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SITUATIONAL ANALYSIS OF THE MICROFINANCE SECTOR IN SUDAN[1]

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LIST OF ABBREVIATIONS

ABS	Agricultural Bank of Sudan
ACORD	Agency for Cooperation in Research and Development
ADRA	Adventist Development and Relief Agency
ADS	Area Development Schemes
ARS	Area Rehabilitation Scheme
BOS	Central Bank of Sudan
CBO	Community Based Organization
CDC	Community Development Committee (NGO)
CSP	Comprehensive Strategic Plan
ECCP	Elnuhud Cooperative Credit Project
FAO	The Food and Agriculture Organization of the United Nations
FSS	Financial Self-Sufficiency
GDP	Gross Domestic Product
GEP	Graduates Employment Project
GOS	Government of Sudan
IDPs	Internally-Displaced Persons
INGO	International NGO
ICDB	Islamic Cooperative Development Bank
ICO	Islamic Call Organization
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
IRC	International Rescue Committee (INGO)
IRDP	Integrated Rural Development Program
L-NGO	Local NGO
M&E	Monitoring and Evaluation
MFIs	Microfinance Institutions
MFP	Microfinance Portfolio
MDGs	Millennium Development Goals
MLFS	Microfinance Loans Funds Scheme
MON	Microfinance Organizations Network
MOSCA	Ministry of Social and Cultural Affairs
NCHI	National Corporation for Health Insurance
NFSI	National Fund for Social Insurance
NFSS	National Fund for Students' Support
NGO	Non-Governmental Organization
NPF	National Pensioners' Fund
ONB	Omdurman National Bank
OSS	Operational Self-Sufficiency
OXFAM	Oxford Committee for Famine Relief
PASED	Port-Sudan Association for Small Enterprises Development
PAR	Portfolio at Risk
PC	Popular Committee
PTPG	Personal Third Party Guarantee
PRCC	Poverty Reduction Coordination Council (Khartoum State)
RF	Revolving Funds
ROI	Return on Investment
SAP	Structural Adjustment Program

SD	Sudanese Dinar (present legal tender, One US $ = SD 230)
SDA	Sudanese Development Association
SDF	Social Development Foundation
SHG	Self Help Group
SIB	Sudanese Islamic Bank
SLA	Specialized Local Association
SMART	Specific, Measurable, Achievable, Result-oriented and Time-bound
SOS Sahel UK	SOS Sahel United Kingdom
SRADP	Southern Rosieres Agricultural Development Project
SRC	Sudanese Red Crescent
SSDB	Savings and Social Development Bank
TOT	Training of Trainers
UNCHS	United Nations Centre for Human Settlements (UN-Habitat)
UNDP	United Nations Development Program
UNIDO	United Nations Industrial Development Organization
UPAP	Urban Upgrading and Poverty Alleviation Project
UIS	Urban Informal Sector
UNCHS	United Nations Centre for Human Settlements (UN-Habitat)
WOTAP	Women's Training and Promotion Society (NGO)

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ABSTRACT

Microfinance arose as a global economic development approach intended to benefit low income women and men. In Sudan, the growing focus on poverty alleviation has increased interest in the role microfinance can play as an effective tool for decreasing poverty. However, current microfinance initiatives in Sudan have limited coverage and impact when compared to the size of the problem of poverty, and thus the huge potential of microfinance remains largely untapped. A clear vision for the development and expansion of the microfinance sector and a strategy for integrating microfinance into national policies are required.

The formulation of such a vision and strategy must be built on a sound and informed understanding of the specific conditions of the microfinance sector in Sudan. The results of this study, "The Situational Analysis of the Microfinance Sector in Sudan", form a major contribution to the growing knowledge base on the Sudanese microfinance sector. The study is based on a number of field surveys and background studies which were used to map current microfinance activities in Sudan; gather data regarding the institutional, operational, legal, and regulatory frameworks governing the performance of the institutions supplying microfinance; and assess the degree to which microfinance programs address the needs and expectations of their clients.

The study analyzes the status of the microfinance sector by considering both its demand and supply sides. As small and micro enterprises are one of the primary groups of microfinance clients, the study provides an overview of the scope of their economic activities in Sudan. The results of a client satisfaction survey and an analysis of the client portfolios of a selected group of microfinance institutions (MFIs) complement the description of the demand side. While the institutional capacity of different MFIs according to their legal identity, portfolio classification, management and information systems, services and service delivery, financial resources, operational and financial sustainability, and networking and institutional linkages complement the description of the supply side. The MFIs included in the study are banks, national and international non-governmental organizations (NGOs), social funds, and rural development projects funded by multilateral donors.

The study concludes that the success of microfinance programs in Sudan has varied considerably between MFIs, according to the variation in approach and the level of financial discipline adopted by each. NGOs, social funds, and rural development projects have succeeded in responding to the credit needs of the poor and the grass-roots level. However, some NGO-MFIs are restricted in their geographical coverage and have a limited funding base and limited sustainability, due to their dependency on donor assistance. Other MFIs have experienced difficulties in shifting from a grants-based approach to a market-oriented approach to microfinance. Subsidized credit and low repayment rates have adversely affected the financial and operational performance and sustainability of some MFIs. Furthermore, banks operating in microfinance have had limited success in terms of targeting, outreach, lending volume and lending portfolios. Lack of training and experience in microfinance has been cited as the major factor limiting the development and expansion of bank micro-lending programs.

Based on the analysis of the microfinance sector in Sudan, the study offers a series of recommendations for further development. Suggestions are made for improving MFI outreach, as well as client access to their services. A supportive infrastructure is recommended for the development, including capacity building, microfinance associations and other institutions of information exchange, apex organizations (credit guarantee facilities), and an umbrella agency to facilitate coordination among stakeholders. Changes in the policy and legal environment are recommended to create a more enabling environment for small and micro enterprises. An important element in this regard is the establishment of smaller and more innovative financial intermediaries that are able to develop products for underserved segments of the market.

PART 1: INTRODUCTION

1.1. Why Microfinance?

Microfinance arose as an economic development approach intended to benefit low income women and men, and has now evolved into a widely used tool for poverty reduction. The term refers to the provision of financial services to low-income clients and the self-employed. Financial services generally include savings and credit, and some microfinance organizations also provide insurance and payment services. Microfinance aims at designing and providing access to *suitable financial instruments for persons hitherto excluded from the conventional, formal financial system*. Those excluded tend to be the most disadvantaged in any society – the poor (particularly women in poverty); operating predominantly in the informal sector; and residing primarily in rural areas, as well as urban slums, migrant habitations, and resettlement neighbourhoods for the displaced.

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.

Traditionally, the formal financial sector has been hesitant to engage in microfinance. When bankers are asked why they refrain from extending credit to the poor, they usually enumerate a number of conditions imposed by the formal financial sector that make financing the poor almost impossible. The table below presents some of these constraints, by presenting the context from the point of view of bankers, contrasted with the circumstances of the poor.

Table 1: Contrasting Conditions of Bankers and the Poor

Bankers	The Poor
Require business license	Usually operate small businesses without licenses
Require land lease or rent contract	Operate in non-permanent premises (e.g. vendors) or at home
Require a "clearance" certificate from the taxation department	Operate informally and usually do not pay taxes
Would like to deal with clients of active bank accounts	Do not keep bank accounts
Require collateral	Cannot meet collateral requirements
Require post-dated cheques for repayment instalments	No bank accounts
Poor are in remote areas and are, hence, inaccessible as banks are concentrated in urban centres. Transaction cost is high and the reward is minimal	Can run a profitable business with a high ROI and can pay market interest rates. Their organizations can help to reduce the administrative costs.
Apply lengthy and relatively complicated procedures	Most are illiterate and require simple and quick procedures

The proponents of microfinance belived that the economically active or enterprising poor have a promising potential, but they cannot meet the conventional prerequisites of the formal banking system. Nevertheless, they met the challenge by designing a financing system that reponds to the needs and conditions of such clients. Microfinance, as a lucrative banking business, emerged and gained momentum.

The first, and most famous, pioneer community microfinance institution (MFI) was the Grameen Bank of Bangladesh (1983), which became a model for many countries. Grameen now serves more than 2.4 million poor landless clients (94 percent of them women). 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 Indonesia. This state-owned rural bank moved from providing subsidized credit, and took 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 than unsustainable subsidy-based income-generation approaches 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.

In Sudan, 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 Foundation (SDF); and the launching of several poverty alleviation initiatives, including a strategy for poverty alleviation developed by the Ministry of Finance. Nevertheless, the government's efforts in developing microfinance policies remain limited. NGOs and rural development projects have continued to be the main providers of microfinance to the poor in Sudan. These initiatives, however, have limited coverage and impact when compared to the size of the problem of poverty. Hence, the need for incorporating microfinance in the country's formal credit policy has emerged.

To complement the above initiatives, the issue of designing a future vision and strategy for integrating microfinance into national policies was brought up by the Central Bank of Sudan (BOS). The idea resulted from the building conviction that microfinance could be an effective tool in poverty alleviation endeavours, in addition to being a lucrative business that could prove attractive to commercial banks.

International experience has demonstrated that even a small amount of money can have a significant impact on the lives of the poor. The experience of Sudanese NGOs and some social funds has also shown that microfinance can be used as a tool for financing the basic services needed by the poor, including health insurance, medical care, education, and clean potable water.

In the field of microfinance today, much focus has been made on women, the overlooked majority. Of the 1.3 billion people living in poverty, 70 per cent are women. Although women perform a great proportion of the world's work, they tend to reap fewer rewards from it than men do. Furthermore, the poorer a household, the more likely it is to rely on women's earnings as its most 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. 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 economy.

Furthermore, women's expenditure on the health and education of their families enhance the human resource base, thus contributing to national development goals. Women's businesses also strengthen local economies through their involvement in retail trade and marketing activities. By servicing the local market, and, in the case of women engaged in small-scale manufacturing, using local inputs, women's businesses strengthen local production and consumption linkages. The income women derive from these businesses often acts as the economic safety net that governments in poor countries cannot provide. Hence, a large number of MFIs have already identified women clients as their primary market niche.

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 potent tool to leverage supplementary inputs from the communities themselves, the state, formal financial institutions, and other sources like NGOs, international agencies and even the private sector, to combat poverty. At the same time microfinance should aim at ensuring full cost coverage with profits for financing institutions. This is essential for on going credit linkages and sustainability. A microfinance policy is most effective when it is nested within an overall integrated, multi-sectoral, national strategy for poverty alleviation.

Thus, the objectives of microfinance can be broadly stated as to:

- *Be a tool for poverty alleviation*
- *Be a tool for creating job opportunities*
- *Integrate informal financing into the formal financial sector*
- *Achieve gender equity with respect to access to and control of resources*
- *Leverage supplementary resources from the informal and formal sectors for the benefit of worse off communities*
- *Ensure full cost recovery with some profits for financing institutions, ensuring sustainability.*

Microfinance is a lucrative business if it is done right. It is the profit that refreshes and recycles the lending system. Microfinance/microfinance providers in Sudan need to be informed and convinced that microfinance as a viable banking system which applies scientific, acknowledged indicators to measure its efficiency and effectiveness. Banks and NGOs need training on the concepts, mechanisms and practices of microfinance to enhance their efficiency and effectiveness. The starting point is the realization that microfinance could be an effective development tool, for which there is a great potential and much need in Sudan today.

1.2 Field Surveys

1.2.1. Study Methodology and Sample Frame

In preparation for the consultative process that would lead to a strategy for the development and expansion of microfinance in Sudan, a number of field surveys and background studies were undertaken. These studies were designed to provide an overall mapping of current microfinance activities in Sudan, and to provide an understanding of the institutional, operational, legal and regulatory frameworks governing the performance of institutions supplying microfinance, as well as the degree to which the services offered on the market match the needs and expectations of microfinance clients. [2]

The field surveys were undertaken by a core team of senior experts and junior researchers experienced in fields related to finance in general and microfinance in particular. The surveys were conducted, and the data was processed, during the period from November 2005 to January 2006. To fully understand the status quo of the microfinance sector, the survey findings were fully analyzed and reported in the background study. This study utilized both quantitative and qualitative information gathered during the survey; and benefited from the insights of many years of experience in the field, and from secondary sources on the subject matter.

1.2.2. Scope of Study

A field survey of microfinance service providers was undertaken to investigate the *supply* end of the market. However, a preliminary assessment of the *potential demand* was undertaken, including the level of coverage of current microfinance clients. A target sample of institutions representing the diversity of service providers and also the breadth of microfinance services in four states were surveyed based on a case study approach. To that end, 64 entities were surveyed, 54 of which provide direct finance (MFIs), while the other 10 provide wholesale finance to the MFIs (Annex A provides a list of the organizations surveyed).

The survey team divided the microfinance providers as follows:

1. The Banking Sector
2. International Non-Governmental Organizations (INGOs)
3. Local NGOs and CBOs (Community Based Organizations)
4. Social Funds
5. Development Projects funded by multi-national donors

The study team targeted full coverage of the areas selected for the survey, particularly Khartoum State where the majority of microfinance projects operate. Three other states were covered in addition to Khartoum, with attention paid to the diversity of experience, scale of operations, and variation in service providers. The study team also consulted secondary data sources to ensure comprehensive coverage in the supply side, while using qualitative indicators to touch upon and highlight the huge demand potential (see Bibliography).

To complement the survey of microfinance service providers, and to obtain information regarding the *demand* end of the market, a small client satisfaction survey was conducted with a target sample of 75 active and exited microfinance clients, both men and women.[3]

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[2] For the purpose of this study, microfinance is defined as not exceeding 500 thousand dinars, or approximately $ 2,174, regardless of the sector or activity financed.

[3] Exited clients are defined as those with no loans currently booked at the MFIs

These sample units were selected to represent the diverse lending programs and geographical areas. The sample units were selected randomly from lists provided by the MFIs. In order to avoid awkwardness and bias, the interviews were conducted by the researchers at the client's residence or place of work without the presence of officers of the microfinance provider.

1.2.3. Survey Instruments

The instruments used for the surveys were designed to collect both quantitative and qualitative data, so as to ensure that the combined information would lend itself to the development of a comprehensive overview of the supply end of microfinance. A questionnaire and a structured interview guide were developed for the survey of MFIs. The questionnaire administered to middle and lower management included both closed and open-ended questions. Information related to the institution's microfinance operations (type, size, geographical and sector coverage, collateral requirements and clients) was elicited through closed-ended questions, while information pertaining to the respondent's views on the impact that the policies/ regulations/procedures of the Bank of Sudan (BOS) or of the institution itself might have in terms of constraining or encouraging the expansion of microfinance was obtained through open-ended questions. The interview guide was used with upper management to obtain in-depth information on issues concerning the institution's engagement in microfinance, including its plans with regard to expansion of operations, training of staff, systems and procedures, and incentives. Throughout the study, the researchers were encouraged to take additional notes recording their personal observations and any additional information they obtained during the interviewing process.

A structured survey form was used for the client satisfaction survey. The aim was to investigate how these clients had heard about the lending program, what they liked or disliked about it, whether they would apply for a repeat loan or not, and the conditions under which they would continue with the program.

1.2.4. Data Processing and Analysis of Field Surveys

Data processing and analysis was based on the following:

- Discussion and consensus among researchers about the interpretation of the qualitative data, and any additional information recorded during the interview process;
- Review and coding of open-ended questions in the survey forms; and
- Statistical analysis of the survey data using SPSS. All data used in the analyses were examined for outliers and invalid values. Appropriate data-cleaning procedures were applied prior to data processing. The analyses included running simple frequency tests and cross tabulations to check the logical relationship between variables.

PART 2: DEMAND FOR MICROFINANCE IN SUDAN

2.1 Defining Small and Micro enterprises (SMEs)

There has been a steady growth in the numbers of micro and small enterprises in Sudan, in response not only to the growing demand among poor and low-income groups for their products and services, which are provided at reasonable cost, with easy accessibility (often at the doorstep of customers); but also as a result of an economic situation that has led greater numbers of people to seek employment in this sector. As the sector has grown, there has been a reciprocal growth in the demand for microfinance. Unfortunately, however, a number of factors have resulted in a situation where the contribution of the formal banking system to the financing of these types of enterprises remains minimal, not only in Sudan, but in the Middle East and North Africa in general. A global survey conducted by the World Bank of 206 MFIs in 1996 revealed that commercial banks worldwide have become increasingly engaged in microfinance after realizing its profitability, with the exception of those in the Middle East and North Africa.[4]

If we begin by a definition of the 'small enterprise' or 'small business' we find that it is characterized by the following.[5]

- it is managed by its owner;
- it is of small size in its sub-sector;
- the personal touch of its owner is evident;
- it has a practical nature; and
- its growth depends on self-generated revenue.

A UNDP/World Bank study on the microfinance experience of the Egyptian commercial banks differentiates between small and micro enterprises according to the degree of interdependence between the enterprise and the activities of the household. According to the study, it is difficult to separate between the household and the activities of the micro enterprise, in so far as economic decisions taken by the household usually have a significant impact on the economic decisions of the micro enterprise, and vice versa. For small enterprises, the line of demarcation between the household and the enterprise is clearer. Hence, a micro enterprise could be defined as "a very small economic activity that generates income for the poor individual and his/her household. It is the means of integrating economic activities with the activities of the household, to enable the poor to secure a subsistence living year by year. It represents a means for protection against "unforeseen economic shocks". In Egypt, for example, micro enterprises are defined as 'those which employ less than 10 workers, whose owners live close to the poverty line'.[6]

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[4] (R. Domali. E. Sabkanine and W. Tacker, UNDP/World Bank, 1996).

[5] As described by Dr. Jaafar Farah, Ph.D. thesis, 2005.

[6] The Egyptian experience may be pertinent in this respect. Estimates show that these enterprises represent 98 percent of private non-agricultural enterprises, and 93 percent of private sector ventures in Egypt. They provide an impressive 52 percent of employment opportunities in the private sector (Egyptian Ministry of Economics, 1998). According to a recent World Bank study, the number of micro enterprises in Egypt amount to not less than 1.5 million

2.2 SMEs in Sudan

There is a lack of reliable data on the size and proportion of small and micro enterprises in Sudan. The few efforts exerted to survey small enterprises (studies by the Ministry of Industry and UNIDO) have been confined to small-scale industries. The Industrial Survey Report, issued in March 2005, states that the total number of manufacturing industries in Sudan is 24,114. Out of this number, small scale industries (those employing less than 10 workers) represent 93.10 percent, equivalent to 22,460 enterprises. 7

As for their social contribution, Professor M.H. Awad, of Khartoum University argues that artisans and 'small' entrepreneurs in Sudan provide two-thirds of the basic household needs for the majority of the population. They provide food, beverages, furniture, utensils, tools and equipment, and various types of services, including maintenance, transportation, and construction (Issue No 20, Industry and Development Magazine, 2005). In order to obtain an appreciation of the significant role that micro and small enterprises play in the Sudanese economy, a number of qualitative indicators could be cited.

As stated above, small and micro enterprises provide vital, affordable, and accessible goods and services to the poor in Sudan, who currently represent the majority of the population. According to the findings of the Sudan-Millennium Development Goals Report (MDGs), issued in December 2004, there is no reliable data and information on the magnitude of poverty in Sudan. The data available, the report reveals, is provided by non-poverty specific and outdated surveys that were mostly confined to northern Sudan, and, at best, some areas under government control in the south. The data also represents the non-oil period. Hence, given the quality of available data, money-metric measures of poverty are of limited use. However, by referring to non-income indicators of poverty (including access to services, infrastructure, assets and social capital; unemployment rates; and changes in food requirements) the MDG report concludes that there is a high incidence of poverty, in spite of recent economic growth.

In Khartoum State, for example, the number of poor has significantly increased during the past two decades due to the influx of rural-urban migrants and internally displaced persons (IDPs) who left their homes as a result of armed conflicts and natural disasters. The number of IDPs in Khartoum State has been estimated by a number of sources at 2 million, while Dr Sharaf-Eldin Bannaga, an ex-housing Minister, has provided an estimate of up to 3 million (Peace and Displaced in Sudan, Habitat Group, ETC-Zurich, 2002). As a result of these migrations, the overall estimated number of inhabitants in Khartoum has risen to 7 million.

The Liberalization Policy instituted in February of 1992, followed by the implementation of the Restructuring Program, contributed to a drop in the real income of workers and salaried employees, who were forced to engage in micro and small enterprises to supplement their meagre incomes. Those who lost their jobs as a result

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UNDP/World Bank study (The Microfinance Experience of Egyptian Commercial banks). The number in microfinance enterprises in Egypt amount to not less than 1.5 million of privatization or restructuring had to follow suit. Due to the liberalization and privatization policies, the employment opportunities offered by the public sector became quite limited. The only opportunities available were either in the private sector or through self-employment. Unemployed graduates, and sometimes students, on full or part-time basis (e.g. petty trade and services), joined the sector and were engaged in self-employment.

Shifting to agriculture, approximately 67 percent of the Sudanese population derive their livelihood from agriculture, which accounts for 36 percent of the country's GDP; represents more than 90 percent of non-oil exports; contributes about two-thirds of all employment opportunities; and supplies approximately 60 percent of the raw materials needed by the industrial sector (2001). The agriculture sector is also responsible for the country's main food staples. 8

Finance to agriculture in Sudan does not match its contribution to the GDP, particularly finance to the traditional sector. Due to the concentration of banking branches in urban areas, mainly in the central and northern parts of Sudan, the access of producers in the traditional sector to financial services remains quite limited. Producers in this sector depend mainly on informal credit sources, usually with high finance costs.

The majority of micro and small enterprises are financed by informal and semi-formal sources (such as individual savings, grants and loans from family, friends, NGOs, and social funds). The involvement of the formal banking system is minimal, primarily because these enterprises are rated by the formal financial system as unbankable. This is despite the fact that a significant amount of liquidity is circulating in the hands of thousands of small entrepreneurs, operating in a number of big popular markets in the seven localities of Khartoum State. The banking system has apparently failed to tap these potential resources.

There are several constraints that limit the interaction of the formal financial system with microentrepreneurs. One such constraint is that the working hours of the local markets continue until the evening, while banks close their doors in the early afternoon (12:30 pm). It is apparent that bankers are still unaware of the huge potential of micro and small enterprises. Professor Malcolm Harper (a reputable small business expert and ex-professor at Cranfield University, UK) described this situation as a 'benign paradox". Although bankers are seeking profits, he stated, and dealing with small businesses has proven to be both profitable and lucrative, they remain reluctant to do business with such group of entrepreneurs.

The percentage of small loans extended by the formal banking sector to "productive families" and small producers in Sudan, during the period from 2002 to 2003, did not exceed 3 percent, according to Bank of Sudan reports (Jaafar Farah, Ph. D. Thesis, 2005). The percentage of micro loans (not exceeding SD 500,000) was less than 1 percent during the period from 2003 to 2004, as shown in the following table:

[8] During the last 10 years there has been a deterioration in the production of cereals such as sorghum and millet. The main reasons behind this deterioration are a combination of climatic conditions and the financial modes adopted towards different farmers in the traditional sector of the economy.

Table 2: Percentage of Micro-loans in the period from 2003 to 2004 in Sudan

	Amount of loans in SD million			
Year	Microfinance	Total amount of loans	% of Microfinance tototal	No. of projects financed
2003	2,935	332,805	0.88	7,628
2004	4,111	479,415	0.86	9,444

Source: Statistics provided by the Bank of Sudan, 2006

The demand for microfinance among women has grown during the few past years. In addition to their poverty and meagre share in resources, women represent the major victims of wars and armed conflicts. The phenomenon of female-headed households characterizes the families of IDPs in the poor urban settlements in the outskirts of Khartoum.

In the absence of the male breadwinners (husbands, fathers, brothers and sons), women have to take care of themselves and their family members such as children, elderly people and other dependants. As a result, women became the neediest group in desperate need of external support. This is one of the main reasons why NGOs emphasize targeting poor women in these locations.

IDPs encounter problems in finding adequate shelter, water, health services, children's education and livelihood. Furthermore, the planned resettlement of IDPs and migrants implemented by local municipal authorities has created a huge demand for "consumption loans" to be used in the purchase of land plots, the construction of low cost buildings, and for home and business environment improvement (home-based production or services). The experiences of the Urban Upgrading and Poverty Alleviation Project (UPAP), the SDF, the Port-Sudan Association for Small Enterprises Development (PASED), SSDB and the Solar Energy Project (implemented by the United Nations Development Programme (UNDP) with the Savings Bank), have demonstrated the viability of providing microfinance to finance home improvement, and to supply poor urban quarters with their basic needs, such as electricity, water, health services and energy, on a cost-recovery basis. Extending microfinance to communities is done through grass-root community intermediaries/community based organizations (CBOs).

The experience of MFIs around the world has demonstrated that the poor are credit-worthy, and microfinance - when properly planned and implemented - is a lucrative business that is both attractive and commercially viable for formal financial institutions. In Sudan, there seems to be a huge potential for such business, but this requires banks to meet the challenge by tailoring services that suit the conditions of the poor, while at the same time generating profits. A huge amount of resources are already in the market and need to be tapped by the formal banking system.

2.3 Survey Findings: Current Microfinance Clients

The following two sections will describe the characteristics of current microfinance clients. The first section summarizes the findings of a survey of 75 microfinance clients. The second section provides a description of the client portfolios of a selected group of MFIs.

2.3.1 Survey of Microfinance Clients

A survey was conducted with a sample of 75 clients of microfinance programs provided by a variety of MFIs (banks, NGOs and social funds) in the states of Khartoum, North Kordufan, Kassala and Red Sea (Table 1). The survey tool was a questionnaire filled by the consultants directly with clients, in the absence of loan officers of the concerned lending organizations. The sample of clients was randomly selected, while considering gender, and including two types of respondents: both active and exit clients.

Table 3: Client Distribution by Location and MFI Type

Location (State)	Banking Units	NGOs	Social Funds	Total	%
Khartoum	19	7	10	36	48
North Kordufan	11	2	-	13	17
Kassala	3	15	-	18	24
Red Sea	-	8	-	8	11
Total	**33**	**32**	**10**	**75**	**100**

The analysis of the questionnaire revealed that the majority of the sample learned of the microfinance program through "word of mouth": 63 percent of clients heard of the credit program from other clients, and 28 percent from the loan officers. Only 9 percent of the total sample mentioned that they learned of the loan program through advertisements (2.7 percent mentioned advertising materials, and 6.7 percent cited radio/TV).

Before applying for the loans, only 12 percent of the total sample met their needs through self-financing, and 12 percent from other credit programs/MFIs. On the other hand, 40 percent of the clients fulfilled their financial needs from family and/or friends, while 21 percent borrowed from merchants/others. These results show that informal sources were the main source of microfinance for the majority of clients.

When asked about what elements they like about their respective microfinance programs, 40 percent of the respondents mentioned the simplicity of procedures and fast processing of the loan, and 22.7 percent pointed out the repayment conditions. Only 5.3 percent of the respondents pinpointed the reasonable cost of financing. These results lead to the conclusion that the main factors that count for most of the clients are the simple and rapid procedures for loan disbursement followed by repayment conditions. On the other hand, 17 percent of respondents mentioned that there is nothing that they do not like about their respective microfinance programs, while 50.7 percent mentioned that they find the loan size rather small. 54.5 percent of bank clients stated that the amount of finance provided was small. 54.5 percent of social funds/rural development project clients and 58 percent of NGO/CBO clients responded similarly. These percentages reveal that there is an emerging need for loan sizes larger than those currently provided.

When microfinance clients were asked about what attracted them most to a particular micro-lending institution, clients of banks and social funds/rural development projects stated that quick procedures were the primary reason they chose these institutions, while NGO clients mentioned simplified procedures as the most attractive component of NGO programs. According to bank and NGO clients, facilities in repayment were the second most attractive component of these programs. Social funds/rural development project clients mentioned the absence of a collateral requirement as the second reason for choosing these MFIs. The third reasons that were mentioned for choosing a particular institution for microfinance services included good treatment (bank clients), easy procedures (NGO clients), and training (social funds/rural development project clients). From these findings it can be concluded that for clients, simplified and fast procedures coupled with flexible and suitable collateral mechanisms are the most attractive features of microfinance services offered by MFIs.

Moreover, 91 percent of the sample respondents expressed their intention to apply for another micro loan in the near future, while only 9 percent have no intention of doing so. This percentage reflects the high demand for microfinance among the sample respondents.

2.3.2 Survey of Microfinance Institutions (MFIs)

With regards to the current profile of microfinance clients, following is a description of the demographic and socio-economic characteristics of clients based on the results of a survey of microfinance providers. This survey was conducted with a sample of 57 MFIs in the states of Khartoum, North Kordufan, Kassala, and the Red Sea (Table 4).

Table 4: Area Distribution of Surveyed MFIs

Area	Banks	NGOs	SDF and Development Projects	Total
Khartoum	22	8	4	**34**
North Kurdufan	5	4	2	**11**
Kassala	5	2	0	**7**
Red Sea	3	2	0	**5**
Total	**35**	**16**	**6**	**57**

The majority of MFI clients (54.5 percent) are between 31 and 45 years of age; 17.6 percent are between 15 and 30 years of age; 15.8 percent are between 46 and 60 years of age; and 12.1 percent are over 60. As regards marital status, 42.2 percent of the clients are married, while 57.8 percent are not (22.7 percent are single, 17 percent are widows, 9.7 percent are deserted, and 8.4 percent are divorced). With regards to the education level of MFI clients, 20.7 percent are illiterate, 30.2 percent completed primary education, 30 percent completed their secondary education, 12.3 percent have a university degree, and 6.7 percent completed post-graduate studies. It is worth noting that a number of respondents at the MFIs – particularly banks - mentioned that they target educated people. The reason for this is that the system is structured to serve literate persons, while illiterate persons, in most cases, have limited access to the formal banking services . In addition, psychological barrier and physical access, survey results show that 84.3 percent of MFIs target both males and females, while 11.8 percent target females, and 3.9 percent target males. The survey results show that female clients constitute less than 50 percent of the client portfolio of two-third of the MFIs. The above results show that MFIs do not have a set target of women clients, and this could result in the implementation of programs that are not gender sensitive.

2.3.3 Survey Conclusions

Based on the survey results, it is clear that there is still much to do in terms of product development and expansion of outreach. While the majority of respondents praised the simple loan disbursement procedures, as well as the repayment conditions, there was some dissatisfaction with the loan sizes available. Therefore, the loan brackets provided need to be re-examined, as well as the range of products offered. Product diversification could be a way to meet higher finance needs. It was also noted that the majority (more than 60 percent) of clients heard about the available microfinance services from other clients, indicating a weakness or even a complete absence of a guided effort to promote microfinance services and outreach to clients.

In conclusion, MFIs in Sudan have to exert more effort in redefining the relevance and suitability of the services they provide to clients, as well as the means by which those MFIs reach out to clients. It is well known that institutions are often biased to what they currently offer and postpone any efforts related to product innovation/development until the demand for current services is materially affected. Inducing banks to offer microfinance services could be a very practical motivation for non-bank MFIs to enhance/develop new products to survive in a more competitive supply environment. Moreover, the inclusion of banks in microfinance services would quickly entice non-bank MFIs to extend outreach to new areas and to concentrate on areas that are not usually reachable by banks, eventually leading to better targeting and giving birth to the idea of market segmentation and product branding.

PART 3: THE STATUS OF MICROFINANCE SUPPLY

3.1 Current Microfinance Supply

Several experiments in micro lending have been launched in Sudan during the past few decades to extend 'small' loans to the poor, small producers and low-income groups, including women. However, it appears that there has been no conformity in approach among the institutions/agencies undertaking these endeavors. Hence, microfinance, as known and practiced worldwide (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. Most institutions and agencies involved in this field operate mainly with a credit minimalist approach. The degree of success achieved varies according to the nature of the agency/institution and the environment in which it operates.

Most micro lending to date has been handled by NGOs. During the past few years, however, as the impact and expansion of poverty has been felt by all, the government has made poverty alleviation a major priority. A section on "social development and social care" was incorporated in the Comprehensive Strategic Plan (CSP) of Sudan (1992-2002). This section contained directives, objectives and policies which focused, for example, on taking care of the family, assisting the under-privileged, alleviating poverty, and mobilizing and coordinating all efforts toward community development and social welfare. A clear-cut commitment was expressed in the Comprehensive Strategic Plan (CSP) in a "SMART' objective: "providing 2 million poor families (one third of the population) with production means within ten years". Following this, and in line with the CSP directives, several social funds and institutions were launched, in addition to other policy measures such as establishing a "Social Planning Ministry" at the federal level (now called the "Ministry of Care and Social Development"), a 'social sector' at the Federal Ministry of Finance, and incorporating social development in the monetary and credit policy for a number of years. Since 1994, approximately 5 percent of total bank loans were allocated to financing the social sector, and the percentage has gradually increased to reach 10 percent in the Bank of Sudan's credit policy for 2005. Banks were directed to allocate not less than 10 percent of their total loans to providing small and micro loans. The bank circulars issued on this policy defined social development as "productive families, artisans and 'small' professionals".

It is important to note that most microfinance operations began after the announcement of the economic liberalization and structural adjustment policies of the 1990s. Social funds did not exist before 1990; 9.4 percent of banks started before 1980, 21.8 percent between 1980 and 1990, 62.5 percent during 1991-2000 and 6.3 percent after 2000; 8.4 percent of NGOs started between 1980 and 1990, 58.3 percent during 1991 to 2000and 33.4 percent after 2000; and 57.1 percent of social funds/rural development projects started during 1991-2000 and 42.9 percent after 2000.

To highlight the Sudanese experience in microfinancing, this paper will identify and analyse the experiences of three main types of microfinance providers: NGOs (both foreign and local); social funds and rural development projects; and banks.

3.1.1 NGOs

The survey conducted with 12 NGOs/CBOs[9], currently operating in the country, revealed that only 8.4 percent of them began the provision of microfinance in the 80s, while around 91.6 percent started after 1991 (58.3 percent in the 1990s, and 33.3 percent after the year 2000), following the announcement of the economic liberalization policy (February 1992) and the structural adjustment programs (SAPs).

3.1.2 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. The survey performed for this study revealed that 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 revolution.

The SDF operates at the state level in Khartoum. In line with the growing concern with poverty alleviation at the national level, Khartoum State established the SDF in 1997, and it began operations in 1998. The SDF has been very active in extending credit to grass-root clients, and in the institutional development and capacity building of intermediately savings and credit associations at community level. The SDF has also initiated and facilitated the establishment of the Microfinance Organizations Network (MON).[10] The SDF has also taken a leading role in establishing microfinance funds at the local level in Khartoum state and in convincing the state government to declare 2006 as a microfinance year. Despite the establishment of foundations in Gezira, White Nile, Gedarif, North Kordofan, and River Nile, they remain for the most part inactive[11].

3.1.3 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. Many of these projects include the establishment of sustainable rural credit services among their integrated services. 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) are some of the most well-known rural development projects to have a rural finance component. Other projects that were implemented during the last two decades and eventually phased out include Area Development Schemes (ADS), the Elnuhud Cooperative Credit Project (ECCP), the Southern Rosieres Agricultural Development Project (SRADP) and UPAP. The rural development projects covered in this study all began after 1991; with three of them starting after 2000. The specific objectives of these

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[9] The selected NGOs/CBOs constitute the main providers of micro credit.

[10] 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. ACORD and Oxfam).

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

rural microfinance projects are to enhance the productivity and income of individual farmers, villages and groups from crops, livestock, natural plant cover products and non-farm enterprises. These projects have assisted rural committees in developing a number of credit services, including informal financial institutions in the traditional form of revolving funds (*sanduqs*).

3.1.4 The Banking Sector

In addition to a few newly established foreign banks, the Sudanese banking system is composed of both commercial and specialized banks. Commercial banks include both government-owned (public sector) and private sector banks. Specialized banks target specific sectors, such as social development, agriculture, animal resources, and industrial development; or specific groups, such as farmers. According to CBOS statistics, there are 23 banks operating country-wide; with 535 branches distributed unevenly among states: 34 percent in Khartoum state; 20 percent in central states; 14 percent in eastern states; 11 percent in northern states; 10 percent in Kordofan state; 8 percent in Darfur state; and the remaining 3 percent in southern states. In line with current Government of Sudan (GOS) strategy, as well as worldwide trends, most Sudanese banks (comprising one of the appropriate types of institutions for the delivery of microfinance) have started providing and expanding microfinance services to cover different regions and various productive sectors.

The entry of Sudanese banks into microfinance began in the 1990s. In accordance with the financing terms and regulations of the CBOS' financing policy, which stipulate 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 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.

3.2 Institutional Capacity

3.2.1 Legal Identity/ Legal Personality

A number of laws govern MFIs in Sudan. NGOs, for example, are registered as non-profit organizations under the Humanitarian Aid Act. Although Article 51 of the Central Bank of Sudan (BOS) Act prohibits undertaking any type of banking business without the bank's approval, NGOs have thus far experienced few problems in extending microfinance to their clientele. However, some NGOs feel that acts such as this one limit their ability to mobilize savings or accept deposits. Nevertheless, according to the results of the MFI survey, 75 percent of NGOs believe that their internal rules and regulations encourage microfinance activities. Similarly, both the administrators of social funds and the management units of rural development projects claim that the by-laws and statues governing their entities do not present any significant barriers to the implementation of their credit programs.

The expansion of microfinance services to cover more geographic areas and sectors has necessitated the establishment of internal rules and measures within banks to regulate the delivery of the service in conformity with CBOS finance policies and regulations.

Despite the efficiency of the regulatory measures set, they cannot be free of short falls given the fact that the microfinance industry is still in its infant stages. The survey of MFIs measured banks' opinions regarding the impact of CBOS policies and internal regulations on the performance, development and expansion of their microfinance services. In general, 59 percent of the banks think that CBOS policies enhance and support microfinance operations, while 40 percent think that they are either constraining or without impact. However, the commercial and specialized banks regard CBOS banking regulations differently; 79 percent of commercial banks and 30.8 percent of specialized banks feel that these regulations are effective, while 21 percent of commercial banks and 69 percent of specialized banks feel that these regulations are constraining or without impact.

With regard to bank internal regulations, 61 percent of the bank officials interviewed confirmed that their internal regulations are effective in enhancing microfinance, while 38 percent think that they are either constraining or have no impact. It is important to mention that the percentage of commercial banks that regard their internal regulations as constraining to microfinance (at 33.3 percent) is higher than the percentage which regard CBOS policies as constraining to microfinance (10.5 percent). This may indicate that internal regulations are not designed in consultation with those who have close contact with the execution of microfinance operations.

3.2.2 Portfolio Classification

The client portfolios of the MFIs are similar with respect to both the targeted and actual credit clients. All MFIs target poor clients and those that operate in the informal sector. With regards to the client portfolio of the surveyed NGOs/CBOs, 91.7 percent of NGO microfinance programs target the poor in general, and 33 percent solely target poor women, while the majority of organizations (66.7 percent) target both men and women. Although NGOs target the poor, 67 percent of organizations have no standard definition for poverty at the institutional level. Definition of the target group varies among organizations, in 33 percent of the sample definitions depend on the initiatives of individual staff members. A significant 66.6 percent of NGOs do not target women.

As for coverage, 83.3 percent of NGOs operate in urban areas only, while 16.7 percent cover both urban and rural areas. With regards to the sectors financed, 50 percent of NGOs distribute their micro-credit provision according to sub-sectors and activities, while the other 50 percent do not. 91.7 percent of NGO clients own informal businesses. Petty trade, services and handicrafts represent 75 percent of business types. 20 percent of the NGOs finance sole proprietors only, while the remaining 80 percent finance both sole proprietorships and partnerships. The main activity practiced by women is petty trade. The percentage of women clients is between 25 percent and 50 percent of the client portfolio of the two-third surveyed NGOs/CBOs, and between 51 percent and 75 percent of the client portfolio of 33.3 percent of the surveyed NGOs/CBOs.

In general, the social funds target individual or group enterprises, which reflect their broad spectrum to serve a wide base of clients. The SDF, for example, targets poor beneficiaries who receive support from Zakat (especially female-headed households), groups with special needs such as the handicapped, and unemployed university graduates. The survey performed for this study revealed that the social funds classify their clients according to demographic indicators, and each social fund focuses on a specialized category of clients such as pensioners or fresh graduates, depending on the mandate of the given social fund. However, while targeting the poor is not the highest priority for some of the social funds, there have been serious attempts on the part of the SDF to include the worst off segments of society. The SDF is gradually shifting its objectives toward poverty alleviation by moving away from just the 'currently productive' who tend to be the relatively better off, to covering the worst of who may be 'potentially productive' also.

Moreover, the social funds work indiscriminately with both women and men, with women's representation ranging between 51 to 75 percent of actual clients, depending on the fund surveyed. Related to this is the capacity of the respective social funds to serve both urban and rural clients. In terms of actual coverage, the economic sectors financed by the social funds were varied and include: agriculture; services; petty trade; processing; and handicrafts/ cottage/ artisan activities. The percentage of clients heading households ranged between 25 to 100 percent.

Some rural development projects have used special methods of "targeting" to ensure that the poor and the very poor are indeed served. Of the four rural development projects, 50 percent of the projects target the poor. The method used by the sample projects in targeting is Participatory Wealth Ranking (PWR) which is a ranking by community members of the relative poverty or wealth of households utilising perceptions and criteria defined by community members themselves. The poor are targeted by the project after being defined by the community through the formulation of village profiles. The participants define three levels according to their own perception of the poorest, poor and better-off. Accordingly, outreach is determined within the project objectives and technical and budgetary limits. Other projects use criteria such as food insecurity to target clients.

In terms of actual coverage, the rural development projects under study have financed a wide range of individual and group enterprises and have provided loans primarily to clients in rural areas. Most rural development projects dealt with informal sector clients discriminately as most of the sampled projects disbursed loans to the particular informal sector related to the mandate of the given project. About 66 percent of loans in 2004 were given to livestock. Of the remaining loans, 16 percent were provided for petty trading, 7 percent were provided for horticultural investments, and 5 percent were provided for food security and services and 6% for other types. The percentage of clients heading families ranged between 76 to 100 percent. Moreover, all the projects surveyed work indiscriminately with both women and men, although they don't target women specifically. Women constituted about 25 to 50 percent of the clients the four projects studied. Women's participation was higher in the group lending programs, with approximately 40 percent of borrowers, but was insignificant in the individual lending programs.

As opposed to other types of MFIs, most banks have not adopted a clear definition of the poor and do not actively target the poor as microfinance clients. According to the MFI survey, 68.4 percent of commercial banks and 46.2 percent of specialized banks do not have a clear definition of the poor. A significant 88 percent of banks operating in microfinance do not adopt client selection criteria that exclusively target the poor. Only two commercial banks and one specialized bank out of the 32 surveyed specifically target the poor as microfinance clients. According to interviews conducted with banks, those banks that target the poor as microfinance clients lack the capacity to actually reach these potential clients. They do not design marketing strategies or outreach plans to inform potential clients of their services and as a result, their outreach to targeted clients is low. Furthermore, they do not conduct market surveys to identify the needs of targeted clients or design loan products that fit their demands.

In terms of geographic coverage, all specialized banks and 79 percent of commercial banks included in the MFI survey have microfinance operations in both rural and urban areas; and 21 percent of commercial banks tend to focus exclusively on clients in urban areas. It should be clarified that the word 'rural' describes areas that are not strictly rural as the term indicates, but rather "rural towns" where a few elements of urbanization are present. Both commercial and specialized banks provide financing to a variety of different enterprises in all sectors. According to the MFI survey, all commercial banks and 84.6 percent of specialized banks provide financing for the establishment of new enterprises or for existing enterprises. This criterion supports those who are creative, have business ideas and entrepreneurship skills, and who need financing to start their businesses. In addition, all specialized banks and 89.5 percent of commercial banks provide initial financing for both capital assets and the cost of operations or working capital; while 10.5 percent of commercial banks provide financing for working capital only.

Specialized banks typically serve more women than commercial banks: 68.4 percent of commercial banks and 30.8 percent of specialized banks have few female microfinance clients (less than 25 percent of total clients); 21.1 percent of commercial banks and 53.8 percent of specialized banks have a slightly higher number of women microfinance clients (25-50 percent of total clients); and only a few banks in the survey had high rates of female microfinance clients. In only two specialized banks, women are between 50 to 75 percent of total microfinance clients, and in two commercial banks, women represent between 75 to 100 percent of total clients. Very few banks serve widowed clients or clients deserted by their husbands; only 9.7 percent of banks serve the deserted and 17 percent serve widowed clients.

In terms of the educational level of microfinance clients, most bank clients were from among the least educated groups: 20.7 percent of clients are illiterate, 30.2 percent of clients have had only a primary education, and 30 percent have completed their secondary education. Moreover, 54 percent of bank clients are between the ages of 31 and 45 years, and only 17.62 percent of banks' clients are between 15 and 30 years of age.

3.2.3 Management and Information Systems (MIS)

The IT capacity and the use of specialized computer programs to operate and manage credit programs varies among the MFIs under study. Around 50 percent of the surveyed NGOs use computer packages to track loans. However, out of these, 58 percent do not classify clients according to socio-economic characteristics. The use of microfinance performance measurement indicators, such as Operational Self-Sufficiency (OSS), Financial Self-Sufficiency (FSS), and Portfolio at Risk (PAR), have been adopted by only a few NGOs such as PASED and ACORD Kassala. In addition, 58 percent of organizations do not estimate the administrative cost of microfinance transactions (as a separate cost center).

Both social funds and rural development projects use computer technology to manage their various activities and operations. In terms of their microfinance programs, the survey found that both social funds and rural development projects use computers in their loan tracking operations. However, the results of the survey revealed that some social funds do not use computers to monitor all the microfinance information and only half of the rural development projects used computers to monitor all microfinance information and operations. Of the banks surveyed, 89.5 percent of commercial banks and 53.8 percent of specialized banks use automated loan tracking systems. Among the banks that used automated loan tracking systems, 91.7 percent use this system to monitor all loan information and microfinance operations, including loan repayment information. Automation of the loan tracking and financial management systems has increased the operational efficiency of banks and minimized costs.

3.2.4 Services and Service Delivery

The majority of the MFIs surveyed offer primarily micro-credit products, including individual and group loans for both new and existing enterprises, but utilize a variety of lending methodologies. The MFI survey identified that the lending methods used by all organizations and institutions engaged in micro-credit are Murabaha (40 percent), Quard-hasan (17.6 percent), hire-purchase (14.5 percent), Salam (10 percent) and Mudaraba (3.7 percent). Murabaha is the main financing mode adopted by NGOs. (Annex B provides a glossary of common terms in Islamic finance).

The main microfinance products provided by the NGOs are micro-credit and savings; with the clear majority of organizations (92 percent) providing micro-credit only. With regards to savings, 83 percent of respondent organizations mobilize savings; 50 percent of the surveyed NGOs include a "*compulsory savings*" scheme in their microfinance programs, 33.3 percent include "*voluntary savings*", and the remaining 16.7 percent do not offer any savings schemes at all.

Following is a description of the main features of the micro-credit programs of the surveyed NGOs in terms of loan size and collateral. The majority of NGOs (83 percent) extended loans to both individual and group enterprises. MFI survey data regarding the individual loan ceiling shows that 50 percent of NGOs provided less than SD 50,000; 33.3 percent provided a range of between SD 50,000 and 100,000; and 16.7 percent provided more than SD 100,000. With respect to the group enterprise loan ceiling, 33.3 percent of NGOs provided less than SD 100,000; 25 percent provided between SD 100,000 and SD 300,000; 16.7 percent provided a range of between SD 301,000 and SD 600,000; and 25 percent did not have a ceiling for group enterprise lending. Half of the organizations provided a total value of loans amounting to SD 50 million, 25 percent provided an amount of SD 250 million, while 25 percent exceeded SD 500 million. The main types of collateral adopted by NGOs are group collateral (50 percent) and third-party guarantee (33 percent).

With regards to the number of loans extended, 66.7 percent of NGOs extend between 100 to 500 loans per year; 8 percent extend between 500 to 1,000 loans per year; and 25 percent extend more than 1,500 loans per year. On the other hand, the majority of banks (66.7 percent) provide less than 100 loans per year, and 22 percent provide between 100 and 500 loans.

In the case of loan default, 50 percent of NGOs resort to rescheduling as a main measure, and only 8 percent take direct legal action. Other measures considered are partial or total write-off, asking for repayment of principal only, or a combination of these procedures; 75 percent of organizations take measures against defaulters in less than three months.

With regards to loan disbursement procedures, 50 percent of NGOs process loan applications and disburse loans for approved applications in less than 15 days, and 33 percent take between 15 to 30 days (i.e. 83 percent of organizations take decisions in less than 30 days, see table 4). For 67 percent of NGOs, loan decisions are taken at the field level, either at the client's place of business (42 percent) or in the office of an intermediary CBO/group (25 percent). The microfinance portfolio (MFP) of the surveyed NGOs constituted from 76 to 100 percent of the total loan portfolio.

The study team observed that the staff members who handle micro-credit and micro-enterprise development activities in the majority of NGOs are not specialized. Such activities are carried out by a small number of staff as part of other duties. However, in 58.3 percent of organizations, a specialized section in a branch office handles these activities while in 33 percent of cases they are handled by a specialized section at the head office; 92 percent of organizations depend on their own staff, while 8 percent resort to other organizations/persons.

The experiences of the social funds in the sample showed that they finance both new and already existing or operating enterprises. Moreover, they provide loans for both fixed assets and operating or working capital. However, the mobilization of savings remained a marginal exercise for the social funds under study. Their programs did not include savings mobilization, and only one program included optional savings. The duration of the social fund loans depend on the type of activity financed. Repayments or loan installments are generally on a monthly basis. The credit ceiling for individual loans was SD 200,000 and there was no specified credit ceiling for the financing of group enterprises. The most common forms of collateral for the social fund credit programs were third party guarantee and group guarantee (group pressure and peer monitoring). Other collaterals used include different types of mortgage (real estate, property, and mobile assets) and insurance.

In cases of loan delinquency, the survey showed that the main recourse of the social funds was rescheduling of debts. Rescheduling actions were initiated in less than three months. The percentage of loan defaulters required to reschedule their loans ranges between 25 and 50 percent. This reflects lack of awareness regarding the best practice related to default risk and the moral hazard risk that may accrue.

The credit instruments most commonly used by the social funds are Murabaha and Salam. The process of loan disbursal includes a sound feasibility study, and criteria such as a current bank account. The decision to finance loans occurs both at the social fund headquarters and at other social fund branches, sections, and intermediaries. Microfinance programs are managed at either specialized branches or special sections in the headquarters. Social fund staff engaged in micro lending generally have limited exposure to microfinance practices and management. Microfinance procedures are mainly performed at the social fund's offices and rarely at the client location. Loan processing usually takes at least 15 days, with the upper limit ranging between 30 to 60 days. However, the number of annual loans processed by social funds ranged between 100 and 500 loans.

The MFP of the surveyed social funds was less than SD 50 million and the microfinance component constituted from 76 to 100 percent of the total organization portfolio. However, the total number of credit and grants program beneficiaries of the different social funds in 2001 was 1.94 million (Rajivan and Abukasawi, 2002) which is just 6 percent of the population. In 2001, the SDF extended SD 85.1 million in the form of individual loans, to 748 small businesses and SD 15 million to 9 group businesses (685 beneficiaries). During the period from 2000 to 2002, the NPF provided a sum of SD 473 million as loans to 4,044 pensioners and their families to establish small businesses. Khartoum State accounted for almost 60 percent of these loans. Within the past year, social funds like the SDF have demonstrated remarkable efforts to replicate ideas from successful projects like the UNDP-funded UPAP in Khartoum, and have expanded their activities by learning from previous field experiences.

Rural development projects' microfinance programs offered a variety of products in 2004, including group lending (28 percent of loans), individual lending (68 percent of loans), and community investments (4 percent of loans). Some rural development projects financed a variety of economic activities, including agriculture; services; petty trade; processing; and handicrafts/cottage/artisan activities. One rural development project financed only agricultural activities. Most of the lending programs provided finance to both new and existing enterprises, while only one project financed only existing enterprises. Moreover, loans were provided for both fixed assets and operating or working capital, with the exception of one project that financed fixed assets only. Mobilization of savings remained a core element of three studied rural development projects, one of which included optional savings mobilization. Nevertheless, one project did not consider savings mobilization. Although savings are considered an important aspect of these projects, clients still resist savings, indicating a lack of awareness or savings advocacy programs.

Repayment or loan installments were generally on a monthly basis. The rural development projects offered a variety of different loan sizes. Loan ceilings for individual enterprises ranged from less than SD 50,000 to more than SD 200,000. The credit ceiling for loans to group enterprises ranged between SD 1 million to 6 million. Rural development project credit programs utilize a variety of guarantees or collaterals; the most common being the group guarantee (group pressure and peer monitoring) and the third partner guarantee.

In cases of loan default, the survey results reveal that most of the rural lending programs resorted to rescheduling the debts and the projects took action against the defaulters in less than three months. However, the percentage of defaulters who were required to reschedule their loans was low, ranging between 25 and 50 percent of defaulters.

The credit instruments most commonly used by the rural development projects are Murabaha, Musharaka, and Quard Hasan. The process of loan disbursal includes a sound feasibility study and criteria such as an acceptable guarantee, certificate or accreditation, and a current bank account. The decision to finance loans occurs both at the rural development project's headquarters and at other project branches, sections, and intermediaries. Microfinance programs are managed at either specialized branches or special sections in the headquarters. Micro-lending staff generally has limited exposure to microfinance practices and management. The duration of loan processing usually takes at least 15 days with the upper limit ranging between 30 to 60 days, depending on the methodology used in client approval. However, the number of annual loans processed by rural development projects generally ranged between 100 and 500 loans (one project disbursed more than 1,500 loans).

The MFP of three surveyed projects was SD 50 million. However, other programs include projects that vary in their portfolio ranging from SD 50 to 250 million. This variation depended mainly on the component of rural finance budget. This microfinance component of three rural development projects constituted from 76 to 100 percent of the project's total portfolio, whereas the MFP of one project comprised 25 to 50 percent of the total project portfolio. Some rural development projects have recently experienced large increases in their lending portfolios. For example, the lending portfolio of the NKRDP has increased considerably from SD 104.41 million for 2,568 beneficiaries in 2003 to SD 264.91 million for 3,313 beneficiaries in 2004. This important increase can be attributed to the continuation of village development committees and sanduqs as financial intermediaries between the Agricultural Bank of Sudan (ABS) and beneficiaries. The main factors limiting outreach are the shortage of planned budget funds and the ineligibility of clients who cannot satisfy the basic loan requirements.

The majority of the banks surveyed offer both individual and group loans for both new and existing enterprises, but utilize a variety of lending methodologies. More than 70 percent of the banks delivering microfinance services provide individual and group lending services. Despite the fact that group lending has proven successful worldwide in taking advantage of group liability, 28 percent of the banks surveyed have limited their microfinance lending operations to individual lending, and all specialized banks focus on individual lending only.

The *murabaha* contract is the most common mode of financing used by all banks, and 34 percent use it exclusively in microfinance. According to interviews with bank officials, the *murabaha* contract is preferred by both banks and clients. Banks regard it as less risky because the investment risk is the sole burden of the client as opposed to *musharaka* or *mudaraba.* The survey revealed that 18.8 percent of banks use both *murabaha* and *musharaka* (partnership) and 18.8 percent use both *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*). With the exception of one of the 32 banks surveyed, the speculation form (*mudaraba)* is never used by banks as the risk is wholly borne by the bank and client is not affected by any failures.

While the majority of banks (56 percent) offer savings services for their microfinance clients, savings are not considered a prerequisite for borrowing in most banks. Furthermore, according to the survey, only two banks require compulsory savings.

The following is a description of the main features of the micro-credit programs of the surveyed banks in terms of loan size and collateral. The majority of banks (70 percent) extend loans to both individual and group enterprises. Loan sizes for individual lending range from SD 500,000 to SD 100,000,000 for the majority of banks. With regards to group lending, 3.1 percent of banks have loan limits that are less than SD 1,000,000.

Moreover, 18.1 percent of banks have loan limits between SD 1,000,000 and SD 3,000,000; while 6.3 percent of banks have loan limits between SD 3,000,000 and SD 6,000,000; and 72 percent of the banks do not specify ceiling limits for group loans. No major differences exist between commercial banks and specialized banks in terms of average loan size for both individual and group loans.

The average number of microfinance loans and the total lending portfolio of both commercial and specialized banks are small when compared to other types of MFIs. A majority of banks (62.5 percent) provide fewer than 100 microfinance loans per year. 21.9 percent of banks provide between 100 and 500 loans per year and 15.7 percent of banks offer more than 500 loans per year. Commercial banks typically offer fewer loans than specialized banks: 94.7 percent of commercial banks offer fewer than 500 loans per year while 69.2 percent of specialized banks offer fewer than 500 loans per year.

According to CBOS statistical records, the volume of microfinance lending has increased by more than 30 percent, from SD 3 billion to more than SD 4 billion between the years 2003 and 2004. Despite this considerable increase, to date microfinance lending has not exceeded 1 percent of the total volume of finance of most banks, with the exception of the Savings and Social Development Bank, the Exports Promotion Bank, the Nelien Bank and the Agricultural Bank of Sudan. In terms of the size of the microfinance portfolios of individual banks, 31.3 percent of banks have a microfinance portfolio of less than SD 50 million; 31.3 percent of banks have a microfinance portfolio ranging from SD 50 to SD 250 million; and 34.4 percent of banks have a microfinance portfolio larger than SD 500 million. No significant differences exist between commercial and specialized banks with regards to average portfolio size.

In comparison to their total lending portfolios, the microfinance portfolios of the surveyed banks are relatively small. In 59.4 percent of banks, the microfinance lending portfolio is less than 25 percent of the total lending portfolio. In general, commercial banks tend to have smaller microfinance lending portfolios (relative to their total lending portfolio) than specialized banks. 73.7 percent of commercial banks have lending portfolios for microfinance that are less than 25 percent of their total lending portfolio. Table 5 presents the number of microfinance loans and the proportion of the microfinance portfolio to the total lending portfolio during 2003 and 2004 for some of the banks included in the MFI survey.

Table 5: Sudanese Banks and Microfinance

Banks	**No. of Microfinance Loans**		**Microfinance/Total Finance (%)**	
	2003	**2004**	**2003**	**2004**
Agricultural Bank	653	864	0.82	1.14
Bank of Khartoum	15	5	0.02	0.00
Nelien Bank	1.995	1.019	3.65	2.24
Savings and Social Development Bank	2.618	5.426	29.02	29.88
Development Cooperative Bank	32	51	0.09	0.13
Sudanese French Bank	36	9	0.17	0.02
Al Ahli Sudanese Bank	37	46	0.40	0.60
Tadamon Islamic Bank	23	14	0.04	0.02
Sudanese Islamic Bank	160	140	0.65	0.50

AlBaraka Bank	55	60	0.08	0.05
Export Development Bank	150	125	5.36	3.64
Saudi Sudanese Bank	-	-	0.01	0.00
Workers Bank	55	33	0.61	0.19
Northern Bank	56	99	0.47	0.63
Real Estate Bank	-	1	0.00	0.01
Farmer Commercial Bank	1547	1.740	1.00	0.55
Animal Resources Bank	54	24	0.09	0.05
Omdurman National Bank	140	54	0.03	0.01
Ivory Bank	-	4	0.00	0.12
Gadaref Investment Bank	2	-	0.04	0.00
Total	**7,628**	**9,444**		

Source: Central Bank of Sudan

The prevailing type of loan guarantee applied by most banks is the personal guarantee followed by the group liability for group lending as collateral substitutes. Real estate is also used as collateral for microfinance loans from banks if it is available. Other types of non-traditional collateral include business equipment purchased with the loan as well as other assets that are pledged through ownership documents. It is very important to mention here that the personal guarantee system, which is the most common form of collateral used by banks, is limited by the fact that a third party with the specifications required by the bank to be a trusted guarantor may not be available to most microfinance clients.

According to the survey, 50 percent of banks offer loans with a duration of one year or less. However, commercial banks tend to offer shorter-term loans while specialized banks tend to offer longer-term loans. Most commercial banks (73.7 percent) offer loans with a duration of between 6 to 12 months. On the other hand, 53.8 percent of specialized banks offer loans with a maturity period of 18 months or more.

Overall, 65.6 percent of the banks use lending incentives systems to reward good clients, with the objective of retaining clients, improving the performance of their lending portfolios, and minimizing costs; 76.9 percent of specialized banks and 57.9 percent of commercial banks implement incentive schemes. The incentives systems comprise stepped loan systems, training in small business management, short lending procedures and priority for repeat loans.

In the case of loan default, all banks follow the standard delinquency procedures. With regards to commercial banks, 15.8 percent resort to rescheduling without taking legal action, 21.1 percent take legal action, and 42.1 percent use a combination of rescheduling and legal action. With regards to specialized banks, 38.5 percent resort to immediate rescheduling without taking legal action and 46.2 percent use rescheduling or partial exemptions after instituting legal action; 75 percent of banks start to take legal action against defaulting clients within 3 months while very few banks resort to partial exemptions before taking legal action. In 2004, 55.6 percent of the commercial banks and 40 percent of specialized banks took legal action against less than 25 percent of their clients, which reflects their leniency in dealing with clients

With regards to loan disbursement procedures, 72 percent of banks process loan applications and disburse loans for approved applications in less than 15 days, while 28 percent of banks take between 15 to 30 days, which is a relatively long time when compared to microfinance best practice. The primary reason for not approving loan applications is related to meeting internal lending terms and conditions, followed by shortage of funding. For 90.6 percent of banks, loan decisions are taken at the bank's premises without visiting loan applicants or their guarantors in their business locations to observe the businesses' performance or inquire about their character. This could be one of the factors that leads to high portfolio at risk ratios. For a majority of banks, loan eligibility requirements include possession of a current account, the provision of acceptable collateral, a business license, and/or proof of the financial feasibility of the enterprise to be established.

3.2.5 Financial Resources

Most MFIs rely on donor funding to support their lending operations. However, the social funds are able to mobilize community contributions and receive government support in addition to donor funds. 33.3 percent of NGOs responded that their resources come mainly from foreign donors while 41.7 percent of NGOs cited foreign donors and client savings as the source of their funds. According to the findings of interviews held with senior managers of MFIs, few NGOs have adequate plans to augment or sustain resources. Funds provided by foreign donors are, in most cases, linked with specific projects, for a specific life span. It is observed that, in a large number of cases, microfinance programs collapse once the donor phases out.

The total resources of the social funds increased from SD 2,427 million in 1995 to SD 33,141 million in 2001. Sources of funds or capital for the social funds in the study included government, international donors, and client deposits. The SDF is financed by the State Ministry of Finance (SMOF), community contributions, loan repayments and some international donors, including UN agencies. Of the SDF's total budget of SD 412.3 million in 2001, SD 239.5 million (58 percent) was contributed by the SMOF, SD 104.2 million (25 percent) was from community contributions (cooperative societies), SD 53.6 million (13 percent) was funded by loan repayments, and SD 15 million (4 percent) was contributed by zakat donations. The diversity of capital sources is a factor that can contribute to both the efficiency and the sustainability of the lending programs of social funds if best practices are adopted with regards to financial operations.

Sources of funds or capital for the rural development projects in the study included mainly international donors, government, loans of co-financers and client deposits. Diversity of funding sources is needed to improve the efficiency and sustainability of these microfinance programs.

Banks primarily rely on deposits and savings to fund their microfinance lending operations. According to 2003 statistics, the total assets of commercial banks in Sudan stood at around SD 790 billion, out of which SD 16 billion are the combined assets of the three government-owned specialized banks (the Agricultural Bank, the Real Estate Bank, and the Savings and Social Development bank). Total deposits reached SD 500 billion in 2003, of which 69 percent were current account deposits. In terms of utilizing the deposit base, only 40 percent are used for lending (32 percent for local trade, and around 12 percent each for agriculture, industry and exports).

Of the banks surveyed, 44 percent depend on bank deposits as a source for financing their microfinance operations. However, given the non-systematic and unpredictable nature of bank deposit fluctuations, it is difficult to depend on them as a major source of funding in microfinance. The survey results indicate that savings are a secondary source of funding to support other forms of bank funding for microfinance lending. Better planning is needed to identify more reliable sources of funding. Savings deposits should be a primary source of funding for microfinance operations and banks should take effective measures to provide attractive savings products that mobilize voluntary savings. Furthermore, private sector banks have a high potential for engaging in MF provision - given the large amount of deposits that they have - provided that they recognize the lucrative potential of engagement with this sector.

3.2.6 Operational and Financial Sustainability

In terms of the operational and financial sustainability of MFIs in Sudan, the fact that they do not charge the real cost of the loan in addition to the low repayment rates of their clients diminishes the working capital of these credit programs, which threatens their long-term operational and financial sustainability.

With regards to the loan repayment system of NGOs, the repayment of individual loans is made on monthly basis for 75 percent of NGOs while other loan programs require repayment every 1to 2 weeks (17 percent of NGOs). In 8 percent of cases, repayment dates are determined according to the nature of activity.

The record of NGOs/CBOs with respect to loan repayment rates, is relatively poor. For 42 percent of the NGOs, the repayment rate is in the range of 51 to 75 percent; while it ranges between 76 and 100 percent for the remaining 58 percent. Portfolio at risk is less than 10 percent for 58.3 percent of NGOs; 10 to 25 percent for 33.3 percent; and more than 50 percent for 8.3 percent. This indicates a high risk, as 41.6 of NGOs have a PAR of more than 10 percent. Even those rates above 5 percent are not advisable; however, the survey did not determine the exact figures between 5 and 10 percent.

In addition, the profit margin of NGOs is low. Around 50 percent of organizations charge a profit margin in the range of 1 to 2 percent per month, while 25 percent only charge a commercial rate of 3 to 4 percent per month; 8.3 percent of NGOs provide interest-free loans. Among the surveyed NGOs, 8.3 percent charge less than 1 percent profit margin per month, 58.3 percent charge between 1 and 3 percent, and 25 percent charge 3 to 4 percent. According to the NGOs who have separate costing systems, the earnings from profit margins charged on loans cover 80 to 100 percent of the administrative costs; for 20 percent it covers 60 to 79 percent; and for the remaining 40 percent it covers less than 40 percent.

It is important to mention in this respect that the availability of funds represents the main problem hindering the expansion of NGO coverage; 50 percent of organizations stated the main reasons for not responding to all loan applications are either lack of funds (33 percent) or failure of clients to meet loan conditions (17 percent). The remaining 50 percent cited a combination of reasons. It is worth noting that subsidized credit and interest-free loans (which survey findings revealed to represent 16.6 percent of loans, may endanger financial sustainability.

The average repayment rate of loans disbursed by social funds was 75 percent, although repayment rates among the social funds range between 50 and 100 percent**.** However, repayment rates for social fund loans have steadily increased since the 1990s. For example, the repayment rate for SDF loans, which was just 13 percent in 1998, rose to 89 percent in 2004.

The social funds in the sample showed that they are working with a profit margin of less than 1 percent. This means that they are working with subsidized credit and this may undermine economic development. The profit margins of some social funds covered only 80 to 100 percent of the costs of the lending program. However, some social funds showed excellent levels of financial self-sufficiency as their profit margins exceeded their costs by more than 100 percent. According to the results of the survey, financial efficiency indicators like PAR had a value of less than 10 percent. This is a reasonable value and it reflects an adequate efficiency level given the status of best practice requirements and the experience of the social funds.

The repayment rates of the different rural development projects varied greatly. The average repayment rate for these lending programs ranged between 76 and 100 percent. However, one project faced extremely low repayment rates that ranged between 25 and 50 percent, due to the use of subsidized loans and the lack of commitment on the part of the borrower.

According to the survey results, rural development projects in the sample generally work with a profit margin of between 1 to 3 percent. One project in the survey is working without a profit margin, which indicates the use of subsidized credit. However, some rural development projects have achieved very high levels of financial self-sufficiency as their profit margins exceeded their costs by more than 80 to 100 percent. Financial efficiency indicators like PAR showed a value of less than 10 percent for three rural lending projects and between 10 and 25 for the fourth project. Around 10 percent is a reasonable value and reflects a standard efficiency level given the status of best practice requirements and the experience of the rural development projects.

With regards to bank loan repayment systems, the type of business and cash flow pattern of the financed business, rather than lending methodology (i.e. individual versus group lending) determine the loan repayment period (52.4 percent of commercial banks and 76.9 percent of specialized banks determine the repayment period for individual loans based on the type of activity); and 47.5 percent of commercial banks and 23.1 percent of specialized banks set the repayment period at one month. For group loans, on the other hand, 36.8 percent of commercial banks and 23.1 percent of specialized banks set the repayment period at one month; and 63.2 percent of commercial banks and 76.9 percent of specialized banks determine the repayment period for group loans based on the type of activity.

Repayment rates are above 50 percent for 88 percent of banks. While most banks perform better than NGOs in terms of portfolio at risk (PAR), PAR levels remain quite high. Only 35 percent of banks have zero portfolios at risk; 35 percent have a portfolio at risk of between 1 to 10 percent; and 30 percent of have a PAR of between 10 and 18 percent. The high ratio PAR discourages new banks from entering the microfinance market and discourages operating banks from expanding their services in terms of lending volume and outreach.

Moreover, bank profit margins are low. Most of the banks surveyed (93.8 percent) charge monthly profit margins that are less than or equal to a 2 percent flat monthly rate, which is low compared to that of commercial lending. Both the commercial banks and specialized banks use low profit margins. From the total banks surveyed, 72 percent do not estimate the cost of administering microfinance lending operations. In general, specialized banks are less concerned with the issue of costing compared to commercial banks; 92.3 percent of specialized banks do not estimate the cost of administering lending operations and 57.9 percent of commercial banks do not estimate their costs. Of those banks that do estimate their microfinance lending costs, 77 percent are realizing a profit margin of 40 percent.

The gender balance among the staff of NGOs, social funds, rural development programs, and banks reflects an emerging awareness of gender equality and the importance of including women as micro-lending clients. Females represent half the staff in 75 percent of the NGOs in the study. Similarly, women comprise between 25 and 75 percent of the staff in social fund lending programs. In 78 percent of the banks, 50 percent of the staff are women. However, rural development programs hire relatively fewer women, as only 25 to 50 percent of their staff are women.

3.2.7 Networking and Institutional Linkages

Networking and institutional linkages among different MFIs contribute to institutional learning within the MFIs as they gain knowledge and information from the experiences of other organizations. The social funds in Sudan have a number of unique linkages with other organizations and governmental entities. The SDF operates in close coordination with the State Ministry of Social and Cultural Affairs and local government bodies. The SDF acts as a counterpart for donor-funded poverty-alleviation projects implemented in the state (e.g. UPAP). To mobilize popular grass-roots participation, the SDF assisted in registering 185 cooperative societies which are expected to act as social development intermediaries. In addition, the SDF covers 7 localities and 38 administrative units through its 7 field offices. The SDF also supervises a number of social centres which are used for conducting training for targeted clients.

The rural finance components of the rural development projects in the sample belong to a project network. Their institutional linkage is guaranteed through project financiers like the International Fund for Agricultural Development (IFAD) and the Food and Agriculture Organization of the United Nations (FAO) together with other sponsors including the Government of Sudan. The government further facilitates the institutional linkages of the projects with relevant stakeholders at different levels throughout related ministries. The project management units also endeavour to network the project components horizontally and vertically both nationally and internationally.

As opposed to other MFIs, banks have not established networking and organizational linkages with other institutions that provide microfinance lending. With the exception of sharing information regarding client history, surveyed banks lack a well-established information network or links with regional and international microfinance networks for the exchange of information and experiences.

3.2.8 Summary and Conclusions

As far as microfinance is concerned, both local and foreign NGOs act as community focused grass-roots operations rather than formal lending institutions. They have been working directly with communities and CBOs and adopting more flexible methods in trying to use 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. Rural development projects focus their efforts in rural communities that have suffered from civil strife and natural disasters such as drought. The social funds and rural development projects target specific niches of clients according to their particular mandate, although some of the projects are expanding their scope to target the poorer segments of society. Commercial banks and specialized banks have recently entered the microfinance market in accordance with CBOS regulations, which stipulate the allocation of 10 percent of the annual lending ceiling of any bank to microfinance. While bank micro-lending programs offer loans to craftsmen, professionals, and small enterprises and producers, a large percentage of banks do not specifically target the poor.

Success has varied considerably among MFIs, according to the variation in approach and the level of financial discipline adopted by each. With regards to NGOs, some NGOs found it difficult to change from a '*beneficiaries*' oriented approach to a '*clients*' based approach, i.e., shifting from grants to credit. The shift from grants to a market oriented approach was resisted not just by the target recipients alone, but by some NGO staff as well. (Oxford Committee for Famine Relief (OXFAM) and PLAN Sudan provided grants; SOS Sahel International and the Governance Project provided subsidized credit; and the Agency for Cooperation in Research and Development (ACCORD), the Adventist Development and Relief Agency (ADRA), UPAP, and PASED provided market-based credit (see Annex C for a description of the PASED success story). This indicates that difficulties in the transition of MFIs to formal business concerns could be faced by NGO staff themselves. However, varying levels of financial discipline were found among all MFIs in Sudan, including banks, social funds, and rural development projects. According to the results of the MFI survey, the majority of microfinance providers apply a profit margin of only 1 to 3 percent per month. From this, it could be concluded that with a few exceptions, the majority of microfinance providers offer subsidized loans which affect their sustainability. In addition, the primary focus of the social funds is providing charity or grants, making the transition to more market-based approaches to microfinance more difficult. In order to tackle such an impediment, there should be a gradual process of exposing MFIs currently active in the field to microfinance best practices in neighbouring countries. Another factor is to establish an acceptable minimum level of performance for an NGO to qualify as an MFI.

One manifestation of the absence of a business approach in service extension is that most MFI operations are restricted in their geographical coverage. Moreover, there is a lack of knowledge among microfinance clients of available microfinance programs, particularly in rural areas. Most MFIs also lack adequate information about credit demand in the different geographic areas. Also, the economic and service infrastructure is not conducive for lending operations in most areas of Sudan. For many MFIs, the decision to work in one location over another is not based on the normal market targeting and penetration, but more on donor preference, which is a 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 a number of needs in the rural community, such as road construction, irrigation, health care needs, and environmental deterioration. While not dependent on donor funding for their microfinance programs, most bank operations are also limited in their geographic coverage due to their lack of extensive branch networks.

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 their programs and, more importantly, deprives local communities from access to financial resources that they were accustomed to, ultimately causing business disruption, and in some cases complete dissolution of micro enterprises. On the other hand, banks are not donor dependent and are able to utilize their own funds to finance their microfinance operations, which could contribute to the potential sustainability of their microfinance programs.

NGOs succeeded in responding to the credit needs of the poor at the grass-roots level by providing small loans, on short-term bases and adopting flexible collaterals and simpler procedures, suitable to target group conditions. They extended finance to a variety of activities, not confined to the so-called productive activities. Social funds were also successful in reaching the needs of their targeted clients, including pensioners and unemployed graduates. The lending programs of rural development projects achieved positive results in reaching a variety of enterprise owners in both the agricultural and non-agricultural sectors in rural communities. On the other hand, banks have achieved limited outreach to microfinance clients and have not adopted any specific criteria that target the poor. Almost all microfinance operations in Sudan are not linked with business advisory or support services, including training of the intended clients in business management and marketing, which would reduce the incidence of business failures among microfinance clients.

Due to the prevalence of relief culture among clients (particularly IDPs), poor financial discipline, lack of specializations and sometimes conflicting and different approaches adopted by NGOs, the financial performance proved to be rather poor, with the exception of a few organizations (e.g. PASED, Kassala Program of ACCORD and ADRA). The concepts of performance measurement indicators e.g. OSS, FSS etc, are only known to, and adopted by, a few organizations. Similarly, few banks have adopted mechanisms that estimate their microfinance lending costs. However, a majority of banks that estimate their microfinance lending costs are realizing a substantial profit margin.

NGOs and CBOs experienced a number of problems that negatively impacted on both their effectiveness and their efficiency. For example, the demolition or re-planning of squatter areas caused business instability and hence negatively affected the repayment of loans; the high poverty level among IDPs and prevalence of relief culture, sometimes diverted business money to consumption purposes or for meeting other urgent needs; the immobility of microfinance clients as a result of resettlement plans, or voluntary repatriation (IDPs); nepotism among association leaders and the dominance of some of them over their associations' affairs; and misallocation of resources and corruption. This is an important indication that different services are needed by different types of microfinance clients (micro enterprises, IDPs, and productive activities), and that these services vary according to the targeted group's socio-political situation. Accordingly, client needs, and methods of outreach and follow-up should change to cater to realities on the ground. Another indication is that NGOs may opt in the future to specialize in dealing with one group of clients or a specific geographical location that matches the organizational capacity of the MFI. All these areas points to a clear and present need for capacity building of NGO/MFIs to better utilize available resources and adopt microfinance best practices. In fact, all MFIs in Sudan should consider adopting microfinance best practices. Because most banks do not follow microfinance best practices in lending, the services provided by them are not in conformity with the special needs and characteristics of the targeted client, and accordingly, the applications of microfinance lending are unorganised.

Due to the absence of an apex microfinance body, and the different mandates of NGOs, social development funds, rural development funds, and banks, coordination between organizations is limited. Few have created platforms for coordination in the geographical areas where they operate. Also, there is a lack of information about the microfinance market in Sudan and the performance of different MFIs. The availability of studies and statistics which provide estimates of the volume of the microfinance market and its characteristics in the different geographic areas and sectors of the economy is central to the development of this sector. Some NGOs have created links with the formal banking system. However, this 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 to the poor by deploying formal financial resources.

CBOs at the grass-roots level complain that their clients, who are engaged in micro and small enterprises, are harassed by the local municipal authorities that ask for licenses, taxes, fees, etc. The local authorities in a number of cases confiscate the assets that were procured through credit from these organizations. At the macro level, the government became concerned about poverty reduction and has launched several initiatives to encourage financing of the economically active poor. In addition, CBOS policies that mandate banks to use a large percent of their finance in social development are an encouraging factor in the development of bank microfinance programs. However, it is not enough for the government to issue supportive policies to encourage small businesses or banks, it is more important that these policies filter down to the smallest administrative unit.

The consultants observed that there are no institutional credit guarantee systems operating now in Sudan except for one that is offered by an individual borrower. Guarantees are needed to support microfinance operations and are distinguished at two levels. The first level is the "portfolio" guarantee approach whereby the guarantor covers whole or part of the default of the MFI according to a specific agreement. This type is normally offered by a specialized institution "Credit Guarantee Fund/Facility/Company". The second level of guarantee is the one covering the "individual borrower" and is offered by an insurance company or in some cases, the MFI itself. The microfinance sector in Sudan will eventually need to develop an infrastructure for guarantee facilities. The portfolio guarantee will assist in leveraging MFI resources to reach more clients with a given level of available funds (financial leverage), while the individual borrower guarantee will lift the burden of loss of the business due to natural hazards, death, or disability of the borrower.

With regards to the institutional capacity of banks, a number of features of current banking practice reveal adequate institutional efficiency of banking institutions. This includes a large number of women employees that manage microfinance operations, the use of automated loan tracking systems, and automated loan repayment information. However, in general banks lack the requirements for achieving financial and operational efficiency in their microfinance operations. Banks lack a compulsory savings program, access to government sources of funding, and a market-based profit margin that would contribute to their financial efficiency. Moreover, banks lack an adequate volume of funds earmarked for microfinance and a mechanism of credit cost estimation that would contribute to their operational efficiency.

In addition, there is a profound need, felt at different levels among concerned MFI staff for recruiting qualified credit and micro enterprise specialists to handle small business and microfinance operations and improve their institutional capacity. NGO staff expressed their desire to have access to capacity building and training services in order to be able to cater to clients' needs. While microfinance best practice favours operating in a commercial manner, even for acquiring capacity building and training services, it has been demonstrated in other countries with a good track record of microfinance performance that donor agencies played an instrumental role in assisting young and promising MFIs to provide a living example of the profitability of microfinance, thereby enticing formal financial institutions to enter into the sector. Sudan can benefit from the experience developed over decades in other countries which has clearly demonstrated that banks (adopting microfinance best practices) can have much greater impact than NGOs when it comes to market penetration and service diversification.

Finally, and with regards to product diversification, the experience of Sudanese NGOs, and some social funds, rural development projects and banks, shows that microfinance could also be used as a tool for financing community services. This is a whole different market for services that meet a public need or provide direct benefits to local communities. This includes showers, access to potable water, electricity, butane gas, and so on. These types of projects could be owned by a number of people and run on a profitable basis. This could be a needed entry point for formal financial institutions (banks) since they are more able to structure loans with relatively higher amounts and longer tenors than non-bank MFIs.

PART 5: RECOMMENDATIONS

Microfinance originally evolved as an economic development approach intended to benefit low income women and men, and it is particularly relevant as a tool for poverty alleviation in light of the fact that international experience has demonstrated that a small amount of money can have a significant impact on the lives of the poor. Furthermore, microfinance practitioners have realized that the economically active poor have great potential, and have gradually adopted a market-oriented approach, based on treating the poor as bankable clients.

The situational analysis of the microfinance sector in Sudan has identified 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 poverty alleviation in its policies. The following recommendations are suggested for further development of this nascent microfinance industry.

5.1 Outreach

A growing concern toward poverty alleviation has been developing during the last few years in Sudan, as reflected by the establishment of several social funds and specialized institutions (such as the SSDB and the SDF) and the launching of several poverty alleviation initiatives. The establishment and implementation of microfinance programs in Sudan is one component of poverty alleviation efforts among social funds and NGOs. Microfinance can be a potent tool to leverage supplementary inputs from communities themselves, the state, formal financial institutions, civil society actors (NGOs, international agencies) and even the private sector, to combat poverty. However, outreach to the poor is still limited among many microfinance institutions. In particular, banks have little experience in fieldwork and few links with grass-roots or community based organizations (CBOs), which limits their outreach to potential clients. Generally speaking, the procedures and requirements of loans 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. Further efforts to define the target group of beneficiaries, conduct needs assessments, diversify products, and increase the network of MFIs would contribute to greater outreach to the economically active poor and enhance poverty alleviation efforts in Sudan.

5.1.1 Definition of Target Group

Absence of a satisfactory definition of poverty and methods of identification of the poor (the microfinance clients) has inhibited credit flows to the poorer, excluded sections of the population. Among NGOs, the decision to work in one location over another is not based on the 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. 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 on a precise definition of who the poor are, there has been a tendency to exclude the worst off and restrict credit access based on traditional interpretations of 'productive' families. It is essential for MFIs to agree upon criteria for identification of the poor, particularly the enterprising poor. As poverty is a multi-dimensional phenomenon, a set of indicators (as against just one, like income) should be short-listed to identify the poor. Local variations on criteria should be considered and rural and urban indicators may differ.

5.1.2 Needs Assessment

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 target populations according to their particular mandate. Efforts exerted by banks to provide microfinance depend entirely on individual bank initiatives and perceptions about the targeted sector. 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, may opt in the future to specialize in dealing with one group of clients or a specific geographical location that matches its organizational capacity. As women comprise a large share of microfinance clients, gender sensitivity should be employed when designing needs assessment tools.

5.1.3 Diversification of Products

5.1.3.1 Consumer Product Level

An assessment of the microfinance sector in Sudan has indicated that different types of services and products are needed by clients (micro enterprises, IDPs, and productive activities). 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. Mobilization of savings would not only provide a needed service to clients but would also serve as a major source of funding for the microfinance operations of banks.

The development of new products and services should vary according to the targeted group's socio-political situation. Recognizing the legitimacy of pressing household needs for consumption and emergencies is necessary. All poor households have priorities other than using funds for income generation; these include treating illness, schooling, construction of lodging facilities, and cultural ceremonies. Unless there is an explicit provision for funding consumption and other emergency needs, credit provided for micro enterprises is likely to be diverted to these pressing requirements, given that money is fungible. Pooled community savings should be used initially for servicing such household needs. Opportunities also exist for the provision of suitable micro-insurance to targeted groups either by NGOs or by a specialized insurance company, shadowing the experience of other African countries. MFIs also need to consider the particular needs of women when developing new microfinance products. With respect to microfinance in rural areas, rural financial policy in general should promote the development of a variety of financial intermediaries to meet the specific demands of a broad spectrum of clients, including farmers, and agribusiness entrepreneurs, among others. In particular, support could be given to the experimentation and promotion of innovative and appropriate financial technologies and products for rural clients.

5.1.3.2 Community Project/Service Level

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 might 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 their basic needs such as electricity, water, health services and energy on cost-recovery basis seems possible, however a thorough needs study should be conducted before designing such products. 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 tenors than non-bank MFIs.

5.1.4 Increase Network of MFIs, Especially Banks

The formal banking system, as it is structured at present, is not designed to serve the finance needs of the poorest in society. 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. In order to improve credit access and improve regional balance, the bank branch network needs to be expanded. While the establishment of new branches is a business decision of the banks, it is recommended that: (a) banks could initiate further microfinance programs by identifying specific branches out of the existing ones that could accommodate the establishment of a microfinance unit; (b) additional bank branches could be opened as banks gain experience in the microfinance sector and as new business opportunities for lending to credit-worthy CBOs are created; (c) banks should consider investigating low cost outreach options like working through credit kiosks, establishing mobile banking services, and employing local, part-time personnel; (d) NGOs and CBOs can be used by banks as intermediaries for field on-lending operations and can also function as semi-banks or non-bank financial intermediaries; and (e) banks should provide specialized training to staff members that interact with poor clients, such as orientation on creating a user friendly atmosphere and treating the clients with respect. Bank management should also create open channels of communication with these staff members in order to solicit their views for making system improvements.

5.2 Supportive Infrastructure

5.2.1 Capacity Building

Lack of exposure to worldwide microfinance good practices coupled with 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. Recently, the SDF, in collaboration with the Microfinance Organizations Network (MON) and ACORD, has organized and implemented awareness and training on microfinance for bank middle managers (directors of investment sections) from 12 branches of Omdurman National Bank and the Savings Bank (SSDB). However, current capacity building efforts are not sufficient. There is a clear and present need for capacity building of MFIs to better utilize available resources, cater to client needs more appropriately, and adopt microfinance good practices in business planning.

The training and experience of the personnel in commercial banks, as it prevails at present, 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. Banks feel it is not their job to go about identifying and helping the poor. An often voiced opinion is that such work is more appropriately done by Government or NGOs. In addition, there is a lack of exposure to and training in microfinance facilitation and management among bankers. Moreover, the lending procedures followed by banks are conventional and are not tailored to the conditions of the microfinance clients. For example, clients must open and activate a bank account before receiving a loan; borrowers are required to issue post-dated cheques for loan instalments; and they have to provide adequate and conventional collateral. Many of these lengthy procedures do not facilitate the quick disbursal of loan funds to clients.

With regards to institutional capacity of NGOs, concerned NGO staff at different levels expressed a great need for recruiting qualified credit and micro enterprise specialists to handle small business and microfinance operations. To that end, greater access to capacity building and training services would enable NGOs to better cater to clients' needs. Success has varied considerably between NGOs, according to the variation in approach and the level of financial discipline adopted by each. Some NGOs found it difficult to change from a 'beneficiaries' oriented approach to a 'clients' based approach, i.e., shifting from grants to credit. The shift from grants to a market oriented approach was resisted not just by the target recipients alone, but also by some NGO staff. In order to tackle such an impediment, there should be a gradual process of exposing MFIs currently active in the field to microfinance best practices in neighbouring countries.

Staff and management of social funds that have adopted micro lending programs lack exposure to and training in microfinance facilitation and management and have limited experience in management information systems that provide timely and accurate information for monitoring and evaluation of the progress and financial soundness of the microfinance program. One main constraint of the microfinance programs of social funds is the perception of these funds as a "support fund" and the widespread belief that the loan is a gift, as indicated by low repayment rates.

Rural development projects currently operating in Sudan extend microfinance as part of an integrated community development package. Although they use credit as a tool for poverty alleviation, they have achieved limited and varying levels of success in their microfinance activities. Their efficiency in delivering market-based lending is adversely affected by their scarce resources, narrow market scope and limited investment potential. The predominance of the grant culture and the tendency of some rural development projects to extend grants, profit-free loans, and subsidized credit have adversely affected their financial performance. The staff of these projects lacks specialized skills and adequate training in credit, small business management and microfinance in particular. No emphasis has been made on savings mobilization or inclusion of consumption loans in their packages.

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 cost-effective and 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 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. The federal government could 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, based on emerging needs.

In order to provide effective capacity building to MFIs, a cadre of potential qualified 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 and the Bank of Sudan 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, different financial products, repayments, monitoring mechanisms, and auditing.

Furthermore, capacity building efforts need to be directed to other important stakeholders to raise their awareness about the concept of microfinance. The thinking among stakeholders at middle to higher levels in some government agencies and NGOs with respect to addressing the problem of poverty is observed to be dual: charity on the one hand versus financial discipline-based credit linkages on the other. It is necessary to increase stakeholder awareness about the incompatibility of charity as a component of a microfinance policy to ensure the sustainability of the microfinance sector. Awareness campaigns should be developed and implemented to mainstream the understanding that there does not have to be a contradiction between profits and services to the poor, in order to change stakeholders' perceptions about the credit worthiness of the poor. In order for microfinance services to be available on a wider scale across the country, a cadre of professionals should be trained at the policy, managerial and implementation levels. These persons should be drawn from all states so that local skills and capacities are built, ensuring that managers who are well trained in microfinance work and have a pro-poor orientation are in charge of the operations in the state agencies. In addition, it is also recommended that all professionals joining the financial services sector undergo at least a basic course in microfinance by making it a normal part of their required training.

5.2.2 Microfinance Associations and Other Institutions of Information Exchange

With the exception of the experiences of a few international NGOs and the SDF initiated MON, there is limited exposure and 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 on the microfinance sector in Sudan are not available. The creation of national and state microfinance associations (MFAs) for the exchange of information and experiences will help promote the development of the microfinance industry in the country. Additionally, the capacity of the MON should be strengthened as a pioneer network of civil society microfinance organizations network. The MON could play an important role in the future in raising awareness on microfinance, and in the training and capacity building of its members and others from similar organizations.

Exposure to new ideas and experiences, and the sharing of opportunities would help MFIs to continuously refine strategies and operations and find solutions to implementation problems. These MFAs should foster the exchange of information and experiences as well as carry out joint activities of mutual interest. Key areas that these MFAs should focus on include:

- Setting industry standards (including minimum acceptable performance levels and measurable indicators);
- Developing best practice strategies appropriate for the country;
- Organizing field visits to successful MFIs within and outside the country;
- Advocating microfinance with state and national governments;
- Facilitating experimentation of new products and services, especially those targeted to Small farmers and other rural, low-income people;
- Organizing technical workshops on key microfinance topics; and
- Supporting further research and surveys that describe current picture of the status of the microfinance sector.

In particular, MFAs could establish an acceptable minimum level of performance with a set of "objectively verifiable indicators" to be used as a barometer against which any type of organization will be judged to qualify as an MFI. Such indicators are necessary due to 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. MFAs could promote 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, which are only known and adopted by few organizations.

5.2.3 Apex Organizations

There are no institutional credit guarantee systems currently in operation in Sudan, except for the credit guarantee offered by individual borrowers. Guarantees are needed to support microfinance operations and are distinguished at two levels. The first level is the "portfolio" guarantee approach whereby the guarantor covers all or part of the default of the MFI according to a specific agreement. This type is normally offered by specialized institutions known as "Credit Guarantee Funds/ Facilities/ Companies". The second level of guarantee is the one covering the "individual borrower" and is offered by an insurance company or in some cases, the MFI itself. The microfinance sector in Sudan will eventually need to develop an infrastructure for guarantee facilities. The portfolio guarantee will assist MFIs in leveraging their resources to reach more clients with a given level of available funds (financial leverage), while the individual borrower guarantee will lift the burden of business loss due to natural hazards, death, or borrower disability and provide a partial or whole guarantee for the creditor.

5.2.4 Umbrella Agencies

Coordination between organizations with different mandates (banks, NGOs, social funds, and rural development projects) is 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 not based on a guided and planned effort to utilize formal financial resources and improve access to finance for the poor. The establishment of a central body or umbrella state-level agency would help to coordinate microfinance activities among the different MFIs and other microfinance stakeholders at both the federal and state levels. This umbrella agency should work in close coordination with the BOS to ensure that the needs and concerns of the banking sector are addressed. Alternatively, a central coordination unit within the BOS could be established to facilitate and coordinate the design of policies and regulations related to loan pricing and product design and to conduct performance assessments to ensure compliance with BOS regulations. This coordination unit should also encourage the private sector to implement specific activities and provide technical assistance to banks and other MFIs

Establishing an apex financing or re-financing agency, combined with setting standards, norms, definitions, and credit rating criteria (in consultation with the BOS) could provide guidance and strategic support to state level institutions. An existing organization/institution, such as the SDF, could be entrusted with the job rather than establishing a new one, however the decision on the selection and the approach of implementation should follow a thorough SWOT analysis. The capacity of such an organization should be strengthened so that it can function as a financing intermediary and benefit from the technical assistance provided by the International Monetary Fund (IMF) for microfinance initiatives.

5.3 Policy and Legal Environment

At the macro level, the central government has become concerned about poverty reduction and has launched several limited initiatives to encourage financing of the economically active poor. The most recent developments in governmental efforts to promote microfinance include increased financial support for both the Savings and Social Development Bank (SSDB) and the Graduates Employment Project (GEP), a microfinance project that targets unemployed university graduates. In addition, Khartoum State has declared 2006 as the year for microfinance and the State Ministry of Social and Cultural Affairs (MOSCA) issued a ministerial decree (No. 3 for 2006) announcing the establishment of a "Poverty Reduction Coordination Council" (PRCC) for Khartoum State. The PRCC is charged with designing general policies for poverty reduction, coordinating all poverty reduction initiatives, and promoting and developing microfinance. Furthermore, Khartoum State has allocated over one billion dinars for a microfinance funds scheme in its seven localities. However, supportive government policies to encourage small business are not sufficient; it is more important that these policies filtrate down to the smallest administrative unit. For instance, CBOs at the grass-roots level complain that their clients, who are engaged in micro and small enterprises, are harassed by the local municipal authorities that ask for licenses, taxes, fees, etc. The local authorities in a number of cases confiscate the assets procured through credit from these organizations.

At the federal and state levels, the objective of poverty reduction should influence macro policy, and approaches to decision making should be approached through the lens of poverty alleviation. Following the lead of the federal government, state governments should formally adopt poverty reduction on their political agenda. Federal and state governments should also place emphasis on developing an enabling environment that focuses on the development of stable macroeconomic policies and a favourable business climate that fosters investment opportunities for small and micro-entrepreneurs and farmers. Therefore, special attention is needed to foster private business development and the agricultural sector. In particular, policies should focus on making farming more profitable.

A study of the challenges facing the microfinance industry in general and MFIs in particular (banks, NGOs, social funds, rural development projects) should be conducted in order to gather timely and relevant data about the microfinance sector. This essential information will then guide the design of appropriate policies that address these challenges and promote the microfinance sector in the future. For example, in the area of regulation and supervision of financial institutions, bank regulators in Sudan should examine the merits of developing special licenses and a framework for non-bank financial institutions. This will allow smaller and more innovative financial intermediaries to operate in and develop products for market segments that are not well served by commercial banks. In particular, Article 2-C of the Bank of Sudan Policies circular, 2006, should be implemented and operationalized. This article calls for the Bank of Sudan "to expand banking services by continuing to design/ draft rules and principles to provide licenses to non-bank institutions/ organizations so they can perform financing intermediations functions and expand their outreach." Other innovative ideas in the area of financial regulation and supervision should include repealing counterproductive regulations, incorporating measures by which regulation and supervision can be enhanced by using market forces to promote accountability, and increasing the number of well trained supervisory staff. In addition, it is recommended that the government provide incentives to support national and community based NGOs to help build a network of credit worthy recipient organizations of the poor. Tax exemptions and official support for NGOs is recommended.

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ANNEX A: LIST OF ORGANIZATIONS SURVEYED

Khartoum State

No.	Name	Nature of Work
١	Farmers Commercial Bank	Specialized Bank
٢	Sudanese National Bank	Specialized Bank
٣	Sudanese Baraka Bank	Specialized Bank
٤	Omdurman National Bank	Bank
٥	Nileen Industrial Development Bank	Specialized Bank
٦	Sudanese Islamic Bank	Specialized Bank
٧	Workers National Bank	Commercial Bank
٨	Export Development Bank	Specialized Bank
٩	Alshamal Islamic Bank	Specialized Bank
١٠	Saudi Sudanese Bank	Bank
١١	Tadamon Islamic Bank	Specialized Bank
١٢	Saving & Development Bank	Specialized Bank
13	Sudanese Agricultural Bank	Specialized Bank
١٤	National Pension Fund	Social Fund
١٥	National Social Insurance Fund	Social Fund
١٦	Graduate Employment Productive Project	Social Fund
١٧	Social Development Foundation- Khartoum State	Social Fund
١٨	Youth Settlement Projects – Youth National Union	Social Fund
١٩	Special Program for Food Security	International organization
٢٠	United Nations Dev. Program / Selected Area Development (UNDP)	International organization
٢١	International Fund for Agriculture Development (IFAD)	International organization
٢٢	World Food Program (WFP)	International organization
٢٣	Food Safety Private Project	Development Project
24	Sudanese Development Association	Voluntary Local Agency
25	Azza Women Association	Voluntary Local Agency
26	ACCORD Organization	Voluntary Foreign Agency
27	ADRA Organization	Voluntary Foreign Agency
28	OXFAM British Organization	Voluntary Foreign Agency
29	IRC / International Rescue Committee	Voluntary Foreign Agency
30	Community Development Society	Voluntary Local Agency
31	Um-Maabad Savings & Credit Association	Voluntary Local Agency
32	Elrahma Voluntary Association	Voluntary Local Agency (one of UPAP's credit association)
٣٣	Alazhar Voluntary Association	Voluntary Local Agency (one of UPAP's credit association)
٣٤	Port Sudan Association for Small Enterprise Development	Consortium of 81organizations and associations; established under the supervision of the Social Development Foundation
٣٥	Women Training and Promotion Society	Voluntary Local Agency (one of SDF's Credit Associations)
٣٦	Khartoum State Facilitators Association	Voluntary Local Agency (one of goals partners)

Kassala State

No.	Name	Nature of Work
١	Farmers Commercial Bank	Specialized Bank
٢	Sudanese National Bank	Specialized Bank
٣	Sudanese Islamic Bank	Specialized Bank
٤	Export Development Bank	Specialized Bank
٥	Islamic Co-operative & Development Bank	Specialized Bank
٦	Saving & Development Bank	Specialized Bank
٧	Sudanese Agricultural Bank	Specialized Bank
٨	Agency for Co-operation & Research & development(ACCORD)	Voluntary Foreign Agency
٩	Practical Agency	Voluntary Foreign Agency

North Kordufan State

No.	Name	Nature of Work
١	Private Project for Food Security	Development project
٢	Shaikan Co. for Rural Dev.& Investment	Development project
٣	Sudanese Agricultural Bank	Bank Branch
٤	Saving & Development Bank	Bank Branch
٥	Animal Resources Bank	Bank Branch
٦	Sudanese Baraka Bnk	Bank Branch
٧	Omdurman National Bank	Bank Branch
٨	Rural Development for North Kordufan	Development Project
٩	Suraia Self Services Association	Services Association
١٠	Productive Associations - Ministry of Education	Development Association
١١	Organization Office for Children Care	International Organization

Read Sea State

No.	Name	Nature of Work
١	Bank of Sudan	Central Bank Branch
٢	OXFAM	Voluntary Foreign Agency
٣	Saving & Development Bank Branch	Specialized Bank
٤	Workers National Bank Branch	Commercial Bank
٥	Sudanese Agricultural Bank Branch	Specialized Bank
٦	Rule of Low Poverty Alleviation Project	UNDP / GoS
٧	Craft Development Association	Voluntary Local Agency
٨	Khor Arbaat Development Project, SOS	Voluntary Foreign Agency

ANNEX B: COMMON TERMS IN ISLAMIC FINANCE

Bea Eijari	Leasing contract/hire purchase, where the borrower owns the asset only after full repayment of the cost of the asset, plus a margin for the lender.
Quard Hassan	A soft loan in cash which is profit free.
Istisna'a	An agreement whereby the financier pays for work in progress, and receives the goods when manufactured.
Mudaraba	A speculative partnership arrangement where the lender (money holder) contributes cash, and the borrower contributes effort and management, with a prior agreement on sharing profits. In case of losses, the financing partner loses money and the other loses effort.
Murabaha	A loan in kind where the lender/financier procures and sells goods to the borrower on a cost plus mark-up basis. Repayment is made in instalments;
Musharakha	A partnership where partners contribute capital/equity, and agree to share profits and losses in ratios accepted before commencement of operations.
Salam Sale	An agreement whereby the borrower sells goods to the buyer/financier at an agreed upon price on a fixed date (e.g. on harvest) and the repayment is in kind.
Riba	Interest
Takaful	Islamic insurance, it operates in a form similar to that of a mutual benefit company.
Wadi'ah	Interest free savings.

ANNEX C: PASED, A SUDANESE MICROFINANCE SUCCESS STORY

Expanded outreach of local NGOs: The case of PASED
Port Sudan Association for Small Enterprise Development (PASED) is a local NGO registered in 2000 which continued the management and operation of a microfinance program previously implemented by ACORD.[12] Since 2001, PASED has extended micro loans to the enterprising poor to establish small businesses and improve the environment for home-based businesses. One of the distinct features of PASED's interventions is that it extends house improvement loans, with an emphasis on women.

PASED operates through five sub-offices located in the poor residential quarters of Port Sudan and employs 21 permanent staff assisted by four volunteers from the local community. PASED is governed by a general assembly in addition to an elected board composed of various stakeholders at the community level, experts and NGO staff. The percentage of female staff members is 57 percent. PASED regularly undertakes training for both its staff and its clients and provides incentives for their good performance. Staff incentives are linked to repayment collection, number of clients reached, amount disbursed and number of closed cases (full repayment). PASED undertakes close follow-up of its clients using its 5 branch offices for field operations in addition to an advanced computerized monitoring system. PASED has also collected baseline data in order to facilitate future evaluation. It also conducts market research for product development and continuously reviews its current products in an attempt to design client-led, demand-based products.

60 percent of PASED's funds are self-generated through revolving the original fund provided by ACORD, while 40 percent of the funds are solicited from a number of European donors. Up to now, the total amount of funds disbursed by PASED amounts to SD 1.06 billion.

Its microfinance program extends credit to both individual and group enterprises. PASED extends an average of 3200 loans per year. The ceiling for individual loans is SD 300,000 while the ceiling for group enterprise loans is SD 400,000. The percentage of women benefiting from these loans is 56 percent. The program charges commercial profit margin rates (4 percent per month). By so doing, it is able to cover its administrative expenses from self-generated income. It extends finance to services (69 percent), petty trade (22 percent) and handicrafts/cottage industries (9 percent) for a maximum duration of 10 months. The main lending method used is "Murabaha" (94 percent). Loans are repaid in monthly instalments and the repayment rate on loans is 81 percent. No savings component is included in the program. Loan processing takes less than 15 days.

Good clients are motivated by the possibility of repeated loans. The average loan size for individuals is SD 74,500 and SD 200,000 for groups (group-based lending).

[12] ACORD's microfinance program was launched in 1984 for the urban poor of Port Sudan and was phased-out in 2000.

However, loans to individuals represent 95 percent of the total number of loans. Nevertheless, PASED also extends short term credit to community projects to finance community services e.g. water connections, lighting, maintenance of schools, social clubs, and kindergartens. At the community level, Loan Advisory Committees (LACs) help in screening loan applications/applicants, recommending guarantors and following up repayments. The repayment rate of these loans is 95 percent and the collateral is in the form of post-dated cheques endorsed by community leaders.

PASED maintains good relations with the local development actors operating in the area and participates as an active member in the activities of regional and international networks and gatherings.

The following table summarizes PASED's performance during 2001-2004:

Description	2001	2002	2003	2004	Total
Total number of loans disbursed	2683	2693	3560	3641	12577
Total number of loans disbursed to women	1227	1348	1958	2143	6676
Percentage of women clients	46%	50%	55%	59%	52.5%
Total value of loans disbursed ($)	720,145	642,215	840,000	996,180	3,198,540
Total value of loans disbursed to women ($)	230,446	244,000	353,000	428,358	1,255,804
Percentage of loan fund to women	32%	38%	42%	43%	39%
Gross portfolio outstanding ($)	315,926	285,000	511,000	540,000	
Repayment rate	85%	86%	80%	77%	84%
Default rate	3%	3%	4%	6%	3%
Operational sustainability	1.15	1.20	0.95	1.02	1.12