childless women who are either the sole income earners for their families or sources of much needed supplemental income. It is now widely accepted by MFIs that women are good credit risks and enthusiastic customers for both credit and savings facilities. Moreover, increases in women's income tend to have a more positive effect on family welfare than increases in men's income, not only for women's well-being but also for the welfare of the family and the health of the larger community.

[1] Ibid

Microfinance is also a lucrative business if it is done right. Microfinance is a viable banking activity when scientific, acknowledged indicators to measure its efficiency and effectiveness are applied. The proponents of microfinance agreed that the economically active or enterprising poor cannot meet the conventional prerequisites of the formal banking system but argued that they do have great promising potential. The challenge was to design a financing system that responded to the needs and conditions of such clients. Microfinance, as a lucrative banking business, emerged and has since gained tremendous momentum. It aims at ensuring full cost coverage with profits for financing institutions. This is essential for on going credit linkages and sustainability.

B. MICROFINANCE IN SUDAN

WHO ARE THE PROVIDERS OF MICROFINANCE IN SUDAN

The providers of microfinance in Sudan can be classified into 4 major categories

The Banking Sector: There are 23 banks operating country-wide; with branches concentrated in the main cities and in particular in Khartoum state. The banking system (comprising one of the appropriate types of institutions for the delivery of microfinance) is composed of commercial and specialized banks both privately and publicly owned. Specialized banks target specific sectors, such as social development, agriculture, animal resources, and industrial development; or specific groups, such as farmers. Most Sudanese banks started providing microfinance services in the early 1990s and have since been expanding their operations to cover different regions and various productive sectors.

In accordance with the financing terms and regulations of CBS' financing policy, which stipulates the allocation of 10 percent of the annual lending ceiling of each bank to microfinance (targeting craftsmen, professionals and small producers, including productive families), 20 Sudanese banks are currently providing microfinance services. Most banks, however, have concentrated on the delivery of microfinance services in Khartoum state, which in addition to being the capital city of Sudan, and its commercial and financial centre, presents an infrastructure appropriate for microfinance operations that is more readily available and developed than in other regions of Sudan.

Apart from banks (commercial and specialized), microcredit in Sudan is extended through a plethora of NGOs (local and international), rural development schemes, and government social funds.

NGOs & CBOs: Most micro lending, to date has been handled, by NGOs and CBOs. A survey covering the major NGOs, currently providing microfinance in the country, revealed that more than 90 percent started after 1991 following the announcement of the economic liberalization policy (1992) and structural adjustment programs. Both local and foreign NGOs act as community focused grass-roots operations rather than formal lending institutions. They work directly with communities and other CBOs and adopt flexible methods in using credit as a poverty alleviation tool. Due to the influx of rural migrants and IDPs to urban areas, and the increasing level of urban poverty, the majority of NGOs operate in urban areas in the informal sector.

Social Funds: There are a number of social funds in Sudan that provide support to poor and low income groups, including women, the elderly, students, graduates, and pensioners. While grants and subsidies consume a major part of the resource of the social funds, two funds, the National Pensioners' Fund (NPF) and the Graduates Employment Project (GEP), have had some limited experience in micro lending. These social funds started their microfinance activities between 1991 and 2000, as Sudan witnessed the world food security declaration, and the onset of the pro poor microfinance activities. Another important social fund is the Social Development Fund (SDF). Established in 1997, it has been active in extending credit to grass-root clients, and in the institutional development and capacity building of intermediately savings and credit associations at the community level in Khartoum State. It has also been a pioneer in launching networks by establishing the Microfinance Organizations Network (MON).[1] Other foundations have been found in other states including Gezira, White Nile, Gedarif, North Kordofan, and River Nile; nevertheless, they remain for the most part inactive[2].

Rural Development Projects: Several rural development projects are financed by international donors. The overall goal of these projects is to improve the living standards and incomes of poor residents in rural communities that have suffered from civil strife or drought and other natural disasters. They target specific niches of clients according to their particular mandate, although some of the projects are expanding their scope to target other poor segments of society. Many of these rural development projects include the establishment of sustainable rural credit services among their integrated services. Among the best known currently running projects, with strong rural finance component, are the North Kordofan Rural Development Project (NKRDP), South Kordofan Rural Development Project (SKRDP), Special Program for Food Security (SPFS), and Gash Sustainable Livelihoods Regeneration Project (GSLRP). The specific objective of these rural microfinance projects is to enhance the productivity and income of individual farmers, villages and groups whose livelihoods is from crops, livestock, natural plant and other farm products. Focus is also on non-farm enterprises. These projects have assisted rural communities in developing a number of credit services, including informal financial arrangements in the traditional form of revolving funds (*sanduqs*).

THE STATUS OF THE MICROFINANCE SECTOR IN SUDAN

Microfinance, as it is known and practiced worldwide, is at an infancy stage in Sudan with supply being extremely small compared to demand for these services. Rough estimates have put the demand covered at only about 1-3%. A microfinance sector, offering financial services such as micro loans, repeated and larger loans, consumption loans, savings, deposits, money transfers, insurance and adopting acknowledged performance measurement indicators, does not really exist in Sudan. Despite the several experiments in micro lending launched to extend 'small' loans to small producers and low-income groups, including women, yet there is no conformity in approach among the institutions/agencies undertaking these endeavors. This is probably a result of dissimilar objectives in terms of poverty alleviation and the absence of a clear strategy for microfinance.

A growing focus on poverty alleviation has developed during the last few years, as reflected by the establishment of several social funds; specialized institutions such as the Savings and Social Development Bank (SSDB) and the Social Development Fund (SDF); and the launching of several, albeit, scattered poverty alleviation initiatives. Nevertheless, the government's efforts in developing microfinance policies that tackle poverty in a most efficient manner remain limited and uncoordinated. NGOs and rural development projects have continued to be the main providers of microfinance to the poor, but these initiatives have remained limited in coverage and impact when compared to the size of the problem of poverty in the country.

There is a huge potential for the development of microfinance programs in the country, particularly in light of current social and economic conditions, and the Government's declarations for prioritizing

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1 MON membership consists of 66 organizations involved at varying levels in microfinance/ micro credit. These include local credit and savings associations (registered as cooperative societies and supported by the SDF) in addition to the SDF itself and some INGOs (e.g. ACCORD and Oxfam).

2 Funding has been inadequate, staff morale and skills low, combined with limited exposure to training and capacity building.

poverty alleviation in its policies. However, there are many challenging constraints facing this nascent microfinance sector which unless addressed will limit its effectiveness in fulfilling its role in poverty alleviation and economic development. Some of theses challenges are addressed here.

Outreach to the poor is still limited among many microfinance institutions. In particular, banks, having little experience in fieldwork and few links with grass-roots or community based organizations (CBOs), are limited in their outreach to potential clients. Generally speaking, the procedures and requirements for loan provision in the banking system (licenses, clearance from Zakat and taxes, land lease, banking accounts, requirements of cheques and collateral) are structured to serve those in the formal sector. The dilemma of weak outreach extends to embrace the ineffectiveness of banks in increasing their network of branches. The current coverage of bank branch networks in the country is such that a large part of the poor do not have easy access, as more than half of bank branches are concentrated in the regions of Khartoum State and Central States. It can be concluded that the ***formal banking system, as it is structured at present, is not designed to serve the financing needs of the poorer segments of the Sudanese society***.

Among non-bank MFIs, donor dependency has limited their outreach. Among NGOs, the decision to work in one location over another is not based on the normal market targeting and penetration but rather on external donors dictating areas of operation - a direct result of MFI dependence on external funding. This is especially true for the rural development projects in which donors choose the target communities to initiate integrated rural programs based on needs in the rural community, such as road construction, irrigation, health care needs, and environmental deterioration.

Another reflection of donor dependency is the risk of sudden phase-out (even for NGOs or rural development projects that achieve good results), which adversely affects the sustainability of MFI programs and, more importantly, deprives local communities from access to financial resources that they had become accustomed to, ultimately causing business disruption, and in some cases complete dissolution of micro enterprises.

The absence of a satisfactory definition of poverty and methods of identification of the economically active poor (the microfinance clients) has inhibited credit flows to these excluded segments of the population. There is no commonly accepted definition, among MFIs, of the target group for microfinance or a set of unified eligibility criteria. While this may be a direct result of donor dependency among NGOs and Rural Development projects, the problem is different for banks. Although the Central Bank directive to commercial banks is set to target productive families, artisans, and small professionals, this is not strictly adhered to and it is left to the discretion of the individual banks and their perceptions about the targeted sector. In the absence of clarity or a precise definition of who the economically active poor are, there has been a tendency to exclude them and restrict credit access to the traditional interpretations of ‘productive’ families.

One of the major factors negatively affecting the expansion of microfinance services is the lack of needs assessments for targeted clients that would allow MFIs to design methods of outreach and follow-up that are tailored to the needs of the designated target group (unemployed graduates, IDPs, productive families etc.). Microfinance programs, having not been derived from market surveys, offer only a limited array of products so that ***product diversification remains a problematic issue***. In particular, ***banks have placed little emphasis on***

the development of microfinance products that are appropriate to the needs of the poor. Currently, banks do not provide consumption or emergency loans and do not include a savings component in their microfinance activities. MFIs also neglect the particular needs of women that should be integrated into the development of any new microfinance product. Rural financial intermediation, in general, does not meet the specific demands of a broad spectrum of clients, including farmers, and agribusiness entrepreneurs, among others. Experimentation and promotion of innovative and appropriate financial technologies and products for rural clients is lacking.

The experience of Sudanese NGOs, and some social funds, shows that ***microfinance could also be used as a tool for financing community services that meet a public need or provide direct benefits to local communities.*** These services include access to potable water, electricity, butane gas or renewable energy sources, construction or maintenance of schools, maintenance of water depots (stations), and construction of public latrines. Normally these types of community projects are owned by a number of people and run on a profitable basis. The viability of providing microfinance to finance home improvement and to supply poor urban quarters with basic needs such as electricity, water, health services and energy on a cost-recovery basis has proven to be possible in Sudan provided its design is based on a thorough needs analysis that ensures sustainability of the project. Providing financial services to this particular niche of microfinance clientele could provide a needed entry point for formal financial institutions (banks) since they are better able to structure loans with relatively higher amounts and longer tenures than non-bank MFIs.

The dominance of short-term (current account deposits) and sales-based modes of finance and the meager use of MSEs-friendly equity financing modes constitute barriers to effectively extening financing to MSEs. There is a clear concentration on *murabaha* contract as the most common mode of financing used by all banks, and according to the survey conducted for the purposes of the strategy formulation, more than 34 percent of banks use it exclusively in microfinance. Banks prefer *murabaha* because they regard it as less risky since the investment risk is the sole burden of the client as opposed to *musharaka* or *mudaraba.* Much fewer banks use both *murabaha* and *musharaka* (partnership) or *murabaha* and *salam*. The rest of the banks utilize a combination of other contractual forms including *murabaha, musharkha*, *salam* (in financing crop production), and the hire purchase contract (*ijara*). The speculation form (*mudaraba)* is very rarely used as the risk is wholly borne by the bank and the client is not affected by any failures. ***The outcomes are a short-term nature of financing, an uneven distribution of the increased banking finance among sectors and a low share of finance to MSEs.***

The absence of institutional credit guarantee systems operating currently in Sudan with the exception of that offered on an individual basis. The individual borrower guarantee that is prevalent lifts the burden of loss of the business due to natural hazards, death, or disability of the borrower. Nevertheless, the "portfolio" guarantee approach, whereby the guarantor covers the whole or part of the default of the MFI according to a specific agreement, is non existent.

Lack of exposure to worldwide microfinance good practices coupled with a lack of training in microfinance facilitation and management constrain service providers' ability to manage and operate programs that effectively and efficiently provide microfinance services to the poor. This is a direct result of the weak existing efforts at capacity building in this sector in Sudan. Despite the prevalence of a large number of capacity building programs, these are still insufficient and too poorly funded to utilize available resources, cater to client needs more appropriately or adopt microfinance good practices in business planning.

The training and experience of the personnel in commercial banks is unsuitable for servicing poor clients. Despite the fact that demand for microfinance has been steadily growing in Sudan during the last decade, most bankers are still reluctant to do business with the poor as a large-scale profitable activity. They still perceive microfinance as a charitable activity that is better dealt with by other more socially oriented organizations. In addition to the lack of exposure to and training in microfinance facilitation and management among bankers, the ***lending procedures followed by banks are conventional and are not tailored to the conditions of the microfinance clients.***

With regards to non-bank micro-credit providers, ***the shortage of qualified credit and micro enterprise specialists*** to handle small business and microfinance operations is constraining their ability to expand their services and to better cater to clients' needs. Success has varied considerably between institutions, according to the variations in approach and the level of financial discipline adopted by each. The lack of exposure to, and training in, microfinance facilitation and management have limited experience in management information systems; which provide timely and accurate information for monitoring and evaluation of the progress and financial soundness of the microfinance program. ***Performance as microfinance providers is limited by the widespread perception that the loan is a gift and by the associated resistance to the shift from grants to a market oriented approach. Moreover, no emphasis has been made on savings mobilization or inclusion of consumption loans in their packages.***

With the exception of the experiences of a few international NGOs and the SDF, there is ***limited exposure and limited ongoing sharing of ideas and experiences among microfinance providers.*** Banks, for example, do not know about the successful experiences of a local microfinance organization operating in the same geographical location (e.g. banks and PASED in Port-Sudan). Statistics, surveys, baselines, and research that provide estimates of the volume of the microfinance market and its characteristics in the different geographic areas and sectors of the economy, central to the development of this sector in Sudan, are very limited or completely unavailable.

Coordination between organizations with different mandates (banks, NGOs, social funds, and rural development projects) is extremely limited. A few NGOs have established links with the formal banking system and created platforms for coordination in the geographical areas where they operate. For example, there are some NGOs, UN agencies, some development projects, and social funds that have established links with the SSDB and ABS. However, this coordination, in most cases, is a result of designing microfinance initiatives as a response to an emerging need or as disaster relief, rather than as a guided and planned effort to avail access to finance for the poor by deploying formal financial resources.

At the macro level, supportive government policies and initiatives have recently been launched to encourage the development of the small and micro business sector, in general, and its financing, in particular. However, these remain scattered and are not undertaken within a more comprehensive poverty strategy. More importantly, ***policies are uncoordinated and are NOT seen to be filtering down to the smallest administrative unit***. For instance, micro and small entrepreneurs are continuously being harassed by the local municipal authorities for licenses, taxes, fees, etc. More serious are the continuous raids on these groups by local authorities who in many cases confiscate their hard won assets procured through credit from the microfinance institutions. ***As a result of***

government policies, NGOs and CBOs have experienced a number of problems that have negatively impacted on both their effectiveness and their efficiency. For example, the demolition or re-planning of squatter areas; which caused business instability and consequently negatively affected the repayment of loans to MFIs.

II. The Vision and the Guiding Principles

THE GOAL

To facilitate sustained access to financial services for the "economically active poor"[1] - both un-served and underserved - in rural, semi-urban and urban areas through the expansion and development of the microfinance sector in a cost effective and sustainable manner.

Microfinance *is defined as "the provision of credit, savings, transfers and other financial services and products to the poor in rural, semi-urban or urban areas thereby enabling them to raise their income and improve their living standard".*

The primary objective of the vision is to develop a framework for more effective policies supporting the delivery of a diverse range of financial services that are widely available, client responsive and reasonably priced. Such a framework would have the twin objective of:

1. Locating microfinance as an essential intervention within the broader approach for poverty alleviation and socio-economic development and thereby enabling the poor to access financial services that are not limited to credit but also include savings, cash transfers and insurance.
2. Developing a microfinance industry that is institutionally and financially sustainable and integrated within the broader formal financial sector.

The vision has been developed within the following framework:

(a) A policy environment that promotes inclusive financial systems and supports the growth and development of the financial sector at the bottom of the market.

(b) An institutional and regulatory framework that is supportive of market oriented approaches in the delivery of broad based financial services

(c) An infrastructure that provides financial institutions with the required human, financial, capital and information resources to provide effective and sustainable services.

Although this vision has been commissioned by CBS, the target audience has been kept broad to increase its added value and allow for including the experience of non-bank MFIs in informing the strategy and its actions. The audience, therefore, includes in addition to CBS, microfinance practitioners, government agencies, NGOs, donor agencies, community groups and so on. The key is to emphasize the need for a range of responsibilities to be taken up by a range of actors and the need for networking and sharing of experiences among these actors.

Shift to the New Paradigm

According to internationally accepted good practices and within the context of Sudan, the vision has been developed based on the following assumptions:

i) The Poor:

- Need easy access to financial services with efficient delivery mechanisms.
- Realize that timely and adequate credit on a commercial basis is preferable and more sustainable than access to subsidized credit.

1 The "economically active poor" is a term coined by Marguerite Robinson (The Microfinance Revolution, Washington, D.C.: The World Bank, 2001). It refers to the small and micro enterprises and the vulnerable poor who work for very low wages. Those two groups are by definition excluded from accessing formal financial sector

- Perceive formal savings (in banks and postal network) as a safer and more rewarding service as opposed to savings at home or in jewelry, especially if the formal saving service is in a reasonably nearby geographical area.

ii) NGOs, CBOs and SHGs

- Act as catalysts of change and involve community assets
- Combine the social and economic agenda with a synergized effect
- Recognize sustainability as the core factor in development.

iii) The Banking System

- Recognizes that microfinance can be a profitable business with controlled risk
- Accepts bank linkages with NGOs and CBOs as a cost effective means of reaching out to the poor and openning untapped markets
- Accepts alternative forms of collateral that are specific to micro-entrepreneurs (such as peer pressure) as a substitute for conventional collaterals

iv) The Government:

- Formulates supportive policy and provides a regulatory environment
- Avoids the distortion of the market by direct service delivery with subsidized fees.
- Avoids policies that negatively impact on both the effectiveness and efficiency of microfinance institutions.

III. Creating a Conducive Legal and Policy Framework

The vision for microfinance in Sudan recognizes the importance of devising a policy framework that is conducive to a competitive macroeconomic environment spurring economic growth and prosperity. It also acknowledges the importance of aligning policies that have a pro-market orientation with an unwavering commitment on the part of the state, civil society and the private sector to poverty reduction. This entails addressing development disparities between rural and urban areas by enacting measures and gearing adequate resources towards enabling the poor to access productive assets, ultimately improving their livelihoods and contributing to the overall development of the economy.

On the operational side, there is a need for policies and measures to promote the mobilization of savings, as well as their deployment in availing more access to business credit for micro enterprises. This would be achieved through wider outreach, communication, and timely availability of services and products. It is concluded that to promote a broad based market for micro-finance, a set of macro-policies should be in place to provide attractive incentives for the market within an environment that promotes equitable economic growth, employment and social policies that address poverty and human development. Furthermore, there should be a nationally adopted set of guidelines for the development of the MF sector, according to which the donors could coordinate their support.

A. Reviewing the Banking Law and CBS Policies

It is generally agreed that in order to reach its full potential, the microfinance industry must eventually be able to enter the arena of licensed, prudentially supervised financial intermediation and that regulations must be crafted to allow for this development.[1]

CBS, in performing its role as regulator and supervisor of the financial sector, will need to accommodate the special characteristics of microfinance activities by putting in place special regulations for this sector. Such regulations should apply to both new and existing institutions engaged in microfinance activities as well as across the financial system.

The Central Bank of Sudan is encouraged to adopt some policies that would encourage banks to engage in the provision of MF services. Among the recommended policy changes are:

- A balanced monetary policy resolving the contradiction between the banking sector endeavor to accept high risks, promoting micro-finance market, and the satisfaction of the international standards for banking safety requirement.

- Flexible pricing policies that enable banks to freely choose their pricing strategies and tactics in support of funds maintenance and sustainability of services.

In sum, credit policies should be flexible to allow banks to freely decide the price of maintaining adequate services, while observing the right policy mix that would promote the service and at the same time manage their risk exposure in line with banking policies and commitment to international safety standards.

[1] CGAP ibid

1. Evaluating the Impact of Current CBS Policy

Current credit policies are too unattractive for banks to engage in micro lending. This is due to the transaction cost, as well as, a faulty perception of high risk associated with micro-finance. Such policies need to be reviewed for more flexibility especially for pricing, facilitation of financial services and streamlining procedures. The following represent practical actions recommended for cost reduction which are deemed appropriate for stimulating demand and consequently improving banks profit margins:

- Increasing the savings component in the funding portfolio targeting Micro loans.

- Promoting and supporting linkages between banks and other forms of financially and institutionally sound institutions (credit and savings unions, community-based organizations, existing networks) and assigning them functional roles that would help the banks reduce transaction costs relating to credit and savings management.

Furthermore, the Central Bank's laws stipulate that 10% of the bank’s portfolio is to be directed to micro credit. International practice reveals that directed credits are ineffective and result in credit mis-funneling to other groups. A similar conclusion was also reached by the situational analysis of the microfinance sector in Sudan that was conducted as a background study to the formulation of the current vision. It is, therefore, important to have an independent, in depth study on the effectiveness of the directed credit policy. The results of such a study should justify the set percentage and evaluate the adequacy of coverage, targeting as well the social and economical impact. Such a study would inform policy makers of the effectiveness of the policy and recommended reforms.

2. Restructuring Banks for More Effective MF Service Delivery

The strategy stresses the need for evaluating the activities of existing specialized banks in microfinance – the Savings & Social Development Bank and the Agricultural Bank. Such an evaluation is needed to identify the weaknesses and strengths in the specialized banking system with the objective of drawing lessons for the reforms being recommended to expand the microfinance industry. Introducing reforms and restructuring based on such an evaluation of the existing specialized system (especially the Savings Bank and the Agricultural Bank) is considered more efficient than the creation of a new bank for the poor by the government.

Although the need to establish a National Bank for the Poor was considered in formulating the microfinance strategy, it was concluded that what is needed is an innovative financial system to serve the poor. Micro-finance services could be effectively extended through the existing but reformed institutions with efficient markets being created through coordination and synergies with social service institutions and the informal community based micro-finance organizations (CBOs). What is really needed is to acknowledge the benefits of assigning a role to these institutions to expand program outreach and enforce commitment to increase savings and upgrade performance.

One of the strongest recommendations of the strategy is the need to greatly improve the outreach of formal financial institutions including banks. Three major avenues should be pursued to achieve this goal. These being:

- Expansion of Branch Networks for existing institutions

- The downscaling and restructuring of existing banks to serve as rural specialized MF banks

- The establishment of new specialized formal microfinance institutions.

To that end, CBS will need to review the following regulations for microfinance portfolios:

i. **New MF Banks Licensing**
In issuing the preliminary license to new bank MFIs, the Central Bank will need to avoid being too prescriptive while ensuring that licensing requirements cover all the conditions necessary to insulate the industry against individuals and institutions that are a risk to its stability and the well being of individual clients. In structuring the licensing framework for new bank MFIs, CBS will need to focus on ensuring that individuals applying for the license understand the business they are seeking to enter and that supervisors are well trained to evaluate and determine the eligibility of such individuals. Licensing requirements should set minimum capital requirements, the financial condition of the owners, management qualifications and the development of a business plan that indicates the geographical area to be served, the type of financial activities and the targeted clients. Threshold benchmarks will need to be agreed upon for licensing purposes at point of entry and for subsequent monitoring. Such benchmarks will also determine the requirements for upgrading licensing of state and local level banks to regional/national level banks and the downscaling of existing commercial banks at the national level to rural specialized banks.

ii. **Capital Requirements**
In setting minimum capital requirements for downscaled banks and for licensing of new ones specialized in microfinance, CBS must strike a balance between, on the one hand, undue barriers to entry and the need to ration the number of licenses in line with its supervisory capabilities and, on the other hand, having weak institutions and the impact of that on banks' effectiveness and on the need for more diligent supervision. International benchmarks for minimum capital requirements can only be taken as indicators because of the uniqueness of each country and each location within the country. Different benchmarks could be studied and capital requirements set according to the size and location of such institutions. Capital requirements for banks working at the state level will need to be different from those working at regional and national levels; the determining factor being the scope of work rather than the geographical location. One benchmark for specialized banks operating at the national level could be to have a minimum capital requirement similar to that of current commercial banks. State or local level specialized institutions could have a capital requirement set at a certain percentage of that for commercial banks (e.g. 20 %); and for intermediate specialized banks (working in more than one state), capital requirements could range in between the requirement for those functioning at the national level and those at the state level.

iii. **Capital Adequacy**
According to Basle stipulations on capital adequacy ratios, banks should strictly adhere to the requirement of maintaining a capital of at least 8 percent of risk weighted assets. This does not, however, restrict the authorities to the 8 percent figure as it could be revised according to international best practice in MF. A number of factors argue in favor of higher

capital adequacy ratios for MFIs, at least in the beginning and until a proven track record is established.[1] Some of these factors are the following:

- Generally, MF institutions restrict their activities to certain geographic areas/ clients which indicate less portfolio diversity and greater concentration of risk.

- MF presents 'different' types of risks which banks and their regulators are not used to dealing with.

There is no consensus on the appropriate framework to set for capital adequacy ratios for the MF industry. Two approaches can be considered and the merits of each be evaluated. These being:

- The Asset Based Model: Capital adequacy ratios are based on management and portfolio risk. Such a risk based approach focuses on the asset side of the balance sheet – i.e. the use of the MFI funds that need to be managed and regulated.

- The Liability Based Model: The MFI's liability structure constitutes the basis for determining capital requirements. This approach considers the source of funding as the main determinant of the regulatory and supervisory issues that need to be addressed. It is useful in designing regulatory standards that recognize the fundamental differences in the structure of capital, funding and risks faced by MFIs.

iv. Limits on Unsecured Lending and Provisioning of Loans

CBS regulations stipulate limits on secured lending as a percentage of the bank's equity capital or total assets. This is highly impractical for institutions providing micro credit as they depend, to a large extent, on unsecured securitization. Moreover, given that most microfinance institutions show lower delinquency compared to commercial banks along with the impracticality for those institutions in provisioning a high percentage of unsecured lending, such regulation should be reviewed in line with MF best practice.

3. Lending Procedures

Lending procedures followed by banks are traditional in the sense that they are not tailored to the conditions of microfinance clients. For example, clients must open and activate a bank account before receiving a loan; borrowers are required to issue post-dated checks for loan installments and provide adequate and conventional collateral. Many of these lengthy procedures do not facilitate the quick disbursal of loan funds to clients. CBS should, therefore, review systems and procedures applied by banks engaged in MF to ensure compliance with MF best practice in service extension.

4. Banks Wholesaling to Non-Bank MFIs

For banks offering microfinance services, two types of bank linkages may be appropriate to expand outreach in an efficient manner:

a- Indirect wholesale lending through NGOs with a microfinance program (National / International) and/or bank agents as legal borrowers; and

b- Direct lending to members through their Self-Help Groups (SHGs) and Associations (formal groups). This would be feasible whenever the participating bank is in a position

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[1] R. Christen, T. Lyman, R. Rosenburg; "Regulation & Supervision of Microfinance", Microfinance Consensus Building, CGAP.

to provide wholesale loans to formal groups who use these funds for loans to sub-groups or individual members.

A pilot lending linkage project to encourage wholesale operations through formal groups acting as intermediaries and in line with existing prudential regulations should be initiated by the Central Bank. The Linkage Project, aimed at encouraging commercial banks to create partnerships with NGOs, should be a commercial decision which both parties must find profitable and advantageous. For banks, benefit would accrue from outsourcing some of the more difficult micro lending components of their program whilst leading to greater coverage of the target group. Attendant costs of the credit cycle such as assessment of credit needs, appraisal, dispersion, supervision and repayment would accordingly be greatly reduced. Importantly also, would be the clear advantage arising from the larger savings mobilization that would be realized. For the informal system, the advantage lies, not only, in the greater availability of financial resources to regions where traditional commercial banks may not have access but also in the access to better technology and possible skill upgrading that can occur as involvement with the banking sector is increased. This will in turn improve the nature and scale of operations that would in turn feed into greater economic development.

Having outlined the extensive gains to be made from such a linkage model, a word of caution must follow. Making available the utilization of formal sector resources to the informal credit system would necessarily require the development of mechanisms to mitigate any risks associated with such dealing. Specific guidelines must be formulated on (i) Criteria of selection of partner NGOs and CBOs; (ii) Selection of sectors/projects to be financed; (iii) Assessment of credit plans; (iv) Cost of financing; (v) Repayment periods; (vi) security;

Also, the Central Bank may wish to avail a re-financing initiative for all lending undertaken under this linkage project. However, the terms of doing so will need to be thought out carefully. Such types of linkage models should draw on lessons learned from the Accion International Bridge Fund (AIBF), a guarantee fund that insures lines of credits from commercial banks to qualifying MFIs. Another good example is a similar initiative undertaken by the Reserve Bank of India. Technical Assistance from WB, CGAP and the IMF would be highly crucial at this stage.

B. DIVERSIFYING THE RANGE OF MF SERVICES/PRODUCTS

1. Examining the Non Traditional Modes of Finance Based on Islamic Sharia Law

Some of the financing modalities e.g. Murabaha (purchase and resale plus profit margin), and Salam (forward crop-financing) are considered by many as not suitable for micro-financing as they are relatively expensive and limited to the production cycle hence depriving borrowers from realizing potential gains at market maturity (peak prices of their produce are normally witnessed after the harvest season). Given that microfinance is needed largely by small farmers, in particular, the Islamic Partnership mode of lending – Musharaka – could be viewed as the most appropriate form. Banks should therefore improve their capacities to, more widely, apply this modality of profit sharing and develop other innovative modalities in line with clients' needs and desires, while observing the essence of Islamic financing regulations.

Moreover, the currently practiced Islamic mode for deposit taking (on a non-interest bearing basis) does not encourage saving. This aspect should be studied with a view to reviewing the Islamic *interpretation, or to treat micro savings as a pool for investment funds to be operated on the basis of "Mudaraba," thereby yielding profits to savers.*

2. <u>Conducive Modes for Increasing Savings</u>

Savings is a service that the economically active poor require and value. It is a habit that is encouraged for children as well as adults, and also a tool for women to empower them to use their own money as opposed to retaining it without creating any mark-ups on the saved amount. This is why savings are encouraged under conventional financial services. In Islamic finance, the basic premise may not agree with regular saving[1] schemes. This is why regular savings may not have a wide acceptance under Islamic modes of finance.

Alternatively, savers who are willing to invest their money under Islamic modes of finance could resort either to Musharaka (equity investments) or Mudaraba (investment in specific activity/transaction). Two problems will arise here: 1) the small amount associated with individual micro-savers will not qualify for investment, even at a micro level; and 2) savers from the "economically active poor" with adequate amounts to be invested will, in most cases, lack the know-how and professional ability to decide on whom to invest with. The proposed action here is to design a specific "savings and investment" scheme for micro-savers. Under the "savings and investment" scheme a formal financial institution would initiate a fund that invests in one or more projects. The funds are collected from micro-savers and pooled to be re-invested.

C. EXAMINING ALTERNATIVE COLLATERAL MECHANISMS

One of the main constraints to production, particularly traditional rain fed agriculture, is the continued lack of access to finance. The limited access to financial services by small farms and non-farm micro-enterprises is mainly attributed, among other factors, to the absence of a legal, policy and regulatory framework for collaterals and guarantees appropriate for microfinance. Therefore, much greater flexibility will need to be exercised in the definition of what type of collateral constitutes an acceptable securitization in the case of microfinance and due consideration should be given to unconventional collaterals. Moreover, MFIs should be allowed to only partially register collateral given that, with tiny loans, it is a more practical technique – both in terms of effectiveness and affordability.

1. <u>Non-Conventional Collaterals</u>

Given that the rural and urban poor are not in a position to provide the conventional collateral needed to obtain loans, this requirement becomes a real constraint to their access to needed finance. As a result, non-conventional collateral that is also known as social collateral should be studied, designed, tested, and adopted. The most important forms of social collateral that could be considered are:

- *Endorsement by Grassroots Organization and Solidarity Group;*
- *Personal Guarantee; and*
- *Community guarantee funds.*

The adoption of such collaterals and guarantees requires that microfinance institutions (MFIs), in general, and banks, in particular, change their procedures and branch structures to accommodate such

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[1] Savings with pre-determined interest could be viewed as a usury practice

changes. It also requires more reliance on reputational collateral that can be generated by credit bureaus through the provision of clients' repayment history which could aid in the assessment of risks. The greater use of technology (mobile, card based, etc…) by MFI, in this respect, is another innovation that has already been adopted to provide MF in countries at similar levels of development.

The strategy recommends a pilot project whereby the provision of unconventional social collateral is first studied, developed and tested for adoption as an acceptable and practical form of guarantee. This is considered to be one of the main elements of the strategy leading to the institutionalization and expansion of a sustainable microfinance system. The main steps for the pilot project are:

- Define and study non conventional collaterals, guarantees and securities accepted and implemented by formal and informal financing institutions;

- Provide a proper design for collateral, guarantees and securities recommended by the study, drawing upon the experiences and innovations that other countries in the region are resorting to in order to bank the un-banked;

- Develop appropriate polices and implementation mechanisms and apply them through the pilot project;

- Provide technical and institutional support together with awareness creation to banks and MFIs.

- The Central Bank of Sudan to issue policy directives on microfinance collateral, guarantees and securities based on practical implementation experiences, lessons learned and outcomes of the pilot project.

2. <u>Unregistered Lands</u>

It is to be noted that many of the microfinance clients – small producers and merchants - in rural areas and in the fringes of urban areas own unregistered real estates. Registration of agricultural lands, particularly Hashab gardens in traditional rain fed areas will increase their market value and solve the collateral issue for small producers. However, the legal intervention needed to strengthen the localities' mortgage system in a similar fashion to that of the Land Registration office is lacking. It is recommended that the issue of land reform and registration be addressed as an important component of the strategy to develop the microfinance sector and that it be in coordination with the country's Poverty Eradication Strategy[1] which states that "…land reform needs to be pursued as a major pillar in government agricultural policies. The Land Act is to be revised so as to provide secure titles to land use and recognize communal rights of pastoralists and small crop producers to land". The Microfinance Vision is in complete agreement with the Poverty Eradication Strategy stipulation that "It is only after such actions on the land reform front have been taken that access to rural credit could be expanded" and that this will call for the transformation of the Agricultural Bank of Sudan (ABS) into a genuine instrument of rural micro-credit.

Concrete steps should be undertaken in this regard as part of the MF Vision and in full coordination with the Land Commission whose mandate it is to undertake the needed reforms in line with the Comprehensive Peace Agreement. Such steps include:

[1] Interim Poverty Reduction Strategy (2004), Ministry of Finance and National Economy, Khartoum, Sudan.

- Strengthening localities' land registration and mortgage systems and mechanisms.
- Developing proper land use strategy, policies and laws.
- Developing a risk mitigation strategy to overcome the risks that may emerge from different land use strategies, policies and laws developed by the 15 states of North Sudan.

3. Credit Guarantee Schemes

The role of guarantee funds as providers of *loan or credit guarantees* to enable a borrower to approach a bank for a loan has gained renewed interest more recently. Guarantees are particularly useful for borrowers who do not have adequate collateral, such as land or other assets. Small borrowers almost always lack (adequate) collateral so loan guarantee schemes facilitate their financing by sharing the credit risk with the bank. It is to be noted, however, that closer examination of international and regional experience reveals that centrally administered public guarantee funds, strictly targeted and under portfolio restrictions are often bureaucratically managed and end up being inefficient, useless and a continuous drain on public funds. In sum, the record of guarantee schemes in developing countries is very mixed[1] and the strategy recommends a careful study that draws lessons from existing schemes. In this regard, there are three mechanisms to be further explored for implementation. These are:

- **Community Repayment Guarantee Fund:** CBO members contribute their share in cash to a common fund that serves as repayment guarantee to all group members. This fund can be deposited into a bank investment account, which is then used to recover the unpaid portion of the loan under specific pre-determined conditions. The community group fund usually earns profit, but its sustainability is closely linked to macroeconomic policies, especially levels of inflation and interest rate policies in conventional systems**.**

- **MFI maintained Credit Guarantee Fund:** The MFI deducts a certain percentage from delivered loans and pays it into a credit guarantee fund. In addition, a pre-determined percent from loan generated profits is deducted and deposited in the credit guarantee fund investment account. This may require the MFI to increase the risk premium in calculating its cost of lending i.e. the cost of the guarantee fund should be shared with the clients. The Central Bank of Sudan must develop strict rules for the utilization of the guarantee fund by the institution, including prudential supervision to ensure proper use of the fund and equitable treatment of borrowers.

- **Joint Guarantee Scheme:** The Joint Liability Group (JLG) mechanism entails the organization of clients in jointly liable groups in case of a group member default; but instead of wholesale lending to the groups, retail lending to individual members of the group is applied. However, the liability for the repayment of the loan will remain the responsibility of the group. Thus, the group provides the security provided by the collateral that the poor do not possess. However, this will require crucial changes in the lending policy and credit

[1] Levitsky: Credit Guarantee Schemes for Small and Medium Enterprises. Drawing lessons from existing schemes on how to implement and design a guarantee system. www.wds.worldbank.org/servlet/WDSServlet?pcont=details&eid=000178830_98101904165145

administration. It is to be noted that this mechanism can be adopted in irrigated schemes (Gezira, Rahad etc.) and linked with warehouse receipt of cash crops.

4. Zakat Fund

The fact that Zakat is considered to be an effective tool in alleviating poverty and inequality directly implies its relevance as an indispensable resource for MF. In distributing Zakat proceeds, the Sudanese Zakat Fund gives priority to the *fuqara* (poor with sustained livelihood) and *masakin* (hardcore poor) by allocating 60 percent of Zakat revenue to them. Hence, it will be rational to utilize Zakat funds in the MF industry particularly since several Islamic countries are now widening their sources and are adopting MF services in their Zakat laws.

In order to enhance the role of Zakat fund in the development of the MF industry; drawing on international experience, the workshop and roundtables recommendations, and current practice, the strategy suggest:

- **Financing of Collective Investments:** Zakat funds are currently being utilized to finance collective investments that benefit the poor, particularly in rural areas. Such investments should provide the poor (through Self Help Groups) with a launching ground and an enabling environment to catalyze income generating activities, that is, mainly economic and social infrastructure (i.e. rehabilitation of irrigation canals for the poor community. This process could be implemented in partnership with specialized banks or directly by working with CBOs and SHGs whereby Zakat funds could be deployed to cover essential infrastructure, health, transportation, roads, and other public services. The existence of such infrastructure will stimulate economic activities and contribute to reducing the vulnerability of targeted clients in semi-urban and rural areas.

The vision fundamentally emphasizes the role of the Zakat funds in enhancing the performance of the MF industry in Sudan. The fact that MF objectives are similar to those of the Zakat makes it rational to try to strategically integrate it in a complimentary manner with the aim of achieving all round benefits. The obstacle lies in harmonizing the mechanisms and ensuring they complement each other, a process that should be tactfully executed to avoid substitution.

5. Insurance

A recommended solution to the problem of securing adequate guarantees and the concomitant limitation on the provision of microfinance, is to promote micro-insurance as security back-up. New insurance funds, in clients' unions and networks, should be established in the form of solidarity funds, which could be further supported by Zakat funds and social insurance initiatives. These mechanisms should be supported by formal insurance institutions both financially and operationally and provided with technical training and advocacy.

The provision of insurance will create a win-win situation: clients experience a reduction in vulnerability to risk and MFIs benefit from an improved lending environment in terms of reduced risk to the poor. Nevertheless, there are many reasons why traditional insurers have largely ignored the low income market. As with micro credit, to overcome the obstacles to serving the low income market, new innovations to product design, delivery mechanisms and even marketing are needed.

The vision recognizes that private institutions will offer insurance to low-income individuals or groups only when risks can be addressed and after certain universal characteristics appropriate for developing an insurance product are in place. These include: a large number of similar units exposed to similar risk or group of risks; limited policy holder control; the existence of insurable interest; losses are determinable and measurable; losses not amounting to catastrophic; chances of loss being calculable, premium scare being economically affordable; and private insurance institution practices offering re-insurance to low income individuals or groups.

Micro-insurance facilities should be encouraged under clients' networks and clusters on the basis of solidarity insurance funds. Formal insurance companies should be attracted by the right incentives especially those leading to greater profitability. Some of the features of insurance products that can be used to reduce cost and protect against moral hazards and adverse selection are as follows:

- **Group Insurance:**
  This entails insuring groups of clients with a single policy rather than using separate policies for each individual. This reduces costs, simplifies the administration of an insurance plan, and reduces the risk of adverse selection.

- **Mandatory Insurance:**
  The insurance company can rely on some form of mandatory insurance to reduce the risk of adverse selection and to develop a large policy holder base quickly. Different institutions employ different forms of mandatory insurance. Most property insurers tie the sale of insurance to either credit or savings. Mandatory insurance needs detailed firm mechanisms to be put in place to ensure feedback is collected and used in improving the insurance product.

- **Positive Incentives:**
  Developing an incentive policy to avoid and overcome moral hazards. Such positive incentives are developed to reward members who experience a claim-free year. Another incentive is to offer a bonus to borrowers with clean repayment records and thereby discourage policy holders from making unnecessary claims.

However, a necessary pre-requisite for encouraging the private sector to enter the arena of the low income sector of the population, is the formulation of a clear micro-insurance policy. This must be based on an evaluation of Sudan's experience in micro insurance and in light of internationally recognized experiences in micro-insurance

D. ESTABLISHING A SPECIALIZED MF DEPARTMENT IN CBS

The strategy strongly recommends establishing a Microfinance department within the Central Bank by restructuring the existing set-up to include a specialized department at senior management level. This department will be responsible for regulating, supervising and promoting microfinance activities, in accordance with prevailing legal mandates, and will specialize in playing the role of the Central Bank in all related issues mentioned in this strategy. It also recommends strong representation of this department at its regional offices to cater for rural microfinance. The unit/department should have a clear mandate and business plan which outlines its strategic and operational plan, as well as detailed accounts for the services it will offer and its cost recovery techniques in order to be sustainable. Staff of this specialized department must be well trained in microfinance activities. In addition, it must be adequately funded to enable it to fully carry out its activities. Special funds should also be allocated to it in CBS yearly budgets. The final configuration and structure of this unit/department is to be decided after clear agreement on the role this unit is to play.

Under any scenario, this department/unit should be light in structure and should employ a strong arm for management information system (MIS), as well as be a continuous link and presence in the field to assure fair and timely feedback from the field. This unit will add a professional edge to the MF sector and benefit the industry through:

- Establishing a "minimum performance level" for MF institutions to become recognized by CBS (could be banks and non-banks).
- Establishing and maintaining a data base for MF service providers, their geographic coverage, the types of services they offer and their market penetration rates, as applicable.
- Assisting in product development through initiating/supporting specialized market research and client-satisfaction surveys aimed at depicting active demand and shifts in this demand.
- Establishing reporting requirements (portfolio performance and financial statements) that comply with MF best practices. In this regard, CGAP disclosure norms could be a useful guide.
- Assisting successful MFIs in accessing loan funds through commercially based agreements.
- Assisting in capacity building through information sharing and support events to exchange experiences.
- Assisting in creating a Self-Regulatory Organization in due course.

It is clear that, initially, the department will need to receive strong technical assistance that should be forthcoming from specialized agencies within the IMF and WB.

IV. Enhancing the Role and Supporting the Growth of MFIs

A. Development of Sustainable MFIs

Microfinance is a specialized field combining banking with social goals, but in order to achieve this double bottom-line, strong institutions need to be developed to provide various financial services in a sustainable manner to the poor. These institutions need to be able to attract savings, recycle them into loans and provide other financial services needed by target groups. Managers' skills and information systems of MFIs need to be developed. Accurate, standardized information – both financial and social – are imperative.

The sustainability of MFIs has internal and external implications: internal, in terms of deposit and savings mobilization, financial performance, staff motivation, loan and administrative costs' efficiency, etc. and external, in terms of availability of funds for loan disbursement and even access to grant funds for community organizing and training and so on.

Besides being efficient and self-sufficient, sustainability goals for an MFI also have other benefits - attracting external financial investment, satisfying central bank reporting requirements if any, building trust among its clients and supporting institutions (including donors).

Promote Efficient Management and Performance Monitoring

Managers must be trained to assess the organization's financial health and overall performance, by using diagnostic and management tools that measure the capital adequacy, asset quality, management, earnings and liquidity of any microfinance institution (MFI). Such tools assist managers to: [1]

- Provide MFIs with an accurate and comprehensive diagnosis of financial performance relative to microfinance industry standards;
- Identify institutional weaknesses and pinpoint areas for improvement;
- Guide management decisions as well as efforts of technical assistance teams;
- Provide funders and potential investors with an objective method to evaluate and verify an MFI's performance.

Experience has shown that conventional collateral does not secure timely repayment while the repayment policy adopted by microfinance institutions gives excellent repayment levels. Therefore, to ensure financial sustainability and overcome hazards created by willful defaulters, a focus must be made on regulations and mechanisms of repayment within MFIs.

Arrears management and loan loss provisioning are crucial factors in lending. High arrears rates lead to high loan losses and are detrimental to the MFI and the client. They make the MFI/bank reluctant to lend, lower its profit and slow down financial intermediation. As a result, clients have less access to loans, are more thoroughly scrutinized and have their loan sizes and loan periods cut down. At the same time, the costs of arrears management and the incentives for loan recovery must be kept within limits, so as not to constrain disbursement and outreach.

1 http://www.accion.org

The above requirements for portfolio quality monitoring and enforcement could not be exercised in the absence of an extremely important element in MF technology, that is, a system of loan tracking backed by staff and customer incentives. Being functionally tied to the incentive system, it is one of the most impressive features of MFIs. Computerized management information systems (MIS) with zero-tolerance can be applied at four levels: the client; the loan officer; the branch and the MFI/Bank. The key elements of the system, thus, are: instant information; direct control at all bank levels; immediate action; staff incentives and customer incentives. The MIS brings out problems at loan officer and branch levels and serves as an early warning mechanism for unsatisfactory performance.

B. Effecting the Role of Banks in the Provision of MF Services

1. Studying the Market: Demand on MF Services

It is well known that the demand for micro-finance products in Sudan is extremely high and experiencing an up-surge due to the escalating poverty in rural and urban areas. A huge gap exists in which the demand far outstrips the supply. This could be narrowed down by working on both sides, firstly by targeting the needs of credit worthy, economically active clients, and secondly by broadening the supply side to reach more home based and start-up enterprises. While the microfinance strategy focuses on the supply side, it is imperative that it be complemented by a specific set of interventions that focus on the types of financial and non financial services in demand by the economically active poor and micro-entrepreneurs, as well as, their areas of concentration. This will require a detailed study focusing on the following:

i. Mapping the Served versus Un-served or Underserved Markets

The approach used by MFIs to identify the needs of clients and design outreach and follow-up methods should be modified to cater to realities on the ground. Currently, social funds provide micro-lending services to targeted populations according to their particular mandate. The efforts exerted by banks in providing microfinance depend entirely on individual bank initiatives and perceptions about the targeted groups. Their microfinance programs do not fall under a national policy and are typically not derived from market studies. Needs assessments of targeted clients would allow MFIs to design methods of outreach and follow-up that are tailored to the needs of the designated target group (unemployed graduates, IDPs, productive families etc.). NGOs, for example, or MFIs may opt in the future to specialize in dealing with one group of clients or a specific geographical location that matches its organizational capacity, and service delivery mode. As women comprise a large share of microfinance clients, gender sensitivity must be employed when designing needs assessment tools.

ii. Defining the Target Clients and Studying their Needs

The absence of a satisfactory definition of poverty and methods of identifying the poor (the microfinance clients) has inhibited credit flows to the poorer, excluded segments of the population. Among NGOs, the decision to work in one location over another is not based on normal market targeting and penetration. Rather, MFI dependence on external donors dictates their operation in areas preferred by donors. With regards to banks, there is no commonly accepted definition of the target group for microfinance or a set of unified eligibility criteria across banks or even across branches of the same bank. Although it is mandated by the Central Bank that commercial banks channel at least 10 percent of their total loans to finance productive families, artisans, and small professionals, in practice this has not been enforced, and it is left to the discretion of the individual banks. In the absence of clarity or a precise definition of who the poor are, there has been a tendency to restrict credit access based on traditional interpretations of 'productive' families, as a result of which, badly needed market segmentation and client targeting is almost absent. It is essential for MFIs to agree upon criteria for identification of the poor, particularly the enterprising poor micro-entrepreneurs. As poverty is a multi-dimensional phenomenon, a set of indicators (as opposed to just one, like income) should be short-listed to identify the poor. Local variations on criteria should be considered in response to differing rural and urban indicators.

2. <u>Expanding the Outreach</u>

i. Using Less Costly and More Innovative Approaches

To facilitate delivery of services according to the clients, requirements for branches such as security standards, working hours, daily clearing of accounts or limitations on location will need to be reviewed with an eye to making them more flexible. Flexibility in terms of the service being provided and extension of working hours may be necessary depending on the location. For example, mobile and part-time units may be considered for remote areas with reasonable security measures. Also, the physical structure of branches should be specified according to the volume of work and money (such as strength, roofs, strong rooms, and safes). Other recommendations for direct lending and savings mobilization in the field through intermediaries should be preceded by a detailed study to assure the soundness of needed procedures and legal status.

ii. Creating Linkages Between Banks, NGOs and CBOs

Experience has shown that such linkages particularly in the remote rural areas where banks have difficulty reaching the poor can greatly expand the delivery of financial services, in an efficient manner through the following specific interventions:

- Providing supplementary credit facilities for meeting the credit needs of the poor by combining the financial resources of the formal financial institutions with the more flexible capabilities of the informal credit systems, their sensitivity to the needs of the poor and their greater ability to identify them and their character strengths.

- Encouraging banking activities, both savings and credit activities, in identifying and reaching the unserved and underserved segments of the population which the formal financial institutions normally find difficult to cover.

- Building mutual trust and confidence between bankers and the poor.

iii. Cost Analysis and Pricing

The pricing of products should be based on adequate costing to stimulate the supply of services. In order to reach this level, it is important to conduct a thorough analysis of cost elements and their relation to product pricing and ultimately to the balance between supply and demand. Some of the factors that influence product costing and pricing are as follows:

- Expanding the supply of services requires tremendous outreach efforts including geographical presence. Capital investments, besides those in field operations and management, are needed to cater for this and add considerably to the costs of the final product.

- Extending to a wider base of services would also require the opening of micro-finance windows within existing bank branches and networks and investing in staff training and orientation for efficient management of micro-finance business. This would also require additional costs.

- Extending micro-finance services (being non-collateralized) increases banks' risk exposure, requiring correspondingly higher reward and thereby determining the remunerative pricing of products. The profit margins should always reflect the risk exposure and opportunity costs should an alternative investment be undertaken by the bank.

- Promoting savings and insurance products requires aggressive outreach efforts to stimulate effective demand, which would add to costs and therefore should be integrated into pricing policies.

- The recommended cost-sharing financing modality requires close management by the banks and their clients. In view of the low management capacity of the targeted clients, much of the burden rests with the bank to facilitate access by clients to Business Development Services (BDS) including advisory and monitoring services (at a fair cost).

- Risk exposure is also linked with delayed repayments, delinquent and doubtful debts, and writing-off of bad debts, which mean additional costs including management actions.

Therefore increasing the supply side requires charging remunerative prices which would only be possible if banks were free to decide the level of mark-ups on financial transactions that would enable them to satisfy demand for services and be more client-responsive. Demand for microfinance services can be considered as being price inelastic in view of the acute shortage in this sector. As such, prices could be pushed up to the point that stimulates other actors to increase supply with the expectation that competition will then bring prices to the equilibrium level where supply matches demand. The process would continue to set different price levels that would provide the adequate market incentive.

C. Developing Non-Bank MFIs

1. Building on the Experience of the Sudanese Postal Authority

The Sudanese Postal Office Savings Fund which was established in 1913 had the following objectives:

- Grouping small and large savings.

- Minimizing monetary transactions in its legal form and preserving it.

- Finding alternative means and incentives for encouraging citizens to save.

Its strategic goals included:

- Contributing to financing the economic and social development process and catalyzing investment operations

- Spreading a saving awareness culture
- Supporting small investors with low income and encouraging their activities in the savings sector
- Building ideal relations with savers and attracting new ones
- Paying more attention to the needs of the Sudanese emigrants and assisting them in investing their savings

The Savings Fund benefited from government guarantee of clients' savings, exemption from fees and taxes, extensive country coverage with flexible working hours (morning and evening shifts) and confidential depositing with no limit restrictions on amount of money deposited per person.

The experience of the Sudanese Postal Office should act as an important guideline and a serious effort should be made to regain its legacy as a pioneer institution in facilitating money transfers and savings behavior. By doing so, a wider geographical coverage will be accessed in various states and also in rural areas.

2. Legal Aspects

The delivery of microfinance services to more geographic areas and sectors will necessitate the expansion of non-bank microfinance institutions which will in turn require an amendment to the laws governing these institutions. NGOs, currently registered under the Humanitarian Aid Act, are constrained by Article 51 of the Central Bank of Sudan which prohibits the undertaking of any type of banking services without the Central Bank's approval. As such, it limits their ability to mobilize savings or accept deposits. Moreover, although the Humanitarian Act has been formulated to regulate the voluntary work of NGOs, it has been severely criticized for lack of recognition of the socio-economic multi-dimensional benefits of such work. The greater engagement of NGOs in a wider range of microfinance services will, therefore, entail a revision of both the Humanitarian Act and CBS Article. It is to be noted in this respect that "the 1999 Cooperatives' Law" governing the work of cooperatives at both the national and state levels, is considered to be the suitable for adaptation in order to allow cooperatives to function legally as microfinance institutions.

V. Establishing a Supportive Infrastructure

A. Creation of a Supportive Information Base

1. Information on the MF Sector

The creation of a database within CBS is a necessary requirement to inform policy making. It is recommended that data be collected and published on the microfinance activities of licensed banks, NGOs, CBOs and donors - a process that may include monitoring the development of the microfinance sector over time. Such a database could be established and maintained by the recommended MF department/unit at CBS.

Other activities may include provision of economic information to the microfinance sector that might cover macroeconomic data, information on the performance of economic sectors and regions, rural financial markets, informal finance, access to capital by the poor, land tenure, mortgaging, foreclosure and small claims procedures.

2. Establishing an Information Credit Bureau (ICB)

One of the challenges that face MFIs is the lack of information on the credit history of the client. An Information Credit Bureau (ICB) can provide information to MFIs on the client's status on repayment of previous/current loans and other financial obligations. Based on this process, diverse MFIs will be able to, more reliably, assess risks to their funding portfolio hence leading to the mainstreaming of MF. To establish an ICB, CBS must issue policies and regulations that give the bureau the legal umbrella to perform the mentioned tasks. Nevertheless, in order to create a credible bureau, there should be a mutually binding commitment on the part of microfinance providers to supply the ICB with updated information on their clients and on the part of the bureau to keep this information confidential. Furthermore, the client should give permission to the information bureau to use his/her details, when and if deemed necessary, under the prevailing legal practices. The strategy encourages the establishment of private information bureau that are owned by the private sector and that use the latest information collection and dissemination techniques. This establishment process can be initiated by conducting a study on mechanisms currently being used to disseminate and exchange information related to the client's credit history, finding means of enhancing them and applying them to all ICBs. Such a process would necessarily have to be under the umbrella of CBS. Moreover, the establishment of such Bureaus would require conducting institutional and legal interventions that can be summarized in a call for setting up a Credit Record Apparatus and utilizing the accumulated experience of the Central Bureau of Statistics.

B. Supporting the Establishment of a Microfinance Network

1. Advocacy for Policy Changes

Microfinance Networks can contribute significantly to building the infrastructure needed for the development of the microfinance sector. Such an entity can advocate for the policy and legal changes that are needed for the growth and development of the sector. To facilitate the process of advocacy for policy change in support of the MF industry, there is a clear need for intensifying awareness raising campaigns and training programs targeting government officials at all levels, as well as bank staff, second-tier institutions and others. MF Networks should develop and implement awareness campaigns, in an intensive and extensive manner, to change stakeholders' perceptions about the credit worthiness of the poor and to mainstream the understanding that there need not be a contradiction between profits and services to the poor. In order for microfinance services to be available on a wider scale across the country, a core cadre of professionals should be trained at the policy, managerial and implementation levels. Such individuals should be drawn from all states so that local skills and capacities are built. Moreover, training programs should ensure that managers who are well trained in microfinance work and who have a pro-poor orientation are in charge of the operations in the State's agencies.

C. ESTABLISHING AN UMBRELLA/APEX INSTITUTION

The establishment of a central body or umbrella agency is needed to improve coordination among the different MFIs and between MFIs and other microfinance stakeholders at both the Federal and State levels. This umbrella agency or Apex institution should be outside the Central Bank BUT work in close coordination with the MF Unit within CBS to ensure that the needs and concerns of the banking sector are also addressed. Moreover, the organization should consolidate the values of partnership amongst the various stakeholders who include, in addition to the Central Bank, the Federal and States' governments, community based organizations as well as the donor community. Such partnerships will work towards stabilizing policies and advocating for issuance of supportive legislations. The supportive role of government and CBS will be vital to the successful implementation of the Institution's mandate, however, the specific form of this relationship should be considered further. The experience of a number of countries including, Indonesia, Nigeria, Cambodia, South Africa, and the Philippine have not only indicated and stressed the supportive role of the State, but have also contributed towards spreading the success model. Most of the aforementioned countries benefited from available laws in registering such an institution.

This Apex Institution should play an important role in exposing MFIs to new ideas and experiences and to sharing of opportunities that would help them continuously refine strategies and operations for resolving implementation problems. Such a set-up should foster the exchange of information and experiences as well as carry out joint activities of mutual interest. Furthermore, the Umbrella Agency should give priority to training and capacity building of its members and others from similar organizations. It should collect statistics, initiate and/or participate in surveys, baselines, and research on the microfinance sector in Sudan with the aim of informing policy making. Key areas that such an institution should focus on include:

- Assisting in raising capital and resources for institutional building;
- Developing best practice strategies appropriate for the country and facilitating exchange visits with international and regional agencies active in microfinance;
- Advocating microfinance countrywide and specifically with state and national governments;
- Facilitating experimentation of new products and services, especially, those targeting small farmers and other rural, low-income people;
- Capacity building, training and organizing field visits to successful MFIs within and outside the country;
- Organizing technical national and regional workshops on key microfinance topics; and
- Supporting further research and surveys that describe the current picture of the status of the microfinance sector.
- Supporting Microfinance Networks
- Coordinating donor funding so as to avoid effort duplication and market distortion by conflicting donor priorities.
- Creating linkages with international specialized agencies such as CGAP.

D. ESTABLISHING A SELF-REGULATORY ORGANIZATION

In formulating the regulatory framework governing the functioning of bank MFIs, CBS will need to undertake the necessary practical planning for effective supervision. One motto to go by is "Do not regulate what you cannot supervise". The importance of this stems from the fact that in granting a prudential license to a financial intermediary – be it a rural bank, village bank, financial cooperative or any MFI – the authorities are asserting fiduciary responsibility. By doing so, they are taking on the responsibility of protecting the deposits of the MFI's clients. Thus, CBS will need to be clear about its ability to guarantee the financial soundness of such financial intermediaries, and accordingly set the standards for a financial institution to be able to attract and capture savings from the public.

Prudential regulation and supervision is clearly needed for microfinance but a balance needs to be struck on when and how to exercise such powers. In making such decisions, careful consideration must be given to supervisory capability, costs, and consequences of regulation. It can be argued that in the case of Sudan, CBS is the most suitable authority to undertake supervision for the prudential regulation of deposit-taking MFIs.

However, when MFIs do not pose any systemic risk to the financial system – be it because the are small in size or are not deposit taking institutions, such regulation and supervision can be delegated to a system of self-regulation or what is otherwise known as Non-Prudential Regulation. Non-prudential regulation encompasses rules about the institution's business operations that include, among others, the formation and operation of microlending institutions; consumer protection; fraud and financial crimes prevention; credit information services; interest rate/profit margin policies; management and sources of capital; tax and accounting issues; and a variety of cross-cutting issues surrounding transformations from one institutional type to another. [see CGAP guidelines on when not to prudentially regulate MF activity based on the experience of various countries].

The strategy, therefore, recommends that CBS limit its responsibility to registering those MFIs, especially if they do not capture savings, and to ensuring that all microfinance initiatives are registered regardless of their source of funding or legal type. The self-regulatory organization (SRO) need not be a separate entity from the Apex institution but can be a graduation of it. Key areas that the SRO should focus on include:

- Setting industry standards (including minimum acceptable performance levels and measurable indicators) and providing the technical assistance needed to implement them. In setting standards and benchmarks for the sector, use could be made of standards established by the Microfinance Information Exchange (MIX)[1] which is one of the lead organizations in benchmarking activities and standardized reporting among MFIs.;
- Acting as a facilitator and promoter for specialized internationally recognized assessments and rating for MFIs with the aim of building systems for transparent reporting while instilling a culture of accountability.

In summary, establishing a self regulatory body that has the responsibility of setting performance standards, norms, definitions and credit rating criteria (in consultation with CBS), will provide guidance and strategic support to microfinance institutions. This will also enable the MF industry to attract and raise performance based capital and resources from the donor community. This job/responsibility could be entrusted to an existing organization/institution or a new one to be

[1] www.mixmarket.org

established. In either case, the selection of the institution and the approach of implementation should follow a thorough study of the costs and benefits associated with selecting one candidate institution over another. The legal shape that the SRO should take has to be a result of a detailed study in light of the internationally accepted experiences. Normally, an SRO should be an independent entity that enjoys the trust and that is viewed as being credible by its member MFIs. It could be a non-governmental organization, a private sector company, or even a quasi-governmental institution. In any case, the functions of the SRO should not be confused or mingled with the "network-like" activities of advocacy and promotional efforts. Moreover, the capacity of such an institution should be adequately assessed and supported so as to ultimately function as a financing intermediary and benefit from technical assistance provided by microfinance initiatives such as those associated with the IMF and the World Bank.

1. Setting Benchmarks / Performance Standards for the Sector

One of the basic functions of the SRO is to build the infrastructure that is critical to the development of the microfinance industry. By collecting financial and portfolio data on leading microfinance institutions (MFIs), organizing the data into peer groups, and reporting this information, the organization is creating the needed infrastructure. This infrastructure is essential for the establishment of industry benchmarks/performance standards that enhance the transparency of financial reporting (by allowing lenders and investors to measure risk) and improve the performance of microfinance institutions. Such indicators are necessary because of the prevalence of relief culture among clients (particularly IDPs), poor financial discipline, lack of specialization and sometimes conflicting and different procedures adopted by NGOs - all of which have weakened the financial performance of many NGO-MFIs. The concepts of performance measurement indicators among MFIs, such as operational self-sufficiency (OSS), financial self-sufficiency (FSS), portfolio at risk (PAR) and cost of product should be promoted by the SRO. These indicators also enable MFI managers to compare their performance against those of their peers on a national and regional scale. The SRO could also assist MFIs to link up with funding sources through evaluation agencies (e.g. MicroRate).

2. Linking to International Rating Agencies

CBS, the Apex Institution and the SRO should promote the use and development of internationally approved rating agencies that aim at improving the quality, reliability, and availability of information on the risk and performance of microfinance institutions (MFIs). It should aim at (i) encouraging MFIs to demand an external evaluation of their financial performance, and (ii) build a supply of competent rating and appraisal services at the local level. CBS and the Apex Institution/SRO should also build a reliable database on the different types of MFIs in Sudan that can serve as a reference point for donors, investors, banking supervisors, and MFIs themselves.

E. BUILDING THE CAPACITY OF MFIS

The lack of exposure to worldwide microfinance good practices coupled with a lack of training in microfinance facilitation and management constrain service providers' ability to manage and operate programs that effectively and efficiently provide microfinance services to the poor. The training and experience of personnel in commercial banks, as prevailing at present, is unsuitable for servicing poor clients as most bankers remain reluctant to do business with the poor on a large-scale. In the case of non-bank MFIs, efficiency in delivering market-based lending is adversely affected by the predominance of the grant culture and the tendency of many of the microfinance lending programs to extend grants, profit-free loans, and subsidized credit. The staff of MFIs, in general, lacks specialized skills and adequate training in credit management and facilitation. In particular, there is very limited knowledge of savings mobilization or inclusion of consumption loans in microfinance packages.

It is thus amply clear that a major pillar of the Microfinance Strategy must focus on improving the efficiency of MFIs by building both financial and managerial capacities. Financial capacity building is needed to improve MFIs' absorptive capacity and ability to attract greater funds, increase the number of loans disbursed and encourage savings and to expand their clientele base, etc. Managerial capacity building, on the other hand, should primarily focus on the institutional and human resources of the MFI - in terms of networking and partnership for training, skill development, information management systems, etc.

Training and orientation of managers, professionals, and staff of MFIs is recommended in the areas of product design, lending procedures, client incentives, flexible guarantees, and monitoring and evaluation. Capacity building efforts should pay special attention to bankers in the formal financial sector given their lack of information about microfinance best practices. Personnel from social funds, NGOs, and rural development projects with microfinance potential should also be provided with opportunities for such training, especially in the areas of market-based lending practices.

Financial discipline, with full loan repayments, is a precondition for microfinance to be sustainable and to contribute to poverty alleviation in the long term. To address the interests and needs of future borrowers, both charity and donor dependency should be eliminated from microfinance programs. The ultimate goal of capacity building efforts should be improvement in the quality of loan portfolios and microfinance programs that operate in a financially sustainable manner. This training and capacity building should also encourage adherence to worldwide best practices when developing new financial programmes that service women and other rural poor. In this respect, there should be a gradual process of exposing MFIs, currently active in the field, to microfinance best practices in neighboring countries.

Capacity building must also be taken in its broader sense to include advocacy and networking in order to create greater awareness of the role that microfinance can play in poverty alleviation and economic development in general, and in order to involve the larger civil society.

Capacity building should, therefore, include training and education, documentation of best practices and ideas as well as strategies, and tools. Such efforts must necessarily aim at the training of trainers in order to expand the capacity building exercise. Workshops and seminars together with the greater involvement of the media should be targeted to create the awareness needed for the suitability and viability of microfinance not only as a potent poverty alleviation tool but also as a potentially profitable business.

1. <u>The Higher Institute of Banking</u>

The Governor of CBS chairs the Board of Trustees of the Higher Institute for Banking Studies. It is thus within its authority to mandate at least a basic course on Microfinance for all student graduating from the institute and intending to join the banking sector. The institute should stand ready to address capacity gaps in bank staff's ability to manage micro-credit and micro-savings operations. In this respect, banks can benefit from the vast experience of the cooperatives in organizational, training and management aspects.

In order to provide effective capacity building to MFIs, a cadre of qualified potential technical assistance providers and trainers in Sudan need to be identified and provided with Training of Trainers (ToT) capacity building. The High Institute of Banking and Financial Studies with support from the Central Bank could be involved in the task of facilitating the provision of training to financial services personnel. The institution/agency selected to coordinate microfinance work and handle training should revamp its training capacity to address the particular needs of microfinance, based on the results of a specific "training needs-assessment" exercise. The content should cover various aspects of microfinance, including poverty focus, client understanding, reduction of transactions costs through social mobilization, methods of credit rating of clients, diverse financial products, repayments, monitoring mechanisms, and auditing.

2. The Local Institutes and Private Sector

A large number of training and academic institutes, such as the High Institute of Banking and Financial Studies, the Management Development Center, the Cooperative Training Center, the Faculty of Business Management – University of Khartoum, the Zakat Chamber Training Center, and the relevant faculties in the states' universities are all appropriate conduits for providing education and training on Microfinance and related issues. It is rationale to mainstream micro finance in their training and academic curriculum in order to satisfy the micro finance training requirements of the sector. Microfinance Institutions as well as the organization at the supportive infrastructure level should support this process of microfinance mainstreaming

Key Actors in the provision of capacity building are Microfinance Networks and Resource Centers, Research and Training Institutions, Universities, NGO and NGO Networks. The Zakat Studies Institute, for instance, can play a vivid role in raising awareness and knowledge of MF components as an integral constituent of the Zakat. More focus should be given to developing studies that would enhance the position of the MF industry and introducing relevant curricula. By doing so, the institute will be able to graduate a generation with reasonable awareness and acceptable knowledge of microfinance/Zakat.

3. Funding of Capacity Building Efforts

In many cases, donor agencies in countries with good track records of microfinance performance have played an instrumental role in assisting young and promising MFIs to acquire the capacity to operate profitable and successful microfinance operations, thereby enticing formal financial institutions to enter the sector. International agencies should direct their assistance to finance capacity building costs for microfinance operations directed at the genuinely poor. CBS should also assist in funding such capacity building efforts for formal financial institutions. The federal government should husband resources from such agencies (including the World Bank, the International Fund for Agricultural Development, and Arab and Islamic donor organizations) to supplement domestic budgetary funding once the poverty focus is established. For insurance personnel, at this stage, a short basic course may be adequate. Needs-based courses can be developed later, depending on emerging needs.

VI. Conclusion

In formulating the strategy for the expansion and development of the microfinance sector in Sudan, much effort has been made to involve the majority of stakeholders in the process. In addition to CBS staff and government officials from the relevant ministries, bank employees and other MF practitioners including NGOs and CBOs participated in the consultative process. This has succeeded in creating ownership and buy-in to the strategy so that coordination between organizations with different mandates (banks, NGOs, social funds, and rural development projects) is enhanced from the beginning.

The strategy presented here aims at giving a comprehensive coverage of all aspects needed to increase the depth and breadth of outreach of financial intermediaries as well as to diversify their products to be more responsive to the needs of the economically active poor and particularly women. It must be stressed, however, that the MF sector is only one of the tools for combating poverty. Therefore, the success of the MF strategy is largely depending on integrating it within the overall strategy for the reduction and eventual elimination of poverty within the country. It must be supported by macro policies that focus on creating an enabling environment and a favorable business climate that fosters investment opportunities for small and micro-entrepreneurs and farmers.

The Federal Government is seemingly concerned about poverty reduction and has launched several, albeit limited, initiatives to encourage financing of the economically active poor. However, much remains to be done to ensure that the policy and legal environment encourages small business development and access to finance. On the other hand, government policies should be implemented so as to filter down to the smallest administrative unit and should be translated into actions that are felt on the ground.

To that end, the strategy has identified the specific actions that if undertaken will go a long way towards increasing access to diversified demand-driven financial services to the economically active poor. The major components of the Action Plan for developing the microfinance industry in Sudan can be described as follows:

- Building on the existing system and/or developing a ***Reformed Financial System*** for the Poor with solid infrastructure and efficient financial intermediaries that have the required outreach to meet the financial needs of the poor;

- Creating an ideal ***legislative and regulatory framework*** that enhances the performance of the MF industry;

- Adopting mechanisms that support ***transparency*** among microfinance lending institutions.

- Applying "***best practices***" and setting distinct performance standards for the sector;

- Creating an efficient information network that includes access to reliable, up-to-date, market information on the financial needs of the poor and MSEs, of gender and geographical imbalances;

- Increasing ***coordination*** among various stakeholders including MFIs, Government, NGO, practitioners, donors, etc; and

Moreover, the strategy is accompanied by an action plan that specifies responsibilities assigned to the relevant stakeholders, as well as priority levels of each activity to be classified on the short, medium and long term. They are actions to be undertaken, not only by CBS as the leader and regulator of formal financial intermediaries, but also by other relevant government entities as well as non-government stakeholders. The role of the donor community is to support the strategy in terms of availing technical and financial assistance to its various components. Commitment at all levels is a corner-stone for the success of this strategy.

In conclusion, with the adoption of this strategy, the microfinance sector in Sudan will witness a giant stride towards establishing the basis for sound growth of the industry. The positive aspect of the process is that this strategy and the accompanying action plan have been formulated at the initiative of the Central Bank revealing its determination and commitment to the integration and expansion of financial services to the poor. While CBS must continue to lead and coordinate the implementation of the strategy, it should continue to do so in the same participatory manner to ensure the engagement of the various stakeholders in moving the process forward.

VII- The Action Plan

The proposed Action Plan is a guiding document that outlines the main interventions agreed upon during the consultative process and the tasks needed to achieve these. The primary responsible entities are the organizations that bear the main responsibility for implementation, and the secondary entities are the supporting ones.

The timeframe for the implementation of the Action plan is 5 years: the expected implementation timeframe for each activity is estimated to be either on the short-term (S) (1 year) or on the medium term (M) (2-3 years), or on the Long-term (L) (4-5 years).

The order of priority of the implementation is high (H), medium (M) or low priority (L)
as agreed upon during the consultative process of developing the vision.

CREATING A CONDUCIVE LEGAL AND POLICY FRAMEWORK					
Intervention	**Tasks / Activities**	**Primary Responsible Entity**	**Secondary Responsible Entity**	**Priority**	**Time Frame**
A. Revisions to the Banking Law and CBS Policies	1. Official Endorsement of the MF Vision by the Government of Sudan	GNU/ CBS	Government Stakeholders	H	S
	2. Evaluating the Impact of Current CBS Policies and the Banking Law				
	• Assessing the current credit policies	CBS	Banks	H	S
	• Assessing the current policy of directed micro-credit as percentage of the bank's portfolio.	CBS	Banks	H	M
	3. Restructuring Banks for a More Effective MF Delivery				
	• Evaluating the experience of existing specialized MF banks	CBS / Specialized Banks	MOFNE / Donors	H	S
	• Introducing legal and procedural reforms as appropriate	CBS	Banks	H	M-L
	• Examining the need for establishment of a new Bank for the Poor	CBS/ MOFNE	Donors	M	M-L
	4. Reviewing the licensing requirements for new MF banks and for downscaling existing banks (capital requirements, capital adequacy, limits on unsecured lending and provisioning of loans) in compliance with the modified vision for MF as well as international requirements (Basel)	CBS	Banks	H	S
	5. Revising the current lending procedures for banks engaged in MF provision (conventional and Islamic)	CBS	Banks	H	S
	6. Facilitating Bank wholesaling to non-bank MFIs (NGOs, CBOs, SHGs):				
	• Studying international experience/models of bank wholesaling to MFIs				S
	• Formulating clear guidelines for linkages between banks and non-bank MFIs in light of existing legislations	CBS/ Banks/ Non-Bank MFIs /	Donors / MOFNE	H	S
	• Adopting a pilot linkage project through which banks can provide wholesale funding to non-bank MFIs				M

B. Diversification in the Range of MF Services/Products	1. Examining the addition of new microfinance services in compliance with Islamic Sharia Law 2. Examining "Savings and Investment" schemes for micro-savers	CBS CBS	Islamic legislative authority/ Higher Institute for Banking Studies	H H	S-M S-M
C. Implementation of Alternative Collateral Mechanisms	1. Introducing Non-Conventional Collaterals Mechanisms: • Studying options for non-conventional collateral mechanisms • Designing and testing the suitable non-conventional collateral mechanisms • Revising the policies affecting the application of the new collaterals 2. Using Unregistered Lands as Collateral • Revising the Land Act to provide secure titles to land use and recognize communal rights of pastoralists and small farmers • Reviewing the localities land registration and mortgage systems and costs • Developing proper land use and risk mitigation strategies 3. Studying the different Credit Guarantee Schemes and applying the most appropriate one to the financial system in Sudan (conventional and Islamic) 4. Studying the possibility of using Zakat Funds in partnership with MFIs and SHGs as an additional leverage for loan capital (i.e. credit guarantee) 5. Promoting micro-insurance as a hedging mechanism for micro-financing • Establishing micro-insurance funds with support from private sector insurance companies • Designing innovative micro-insurance products at low-risk	CBS Land Reform Commission CBS Zakat Studies Institute/ Ministry for Social Welfare MOFNE MFIs	Islamic legislative authority Banks / Non-Bank MFIs / MOFNE Banks / Non-Banks MFIs / MOFNE / Donors Islamic Legislative Authority / MFIs Banks / non-Bank MFIs / Private sector Insurance Companies / Zakat Fund / Donors	H M H H-M H/M	S-M M-L S S-M S-M
D. Establishment of a Specialized MF Department at CBS	1. Examining the existing set-up of CBS vis-à-vis MF 2. Establishing a specialized MF department at the general managerial level 3. Extensive training of staff in MF regulation/facilitation	CBS	Higher Institute of Banking	H	S

ENHANCING THE ROLE AND SUPPORTING THE GROWTH OF MFIs

Intervention	Tasks / Activities	Primary Responsible Entity	Secondary Responsible Entity	Priority	Time Frame
A. Development of Sustainable MFIs	1. Providing capacity building to MFIs management to efficiently and effectively manage the MFI 2. Identifying key performance indicators to measure MFIs performance as it relates to outreach, portfolio quality, and financial performance 3. Availing automated MIS / loan tracking systems to the MFIs	MFIs / MOFNE / Donors / CBS	Private Sector Technical Service Providers	H	S
B. Effective Role of Banks in the Provision of MF Products / Services	1. Studying the Market Demand for MF Services • Mapping the Served versus Un-served or Underserved Markets • Defining the target clients/groups and determining their needs	CBS/ Ministry of Social Welfare	Banks / non-bank MFIs / Donors / Private Sector	H	S
	2. Expanding Outreach to target clients/groups • Using innovative and more efficient delivery mechanisms • Creating Linkages Between Banks, NGOs & CBOs • Revising costing and pricing strategies at Banks	Banks	CBS	H	S-M
C. Developing the Non-Bank MFIs	1. Building on the past experience of the Sudanese Postal Office Savings Fund to regain its legacy as a pioneer institution in facilitating money transfer and micro-saving	MOFNE/ Sudanese Postal Office Savings Fund	MOFNE / Donors	H	S
	2. Revising both the Humanitarian Act and CBS Article (51) to empower NGOs to function as legislated MFIs	Legislative Authorities/ CBS	MOFNE / NGO-MFIs	H	S

ESTABLISHING A SUPPORTIVE INFRASTRUCTURE					
Intervention	**Tasks / Activities**	**Primary Responsible Entity**	**Secondary Responsible Entity**	**Priority**	**Time Frame**
A. A Supportive Information Base	1. Creating an information database on the MF Sector within CBS (including demand and supply related information)	CBS	MFIs / Research Centers / Donors	H	S
	2. Establishing an Information Credit Bureau (ICB)	Private Sector/ MFIs	CBS / Donors	H	S-M
B. Advocacy for Policy Changes	1. Effecting the role of the existing MF Organizations Network or establishing a new network to advocate for needed Policy Changes	MFIs	CBS / Government Stakeholders / Donors	H	S
C. Coordination of MF Activities	1. Studying the international models of umbrella / Apex Institutions				
	2. Establishing an Umbrella / Apex Institution with clear service scope and mandate	MFIs / CBS	Donors/ MOFNE	H	S
D. Set Performance Benchmarks and Standards	1. Studying the legal requirements for the establishment of a Self-Regulatory Organizations	MFIs	CBS / Donors / MFIs	H	S
	2. Establishing a SRO	SRO	CBS / Government Stakeholders / MOFNE	H	M
	3. Setting Benchmarks / Performance Standards for the Sector	SRO	MFIs / CBS / Donors	H	M
	4. Establishing linkages with International Rating Agencies		Donors / MFIs	H	M
E. Provision of Capacity Building Programs to MFIs	1. Designing specialized training programs in MF for bankers	Higher Institute of Banking	Donors / MOFNE / Umbrella Organization/ CBS	H	M
	2. Designing training programs to non-bank MFIs	Private Sector / MFIs		H	M
	3. Designing an awareness raising campaign and training courses addressing policy makers and government stakeholders	MOFNE		H	S

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