MICROFINANCE PROVIDED BY THE SUDANESE BANKING SYSTEM 2000 – 2015

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Abstract

The Government of Sudan is committed to supporting the expansion of sustainable microfinance through a process managed by the Central Bank of Sudan (CBOS). Because microfinance is new to the country, however, very few specialized microfinance institutions (MFIs) operating , and the Government has thus focused on channeling funds for microfinance through commercial banks. but banks are reluctant to expand services, towards meeting the 12 percent of investable funds target for MF lending set by the CBOS. It was one percent in 2007 and about five percent at end-2012 but Banks optionally steady progress hold up to 20 percent (25 percent until end-2012) of their financing portfolio in Government Musharaka Certificates (GMCs), Government Investment Certificates (GICs), CBOS Ijarah Certificates (CICs), despite the call from the Central Bank for all banks to allocate 12% of their portfolio for microfinance as stimulus policy backed by incentives. This paper is an attempt to analyze why the sudanse banks do not strictly apply the central bank of Sudan directive of allocating 12 percent of their loan portfolio to microfinance *excessive government interference* The banks have made move to broaden of their financing portfolio in Government Musharaka Certificates (GMCs), Government Investment Certificates (GICs), CBOS Ijarah Certificates (CICs),

Keywords: Microfinance, Banking System, financing

Introduction

Most of Sudanese banks do not strictly apply the central bank of Sudan directive of allocating 12 percent of their loan portfolio to microfinance The 12% requirement was estimated by Al ebeid (2012) at the figure of SDP 832 million, the equivalent of 397 US dollars just for the year of 2012 due to the high unfixed cost of service provision involved in small loans, the difficulty, high administration expenses of Microfinance, in managing small projects as a condition of conformity to some Islamic financing procedures; in addition to the high risks involved in financing small projects as well as unreliable collateral arrangements. The only Islamic methods of financing are used by Sudanese banks for all financial transactions. and prefer two types of Islamic transactions which do not involve such costs: murabaha and Salam

Research Problem:

This Research attempts to answer the following questions:

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1- What are the microfinance challenges arised in applying the CBS directive of allocating 12 percent of their loan portfolio to microfinance?

2- how much capital adequacy ratio is necessary for Sudanese banks after Sudanese banking adopted risky microfinance and impact their capital adequacy negatively due to that The poor have very little income and cannot offer any collateral, Microfinance institutions used the profit-loss-sharing (PLS). contracts have inherent risks (such as enterprise failure, adverse selection and moral hazard) microfinance in sudan over-rely on cost-plus and deferred payment sales exactly like Islamic banks and, which are prefer Macro finance

3- What is the competitive alternative profitable for the microfinance are (GMCs), (GICs), (CICs)

Research objectives:

1. The main objective of this research is to highlight the importance microfinance.
2. The research discusses the major constraints facing of the microfinance and proposing ways and means to Enhance its operations. Compared with the competitive alternative profitable for the microfinance are Government Musharaka Certificates (GMCs), Government Investment Certificates (GICs), CBOS Ijarah Certificates (CICs

Research importance:

This is the first major Islamic Experiment in the world run by a central bank and to know the extent of their applicability to Islamic Sudan banks

Research Methodology:

The researcher used descriptive, analytical and historical methods in preparing the research, and used of Previous studies on microfinance, and incorporated of many of the best practices and lessons learnt from conventional microfinance movements from across the globe

Hypothesis of Research:

1. The Government Musharaka Certificates (GMCs), Government Investment Certificates (GICs), CBOS Ijarah Certificates (CICs), are the competitive alternative profitable for the Sudanese banks than the microfinance.
2. Most of sudanse banks fail to apply the central bank of sudan directive of allocating 12 percent of their loan portfolio to microfinance

Definition of Microfinance:

Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and, their micro and small enterprises. • Formal institutions, such as banks (mainly rural banks) and cooperatives;

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Microfinance services provider:

Deposit-taking MFPs have to be legal entities (either public corporations, public or private companies limited by shares, NGOs, credit associations or cooperatives) and are required to be licensed by CBOS if they provide microfinance as one of their business activities. They also have to document a minimum capital ratio of SDG 10 million (USD 4 million) if they operate at national level or half that if below (at state or locality levels). They need their Board and management approved by CBOS, and are required to submit operational policies and business plans. They are required to have computerized accounts, internal and external auditing, and Basel I compliant reserves. So far, one entity has been registered under this framework.

The Youth Microfinance Institution was established in 2010, and the AL-Amal Women's Microfinance Institution in 2013, by their respective trade unions. The former is in the process of becoming a deposit-taking microfinance bank. can play an important role in reaching out to rural areas. Non-deposit taking MFPs that lend only to 'members' are exempt from the otherwise rather conventional capital adequacy requirements, whereas such an MFP that wishes to serve the public must have at least SDG 500,000 as equity (although annex 3 to the Regulations would seem to contradict this). Any and all organizations or projects providing any type of microfinance, however, must register with CBOS and then have 30 days in which to incorporate as either a company, a cooperative, or under special legislation. No entity has yet registered with CBOS

Non-deposit taking MFI.

CBOS' Microfinance regulatory framework lists a broad set of allowable activities for MFPs, including financing (lending), guarantees, salary payments, distribution and delivery of finances extended by government, input provision, provision of consultancy and technical assistance, and other 'non banking tasks' . Only microfinance banks are allowed to take public deposits, but non-deposit.

Distinctive features of microcredit include:15

(a) **Micro borrowers**

. A microcredit provider usually caters to low-income clients, both the underemployed and the entrepreneur with an often informal family business (e.g. petty traders). Borrowers are typically concentrated in a limited geographic area, social segment or entrepreneurial undertaking.16 Loans are usually very small, short term, and unsecured, with more frequent repayments and higher interest rates than conventional bank loans. Many providers require higher interest rates to offset higher operational costs involved in the labor-intensive micro lending methodology.17

(b) **Credit risk analysis**

Loan documentation is generated largely by the loan officer through visits to the borrower's business and home. Borrowers often lack formal financial statements, so loan officers help prepare documentation using expected cash flows and net worth to determine the amortisation schedule and loan amount. The borrower's character and willingness to repay is also assessed during field visits. Credit bureau data are not always available for low-income clients or for all types of microfinance providers, but when they exist, are used as well. Credit scoring, when used, complements rather than supplants the more labor-intensive approaches to credit analysis.

(c) **Use of collateral**

Micro borrowers often lack collateral traditionally required by banks, and what they have to pledge is of little value for the financial institution but are highly valued by the borrower (eg TV, furniture). Where the lender does take some sort of collateral, it is for leverage to induce payment rather than to recover losses. In the absence of collateral, underwriting depends on a labor-intensive analysis of the household's repayment capacity and the borrower's character.

(d) **Credit approval and monitoring**

Because micro lending tends to be a highly decentralized process, credit approval by loan committees depends heavily on the skill and integrity of loan officers and managers for accurate and timely information.

(e) **Controlling arrears**

Strict control of arrears is necessary given the short-term nature, lack of collateral, high frequency of payments (eg weekly or bi-weekly), and contagion effects (see h. below) of microloans. Traditionally, monitoring is primarily in the hands of loan officers as the knowledge of the client's personal circumstances is important for effective collections.

(f) **Progressively increasing lending**

Customers who have limited access to other financing are usually dependent upon ongoing access to credit.18 Microlending uses incentive schemes to reward good borrowers with preferential access to future, larger loans (sometimes with favorable repayment schedules and lower interest rates), which raises the risk of over-indebtedness, particularly where credit information systems are absent or deficient. This feature also affects interest rate risk management, as microfinance customers expect rates to decline as the customer's track record grows, regardless of changes in the general level of interest rates.

(f) **Group lending**

Some micro lenders use group lending methodologies, where loans are made to small groups of people who cross guarantee other members of the group. Peer pressure also helps to ensure high repayment levels, as the default of one group member could adversely affect the availability of credit to others.

(h) **Contagion effects**

Tight control of arrears and peer pressure has driven traditionally sound repayment rates in most jurisdictions to date. However, the quality of individual loan portfolios can deteriorate quite rapidly, due in part to the unsecured or under-secured nature of microloans as well as so-called contagion effects, where borrowers who notice increasing delinquency in the institution may stop paying if they believe the institution will be less likely to offer future loans due to credit quality problems.

(i) **Currency-related risks**

Occasionally micro lenders lend in a currency other than that of a borrower's repayment source (eg sale of goods or services), so foreign currency fluctuations may affect the borrower's ability to repay. While not unique to microcredit, micro borrowers may be less able to appreciate the nature of this exposure, much less take measures to mitigate it.

(j) **Political influences**

Microcredit, and microfinance in general, may be seen as a political tool in some countries, tempting politicians to demand forbearance or forgiveness of loans to poor customers during times of economic stress. This might affect repayment culture of microfinance borrowers.

(jh) The dynamics of microfinance assets and liabilities also differ from those of commercial banking, affecting liquidity and interest rate risk management.

Lending Methodologies

Sudan MFIs offer their clients loans using two specific lending methodologies; namely, solidarity group lending and individual lending. The choice of methodology offered by an MFI is often subject to a number of factors including the MFI"s social mission, available delivery channels, product pricing and risk factors, and client needs. Examples of Recent Innovations in Financial Services for the Poor:

1. **CCACN (Central de Cooperativas de Ahorro y Crédito Financieras de Nicaragua)** is marketing its "Agriculture Salary" savings product to farmers. The goal of the product is to smooth the flow of income from the proceeds of an annual or semi-annual harvest. Each credit union works with its farmers to identify their individual expenses and determine a monthly "salary" (portion of harvest proceeds on deposit combined with an above-market interest rate) to be withdrawn from the credit union. In its infancy stage, the credit unions have noted an interest from agriculture-based clients in such a savings management program.

2. **Caja los Andes in Bolivia** offers four loan repayment options that fit the cash flow of various agricultural activities, including an end-of-term payment for both principal and interest that fits single crop activities, and unequal payments at irregular intervals for farmers that have planted several crops with different harvesting periods. Flexibility is also provided in loan disbursements, and farmers can receive the sanctioned loan amount in as many as three instalments.

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3. **Prodem in Bolivia** has introduced a combination of biometric fingerprint and Smart Cards to deliver financial services to its clients. Biometric technology measures an individual's unique physical or behavioural characteristics, such as fingerprints, facial characteristics, voice pattern, and gait, to recognize and confirm identity. Although the technology is still new, growing awareness of the importance of data security is increasing adoption steadily. Prodem's fingerprint verification has reduced fraud, error, and repudiation of transactions. Staff had not had to deal with forgotten PIN numbers or unauthorized use of cards and accounts so they have more time to provide personal service and advice to clients.

4. **Unibanka (Latvia):**

Prior to introducing credit scoring, Unibanka, a commercial bank, viewed microfinance loans as too costly to deliver. With the assistance of Bannock Consulting, Unibanka instituted a credit-scoring system based on qualitative client data because sufficient quantitative data was not available to develop a statistical model. Branch staff now uses scorecards to evaluate microfinance loan applications quickly, which has reduced the cost of review and made microfinance lending profitable for Unibanka.

5. **ICICI Bank (India): Two state banks in India (Corporation and Canara)** partnered with an NGO to provide salaried low-income workers with access to savings. The project uses the already established automatic teller machines (ATMs) in the factories to offer a recurring savings product, along with education on personal finance. .

6. **Microenterprise Access to Banking Services (MABS)** in the Philippines nurtures the expanded use of the credit bureau by rural banks, which was started in 2001 to minimize client over indebtedness and defaults. MABS has helped to integrate the rural banks' microenterprise loan clients into an existing national credit bureau, by creating an e-mail encryption program that allows rural banks to share information electronically at a low cost.

7. **BASIX in India** reduced transportation and transaction costs for its clients and decreased staff expenses by establishing tellers in manned phone booths operating in India. The company operating the phone booths receives a service fee and phone booth operators are being trained in basic collection operations and accounting. BASIX is currently redesigning the project after the pilot and preparing it for relaunching. .

8. **Credit, life, and funeral insurance**: A WOCCU study on savings and credit cooperatives (SACCOs) in Kenya indicates that HIV/AIDS poses high levels of risk to rural finance institution soundness. The Cooperative Insurance Company (CIC), a professional insurance provider, insures over half of Kenya's more than one million credit union members who subscribe to policies through their credit unions.

9. **The National Microfinance Bank in Tanzania (NMB)** was created to retain the extensive rural branch network of the National Bank of Commerce (NBC) when it was privatized in 1997. The key to making it commercially viable has been rigorous control of costs through drastic

simplification of the business model and tight managerial oversight. Key initiatives have been correct pricing of products, particularly payments and remittance services, which had traditionally been cross-subsidized by other product lines, and the development of microfinance products, mainly small (average US $400) individual loans.

10. **ADOPEM (Dominican Republic)** thoroughly evaluated its PDA (Personal Digital Assistants) program and recorded dramatic improvements. Client retention improved significantly, and the number of days between application and disbursement dropped from five days to two days. Expenses for paperwork dropped by 60% and data entry expenses dropped by 50%. Loan officer caseloads and other productivity measures increased by about 35%.

11. **Savings-based, Agriculture-oriented Rural Credit Unions - SICREDI - Brazil** specializes in agricultural lending, primarily for the production of rice, wheat, beef, fodder, fish, vegetables and for agricultural equipment. Loan approvals are based upon the members' savings history and credit record, with the size limited to 50 percent of production costs and dependent upon the potential return of crop sale at harvest as well as household income and debt obligations. The borrower makes monthly interest payments and then a balloon payment of the principal at harvest time. In addition, SICREDI participates in the PROAGRO national crop insurance, for which a premium is added on the loan rate. PROAGRO pays 100% of the loan loss if the crop fails.

12. **Producer Associations as Clients of a Financial Institution: GAPI and CLUSA** in Mozambique: GAPI offers investment and working capital loans to fora (federations of associations) of small farmers and small and micro-enterprises. GAPI collaborates with CLUSA to set-up and register these fora. Loans are secured through a solidarity group-like guarantee between the participating fora. Each forum on-lends to its member associations, who collect the produce from their individual members and other area farmers and deliver it to the forum in return for the loan. About 80% of the profits from the sale of produce are handed back to the associations - the remaining 20% of the profits are kept by the forum as interest payments.

13. **In South Africa,** a network of 8,000 armored trucks equipped with thumbprint recognition and smart-card technology deliver pension payments of about $60 each month to 4.5 million South Africans. The potential of this vast infrastructure to offer pensioners other kinds of financial services is tremendous.

14. **Banco Postal in Brazil**, a joint venture between the Post Office and the largest private bank (Bradesco) has offered banking (and payment) services through its network of postal branches in remote and poor areas of the country

15- Indonesia (BRI)

The major features of the experience of Bank Rakyat Indonesia (BRI) is clients' saving, charging market interest, clients' honoring of obligations and repayments of loans. The lessons of success are mostly related to scattered small units (outreach), the saving components, no subsidy or funds

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from government, effective leadership, strong commitment and political support. The relative success of Bank Rakyat Indonesia (BRI) is partly related to the incorporation of many of the best practices and lessons learnt from conventional microfinance movements from across the globe. This experience clearly tells a lesson that large scale, market-led Islamic banking microfinance is possible, if certain conditions are met, and can have a positive impact on the lives of millions of people. The success story is not unrelated to the following:

Much of its success may be attributed to the organizational set-up of the single BRI Unit as a highly decentralized and semi-autonomous financial entity. The BRI Unit is commonly found in a central location of the sub-district town, often near the market place. It typically rents a one room office in order to keep overhead costs low. A Unit covers about 16–18villages at the sub-district, and currently serves an average of 10,000 savers and a little over 1,000 borrowers. The individual Unit was purposely kept small, by limiting the number of staff and focusing its operations (Klaus, Maurer, 2004).

Traditional Bank's Difficulty in Lending :

Different barriers prevent traditional banking system from serving poor:

1. Subsidized credit programs

In order to supply cheaper credit, many commercial banks have attempted to offer financial services to the poor in rural areas by implementing large-scale subsidized credit programs between the 1950s and 1970s. Their objective is to provide a subsidized credit at below-market interest rate to small agricultural producers . Morduch (1999) cites the work by Adams, Graham and von Pischke who claims that subsidized credit was a keystone for many

developing countries in the 1950's as a poverty reduction effort but all these attempts were disappointments with repayment rates less than 50 percent.

2. The Banks need collateral.

The poor cannot offer collateral. Moreover, the poor are not to be trusted. They are not credit worthy. Banking is a business. It cannot indulge in charity for the poor' (Yunus, 1994a, p.5). Collateral debt can be viewed as a mechanism to reveal the information concealed ex ante from the lender. It can be used also as a credit enhancement or credit risk transfer mechanism from the lender to the borrower. If the borrower cannot (involuntary default) or would not (strategic default) pay back the loan, collateral would be the compensation.

3. The high transaction costs

Associated with the small loans is also main barriers preventing traditional banking system from serving poor rural households. Actually, the process of lending a loan entails many bureaucratic procedures, which lead to extra transaction costs. This transaction costs have a large fixed-cost component regardless of the size of the loan. Thus, the costs for the bank to lend multitude loans

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of small amount of money to a multitude of borrowers are much higher compared to lower transaction costs for offering larger loans to fewer borrowers. It is difficult if not impossible for NGOs to borrow money from banks for lending to micro entrepreneurs. Banks are wary of extending such loans because they cannot sue NGOs in cases of default.

Financial Sector in Sudan:

Sudan's financial sector is dominated by commercial banks including two state-owned, 2 branches of foreign (Gulf-based) banks, and26 joint-venture banks. Five additional banks – and 4 state-owned are registered as 'specialized' including three important microfinance providers (MFPs): The Agricultural Bank of Sudan; the Savings and Social Development Bank and the Family Bank in Khartoum state and The41% of bank branch network, are concentrated in Khartoum , still numbers 564 outlets6. Accordingly, by African standards, bank usage in Sudan is relatively high at 144 bank accounts per 1000 adults .

Non-bank financial institutions including insurance companies continue to be rare. financial sector comprising 35 licensed banks of which most are registered as commercial, In addition, the financial sector includes at least 12 financial services companies; a leasing company; a government bond institution issuing sukuk and other Islamic financial papers; the Khartoum Stock Exchange listing around 53 companies (end 2008); some 22 foreign exchange companies (the central bank strictly regulates the supply of foreign exchange to bureaus and most commercial banks do not trade currencies8); and 4 national funds, including the Pensioners Fund, the National Social Insurance Fund, the Industrial Finance Fund and the Bank Deposit Security Fund9. Insurance is a particularly well developed industry in Sudan,

The depth of financial intermediation (proxied by the ratio of M2 to GDP) is shallow (23.7%) about one percentage point up from the end of 2011 , which translates into excessive bank liquidity. The adopted regressive credit policy after secession and the liquidation of six banks belonging to South Sudan had squeezed banks' balance sheets and exposed the sector to greater vulnerability. ; although , The fiscal expansion and rapid credit growth for public sector financing in 2006-07 significantly weakened the financial sector and required several injections of liquidity by CBOS totaling 1.5% of GDP between September 2006 and January 2007. During 2008, CBOS increased its capital contribution (shareholding) to banks by 120% while it's lending to banks fell by 24%13. From a low at end of 2007, broad money and reserve money grew by 16% and 22% respectively, in 2008. Private sector credit growth, however, slowed to 13% by March 2009, in line with a drying up of credit lines from foreign banks. Another reason for the private sector credit crunch is decreasing liquidity in the banking sector, as government sukuk certificates (bonds), considered safe and high yielding, are crowding out credit to the private sector, especially SMEs. The generous returns offered on the bonds are widening the fiscal deficit and delaying the repayment of government arrears to private suppliers and contractors, who in turn default on their bank loans, increasing the NPL. Both the size and the depth15 of the formal financial sector remain limited and in addition, performance is not encouraging. Bank (ONB). The government has pledged to restructure and privatize the bank,

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which accounts for 28% of all lending (2008)17. Add to this that only 21 banks – 66% of the entire banking industry – were able to meet the minimum capital requirement of SDG 50 million by end of 200818, and the contour of a weakening banking sector appears. Many banks are in distress due to the lack of efficient, transparent and accountable lending practices as well as weak monitoring and supervision by the CBOS. Non-Performing Loans (NPL) was 24% of the entire financing portfolio of the banking sector as at March 2009, and the provisions set aside to cover these potential losses are insufficient at 19%16. A massive 80% of the non-performing loans (NPL) is concentrated in one very large , the Omdurman National BANK The ratio of gross non-performing loans (NPLs) to total gross loans remained high (14%) and is projected to rise to 15% by the end of 2013 because of the adverse effects of the devaluation of the Sudanese pound on committed foreign denominated loans. Additionally, the escalating inflation significantly eroded returns on assets and equity by about 2.5% and 18.4% by March 2012, down from 3.6% and 26.5% in 2010, respectively, and hence increased banks' risk aversion, while reducing credit to the economy. The BoS continues to urge the banks to allocate at least 12% of their portfolio to microfinance in order to increase the access of small producers to credit. Nevertheless, bank lending to agriculture and social development dropped by 6.7 percentage points by end-2011 down from 17.5% in 2010 and average 9.7% in 2012 with a meager 0.01% for social development. Lending to trade increased by 3.8% in 2011 up from 27% in 2010 and contributed an additional 5% in 2012.

Microfinance in Sudan:

Sudan has attempted to utilize Microfinance as a means of reducing poverty levels since the mid-1990's. However decades of civil war and political instability have prevented Sudanese microfinance efforts from having any noticeable impact. By some accounts an estimated 60 – 70% of the Northern population lives on less than USD 1per day . In 2006 the CBOS signed an agreement with the World Bank to launch a $50 mn microfinance fund. The purpose of the fund was to support Microfinance efforts and establish a microfinance department within the CBOS. With the formation of the Sudan Microfinance Development Facility (SMDF) . NGOs have been the main providers of micro loans to the poor thus far. - Community-based organizations (CBOs) Located mainly in or around Khartoum, these urban community initiatives include the Port Sudan Association for Small Enterprise Development (PASED), the largest microfinance service provider as of December 2006. PASED at the time serviced 4010 clients with an average repayment rate of 85%. Elkifaya Bank, the Sudanese Development Association, Sudanese Red Crescent and the Women's Fund of the Women's Union of Khartoum State all support CBOs focused on the urban poor and especially on women. - Commercial banks prior to the 2009 Directive Some commercial banks have been providing microfinance services for over 15years. These include the Agricultural Bank of Sudan and the Savings and Social Development Bank (which serves as an intermediary for INGOs and UN agencies). To a lesser extent, the Sudanese Islamic Bank, the Faisal Islamic Bank, Albaraka Bank, and the Islamic Cooperative Development Bank.

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Financing portfolio Microfinance OF based on the CBOS policies

The evidence in table-below indicates the relationship between the allocated budget for Islamic microfinance out of the financing portfolio based on the CBOS policies and the actual amount allocated for the microfinance for the period from 2000 up to 2010. Contrary to the expectation, this relationship is inversely related. The actual utilization budget of the provision of the microfinance portfolio is decreasing yearly while the CBOS raises the ceiling of the provision until reach 12% in the current year 2014, from 7% in the year 2000. It is difficult to understand the basis on which the CBOS increase the planned allocated budget for the microfinance yearly at the time the actually utilization of the Islamic microfinance provisions are less than 2% in the recent years between 2000-2010.

Year	CBOS Allocated as per policy%^	The actual microfinance%	The deviation from CBOS Allocated as per policy%^
2000	7	7.2	2.1
2001	7	6.1	(o.9)
2002	10	4.4	(5.6)
2003	10	4.4	5.6)
2004	10	4.6	5.4)
2005	10	3.6	6.4)
2006	10	3.1	6.9)
2007	12	1.3	10.7)
2008	12	1.6	10.4)
2009	12	1.6	10.4)
2010	12	1.8	10.2)

CBOS: Annual report 2000 - 2010

. the banks are making steady progress towards meeting the 12 percent of investable funds target for MF lending set by the CBOS How It was low one percent in 2007 and about five percent at end-2012 although banks are expected to continue to track towards the 12 percent target. This is to be accomplished mostly through the newly established Wholesale Guarantee Agency which would partially guarantee finance from banks to MF institutions.

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3 the implementation of best practice in terms of loan analysis, loan product design, risk and delinquency management procedures, actions before and after loan disbursement, and close monitoring. To adopt such practices, banks interested in delivery of microfinance services should restructure their branches in an efficient manner and adopt mechanisms, which make them nearer to the targeted clients. Intensive training to the sales force will be crucial for ensuring proper assessment of projects' viability and client's credibility,

Microfinance and Mobile Phones

One potential remedy for the limited reach of microfinance in Sudan, may lie within the mobile phone industry. While microfinance currently covers 1% – 3% of potential demand, Sudan's mobile phone network covers 70% of the population, including the poor. The CBOS Microfinance Unit realizes the potential of mobile banking, already an effective vehicle of microfinance in other countries, and recently placed a request for feasibility study to be done. In the request they noted that one of the newer microfinance institutions, North Kordofan Microfinance Bank (Gudaim), has already begun to invest in the Management Information System (MIS) and Mobile Payment Platform (MPP) needed to make this a reality. In 1994/95: incorporation of "Craftsmen, Professionals & Small Producers, Including the Productive Families" as a priority sector for financing, with some preferential treatments . CBOS oversees an institutionally diversified at end 2008. Total local currency deposits reached SDG 13.5 bn (USD 5.4 bn), of which 91% were from the private sector. Of these private deposits, half were mobilized in savings or investment accounts. 90.6% of this deposit base was used for lending in 2008 (12.3% for import, 18.6% for local trade, 9.3% for industry, 11% for agriculture and only 3% of the 47% "others" is for 'social development' including microfinance – despite the call from the Central Bank for all banks to allocate 12% of their portfolio for microfinance). Without commitment, capacity, commercial incentive and means of enforcement, this requirement is perhaps better left unfulfilled for now, as there is never good argument for poorly implemented microfinance. The Central Bank of Sudan (CBoS) has formulated a strategy for developing and expanding the microfinance sector. The development of the strategy and accompanying action Plan to develop the microfinance industry include:

1. Building on the existing system and/or developing a reformed financial system for the poor with solid infrastructure and efficient financial intermediaries that having the required outreach to meet the financial needs of the poor;
2. Creating the legislative and regulatory frameworks that enhances the performance of the microfinance industry;
3. Adopting mechanisms that support transparency among microfinance lending institutions;
4. Applying "best practices" and setting distinct performance standards for the sector;
5. Creating an efficient information network that includes access to reliable, up-to-date, market information on the financial needs of the poor and MSEs, of gender and geographical imbalances;

6. Increasing coordination among various stakeholders including Microfinance Institutions MFI), government, NGO, practitioners, donors, etc.
7. The strategy to promote microfinance is through both banks and non-bank financial institutions and will facilitate the use of both government and non-government financial and technical resources. In 2007, CBoS mandated commercial banks to lend 12 percent of their lending portfolio to microfinance. The Multi-Donor Trust Fund, administered by the World Bank, has supported this approach to micro finance, with funding for a microfinance project in the amount of $20 million. This facility, approved in May 2007, is supporting new and existing microfinance institutions and ; technical assistance; training; financing; and managing donor resources. The objective is to provide affordable financial services to 200,000 households by supporting the emergence of commercially sustainable microfinance service providers. The project will also assist the CBoS in building its regulatory capacity for deposit-taking and non-deposit taking MFI's. The project is supporting innovations in the development of the microfinance sector in Sudan. One of the innovations is the introduction of a management information system (MIS) for microfinance institutions in Sudan. This Loan Tracking System (LTS) is intended to support microfinance institutions in managing data relating to loans disbursed to clients. bank training course in 2007, which has now successfully been spun off to the Sudanese Higher Academy for Finance and Banking. By end of 2008, 400 bank staff had completed the standardized 5-day training,

Instruments of Financing in Islamic Microfinance

The lending methods used by all sudanse banks engaged in microfinance are Murabaha (64.6 percent), mudaraba (13.8 percent), hire-purchase (14.5 percent), Salam (2.3percent) on average during the period 2000- 2004 The murabaha contract is the most common mode of financing used by all banks, 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. . 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.

Microfinance by Sectors the executed microfinance for the year 2010 amounted to SDG 189.7 million, and the number of the households benefiting from it was 22678. Agricultural 26.2 %20 and Services 68.0 %52 and Commerce 16.0 %12 and Real-estate 9.0 %7 and Professing 7.8 %6 and Transport 3.9 %3 The MF percentage is low, in non speaslaized banking however, saving & social development Bank reached high percent (5o% in 2006) finance from the total of MFcompared with other banks also family bank attained maximum percentage 23%, in 2006 The Central Bank of Sudan introduce the wholesale via a governmental agency (Kefalas) and to exploit the restricted Mudarabah as a formula for microfinance wholesale lending The new Comprehensive National Microfinance Strategy (CNMS) cover up to 2017. This microfinance strategy will replace the CBoS strategy, and includes all microfinance stakeholders. The major expected outcome: increase contribution of MF sector to GDP from 1 to 3%, increase number of clients from 494000 to 1.5 mill. by 2017, Increase in the % of poor microfinance clients (18 years +) from 8.2% to 24.6%, & women clients from 30% to 50% Khartoum state share 13% of the total MF clients, ranked after Gadarif state (18%), North Darfur state (14%), & North Kordofan state (13%), all are remote areas There is no consistent pattern of the relationship between the clients and the volume of finance at all states. Khartoum State came first with the share of 33%, Gezira state second (9%), then River Nile, Gadarif, and Sinnar (7%). A sizable finance is in Khartoum, the Capital, while the sizable numbers of clients were in other states. The degree of banks concentration: the average share of Khartoum state is 38.9% of the total branches during the period 1979-1987, reduced to 32.8% during the period 1997-2001, up to 41% in 2012. Other regions: The central region around 20%, eastern region around 12%, northern region around 10% recently, while western regions (Kordofan and Darfur) share less than 10% over the same period (regional inequality in the distribution of branches in towns and urban areas) MFIs: Out of 23 MFIs currently working, Khartoum state share only 5 MFIs. The microfinance sector (MF) is still small relative to the needs, although the authorities are actively promoting its development and it has recently started to grow rapidly. The number of CBOS-regulated MF institutions went from zero in 2007 to 18 at end-2012, and over the same period, the number of borrowers went from 49,000 to 494,000. However, one of the factors that may slow further growth is that MF institutions depend on wholesale funding, for which they have to compete with high-yielding Government Musharaka Certificates (GMCs). The trade unions play an active role in funding and setting up MF institutions. Although the MF regulatory framework in Sudan allows unions to establish MF institutions, so far there are only two that have. However, Sudanese trade unions have social programs that provide cash support to members, which would make their involvement in the MF sector a natural fit. Also, the 2013-2017 Comprehensive MF National Strategy calls for a review of the cooperatives regulations with the intent of increasing the involvement of cooperatives in the MF sector. . The Government through CBOS has tried to speed up the development process, first by requiring banks to provide financing to poorer people (the 12% allocation), then by incentivizing banks with generous amounts of subsidized capital (the Microfinance Pilot project). But partly because:

1. Microfinance has been introduced ‘from above’ as a required target - often without adequate training, additional staff or resources –
2. Most bank branch staff consider the new market segment unprofitable, unfamiliar and risky
3. the products and procedures expensive in both staff time and arrears; and the methodology unknown
4. Many MSEs do not trust the banks or find their products to be unsuitable for their businesses.
5. Due to the cost associated with microfinance and low returns Some believe that providing loans to the poor is a "social” service which is beyond their mandate and should be handled by Government organizations or charity bodies. This could be attributed mainly to their limited awareness of the potential of microfinance as a lucrative business and their limited exposure to local and international success stories.

Current status of Guarantee Funds in Sudan:

1. **Harsh conditions for personal guarantor:**

The Third Party Personal Guarantee (TPPG) is widely used by banks to secure loans not exceeding SDG 2o,000 where the guarantor is required to issue postdated cheque/s in addition to those issued by the borrower for repayment. For each cheque issued by the borrower, a parallel one is required from the guarantor. The number of cheques required is a function of the number of installments, which in turn is determined by the nature of the transaction e.g. in financing agricultural activities, payment is made by one cheque after harvest. Both borrower and guarantor must have a current, deposit or savings account with the concerned bank. This practice in itself is considered as an "entry barrier" to many economically active poor

2. **Lack of proper client follow-up:**

Visiting clients in their business places, before and after loans' disbursement, is rare because there are only one or two investment officers in each bank branch who are expected to cover both microfinance and commercial lending. In fact, the staff structure of bank branches is not appropriate for delivery of microfinance services which is a labor-intensive process. Successful delivery of microfinance services requires banks to operate near the community and depends on close monitoring and personal knowledge of clients and their businesses. The general staff structure is that, on average, there are 10 officers doing office work only for each investment officer.

3. **Lack of recognized best practice in micro-lending procedures:**

The common feature among banks is that they apply similar lending procedures that mainly depend on office work and formal documentation rather than fieldwork. All banks are actually applying microfinance lending in a manner similar to commercial traditional lending. The focus of a bank branch is on the collateral, the character of the borrower, and the formal documents.

4. **Causes of defaults in microfinance *sudan *:**

the causes of default can be divided into two categories:

(a) Lender side -Weaknesses in funds administration

i. Absence of post-disbursement monitoring system

ii. Lack of technical assistance given to the microfinance recipients

iii. Lack of experience and education

iv. Immediate payment system

v. Lack of common accessible database of the microfinance recipients

(b) Borrower side - moral hazard problem

resulting from the lack of technical assistance and post-disbursement supervision, followings are the consequences

which result in greater possibility of default by the loan recipients.

i. Hiding business

ii. Family member's illness

iii. Lack of motivations

Microfinance Cost Sudan Experience

The most expensive and time-consuming part of efforts to reach hundreds of thousands of microfinance clients in sudan (including those in rural and remote areas) is the investment in building up physical and administrative infrastructure—that is, a branch network. However, impediments remain, including the costs of extending branch networks to the largely rural population, and crowding out by the government borrowing. . It is worth noting that new functions have been added to the banking supervision

1 . Microfinance cost is unfixed and it varies from bank to bank according to many reasons. The main factors are: Nature of the project to be financed, high admin-istration expenses of Microfinance, amount and period of the loan, loan losses, profit needed to expand their capital, expected future growth. The study (Siddig, Khadra 2013). Shows the following:

1. That most of the banks agreed that microfinance cost is over 12%. Microfinance costs are set up according to the Central Bank policy, and the bank's own policy, with all these policies in consideration still microfinance rates are very high. This is because microfinance scheme is very costly, as well as it is unsecured. Banks incur large cost on administering tiny loans and it is much higher than the cost of making large loans. For this reason competition among banks to offer microfinance will not reduce these costs. Banks prefer variable microfinance costs7bank with 58.33 than fixed costs5 bank with 41.67 to encourage all categories of people to take advantage of microfinance loans and everyone according to his/her/their situations and needs. In addition banks hope that microfinance would be a promising instrument to help in reducing Sudan poverty. Most of the banks take 3 to 4 months to finish the processing of Microfinance Customers Applications, only few applications take a long period to be processed. Most of the customers received the microfinance loans after a time and only few got it as soon as they applied
2. Profit margin for the Mudarabah and contracting modes shall be 15% a year for microfinance operations. Other modes shall be in accordance with the contracts signed

between the branch and clients so that expected returns of profits of operations for the branch shall not be less than 15%.

3. Profits And cost OF the commercial banks and specialized banks IN Microfinance

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 commercial30 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 thosebanks that do estimate their microfinance lending costs, 77 percent are realizing a profit margin of 40 percent.

Musharaka Certificates (GMCs), Government Investment Certificates (GICs), CBOS Ijarah Certificates (CICs) :

Banks may hold up to 20 percent (25 percent until end-2012) of their financing portfolio in Government Musharaka Certificates (GMCs), Government Investment Certificates (GICs), CBOS Ijarah Certificates (CICs), Khartoum Petroleum Refinery Certificates, and other Sukuk. GMCs, also known as Shahama, are issued in registered form by the Ministry of Finance (MOF) through auctions. They are based on Musharaka with a one year renewable maturity at the government's option. The nominal value of each certificate is SDG 500 and their profits are distributed annually. The return on GMCs is based on the return from underlying projects and capital gains derived from revaluations of project assets. These are the highest yielding certificates. GICs known as Sarh/Sukuk and issued in registered form by the MOF are used to finance development projects. They are based on a pool of Islamic financial instruments such as Mudarabah and Ijara with nonrenewable maturities ranging from two to six years (typically five). Investors get a share of the profits generated by the underlying projects. The nominal value of each certificate is SDG 100 and their profits are distributed quarterly and semi-annually. There are also GICs known as Shama backed by the assets of the Petroleum Refinery of Khartoum. The yield is fixed and is paid on a quarterly basis. Central Bank Ijara Certificates (CICs) known as Shehab are issued only to banks by the CBOS with a 10 year-maturity and a fixed annual return of 12 percent paid monthly. CICs are backed by the CBOS building and are issued by the SFSC. These are mainly used by the CBOS for open market operations, and purely for monetary policy purposes. Dealing in these certificates is restricted among the banks and the CBOS. The nominal value of each certificate is SDG 1,000. Musharaka Certificates (GMCs), Government Investment Certificates (GICs), CBOS Ijarah Certificates (CICs) as competitive investable funds of MF. The results of push by The CBOS have been impressive to date. The number of MF borrowers went from 49,000 at end-2007 to 494,000 by 2012. The growth has occurred in both bank portfolios (49,000 to 300,000) and at the dedicated MF institutions (zero to 194,000). The CBOS MF Unit (MFU) estimates that the proportion of the adult population receiving MF funding from banks and MF institutions has gone from 0.7 percent to 8.2 percent over the same period. And returns

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are estimated to be competitive with those on Government Musharaka Certificates at about 18 percent. Moreove16 NPLs on MF funding transactions average about four percent. Typical micro insurance policies add about 1 to 3 percentage points to the annual cost, and cover 75 percent of losses. NPLs on MF loans are much lower than those of commercial bank loans, although micro insurance, paid for by the borrower, plays a role in keeping them low. The high returns GMC draw potential wholesale funds away from the MF sector, private-sector MF institution investors are looking to establish solid institutions for future higher returns. Also, some look at these investments as serving their communities and social obligations. Nevertheless, reductions in GMC issuance and/or returns could only be a good thing for the MF sector these lead to a loss of monetary control with the CBOS providing direct credit to government and the lack of adequate monetary instruments has led to high intermediation cost and persistent inflationary pressures

MFIs and capital adequacy

The Sudanese banks not changed the minimum capital adequacy after Sudanese banking adopted risky microfinance . MFIs should have a larger capital buffer for several reasons: first, delinquency rates for MFIs can be volatile; second, MFI operating expenses are generally higher than for Commercial banks; and third, access to funds for emergency recapitalization is more limited.

CONCLUSIONS

1- the CBOS raises the ceiling of the provision until reach 12% in the current year 2014, from 7% in the year 2000. Despite more than 13 years in operation, the Islamic microfinance providers reach less than 3% out of the targeting clients. These might be due to the actually utilization of the Islamic microfinance provisions are less than 2% in the recent years between 2000-2014. These might be due to a number of factors such as portfolio consisting of small short-term loans to rural borrowers can be sensitive to droughts, crop and animal diseases for these reason microfinance in Sudan concentrated in urban area, the weakness of the regulations, the designed criteria by the Islamic banks and microfinance providers did not consider the diversity of microfinance clients in Sudan and microfinance has been introduced 'from above' as a required target - excessive government interference* often without adequate training, additional staff or resources – their products to be unsuitable for their businesses- MSEs do not trust the banks and due to the cost associated with microfinance and low returns and the competitive alternative profitable for the banks are (GMCs), (GICs), (CICs) .

2 –The dominance of short-term and sales-based modes of finance -murabaha(purchase and resale plus profit margin) and Salam(forward crop-financing)

3- Lack of strong institutions able to attract savings, recycle them into loans and provide other financial services needed by the economically active poor in a sustainable manner.

4 .Coordination between institutions offering microfinance services and those with different mandates (banks, NGOs, social funds, and rural development projects) is extremely limited.

5 .Performance as microfinance providers is limited by the widespread perception that the loan is a gift and by the associated resistance to the shift from grants to a market oriented approach.

6- microfinance percentage granted by savings and Development Bank and family bank are very high compared to macro size of microfinance, which emphasizes the its effective role in financing of development

7- Microfinance services which is a labor-intensive process. Successful delivery of microfinance services requires banks to operate near the community and depends on close monitoring and personal knowledge of clients and their businesses.

the Bank of Sudan issued the Guidelines for Branchless Banking authorizing deposit-taking institutions to accept deposits from public , but subject to lower capital requirements

8- The lack of physical infrastructure increases the transaction costs for micro enterprise and the cost of reaching people by Microfinance Providers is high. The technological solutions available to overcome some of these constraints

9- The formal banking system, as it is structured at present, is not designed to serve the financing needs of the poorer segments of the Sudanese society.

10- .The training and experience of the personnel in commercial banks is unsuitable for servicing poor clients.

RECOMMENDATIONS

1- Encourage microfinance institutions to take deposits in the future. That would make them less dependent on donors and enable them to provide a financial service that is needed but not offered. It would also enable them to grow.The only way for these institutions to take deposits would be commercial banks. Supervised by a central bank of Sudan the minimum capital required may be higher

2- Linkages bank with NGOs and CBOs as a cost effective means of reaching out to the poor and open untapped markets instead of opening new branches of bank

3 . Continue to employ the ratio of 12% of the financing portfolio total for each bank microfinance and micro-finance with a social dimension of policy, through direct financing from banks to individuals, groups, or through wholesale from banks to MFIs licensed finance.
4 . Banks use the guarantees provided by the agency to ensure microfinance wholesale funding to provide wholesale services to MFIs and collective projects.
5- Banks and MFIs application funding formulas Islamic different so not to exceed the smaller Murabaha rate of 70% of the microfinance portfolio financing, taking into account to determine

appropriate margins for profit Murabaha cover the financing costs and the use of the guarantees of non-conventional and work to devise new safeguards appropriate.

6- Linking Borrowers to Credit Risk

7 –Accept alternative collateral that are specific to micro-entrepreneurs (such as peer pressure) as a substitute for conventional collaterals

8- Design wholesale group loans to Associations that bank can better manage

9- Link the formal and informal providers by introducing “branchless banking”: the use of non-bank retail agents and information technology to deliver financial services to low income people beyond traditional banking channels

10 - MFIs should have a larger capital buffer And sudanse banks must adopt the Basel requirements for MFIs

11- Learning from Recent Innovations in Financial Services for the Poor

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Sudanese authorities, World Bank, and IMF staff estimates DEBT SUSTAINABILITY ANALYSIS

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