MICROFINANCE CONSULTANCY TO EASTERN SUDAN

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FINAL REPORT

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Acronyms and Abbreviations

ABS	Agricultural Bank of Sudan
ASCA	Accumulating Savings and Credit Assoc
ATM	Automated Teller Machine
BDS	Business Development Services
BOP	Bottom of the (economic) Pyramid
CAR	Capital Adequacy Ratio
CBO	Community-based Organisation
CBOS	Central Bank of Sudan
CIT	Cash in Transit
COR	Sudanese Commission for Refugees
CPA	Comprehensive Peace Agreement
CRS	Credit Reference Services
EC	European Commission
EPOS	Electronic Payment Service
ESPA	Eastern Sudan Peace Agreement
FAO	Food and Agriculture Organisation
FDI	Foreign Direct Investment
FSP	Financial Service Provider
GDP	Gross Domestic Product
GEF	Graduates Employment Fund
GoNU	Government of National Unity
GNI	Gross National Income
HAC	Humanitarian Aid Commission
HIPC	Heavily Indebted Poor Country
HRD	Human Resource Development
ICT	Information & Communication Technology
ICDB	Islamic Cooperative Development Bank
IDA	International Development Agency
IDP	Internally Displaced Person
IFAD	International
IGA(/O&M)	Income Generating Activity (/Oper & Maint.)
ILO	International Labour Organisation
I/NGO	International/Non-Governmental Organisation
IMF	International Monetary Fund
JV	Joint Venture
LDC(/VDC)	Local Development Committee (/Village Development Committee)
LPG	Liquid Petroleum Gas
ME	Microenterprise
MF	Microfinance
MFI	Microfinance Institution
MFP	Microfinance Provider
MFU	Microfinance Unit (of CBOS)
MIS	Management Information System
MoFNE	Min. of Finance & National Economy
MoSW	Ministry of Social Welfare
MSE	Micro- and Small Enterprise
NCP	National Congress Party
NHI	National Health Insurance
P.A.	Practical Action (NGO)
PaR	Portfolio at Risk ratio
ROSCA	Rotating Savings & Credit Association
SCA	Savings and Credit Association
SDF	Social Development Foundation
SDG	The 'second Pound' currency of Sudan since July 2007. One 'second' pound = 1000 'first pounds' (SDP) and = 100 Dinars (SDD)
SMDF	Sudan Microfinance Development Facility
SO(C)B	State-Owned (Commercial) Bank
SSDB	Savings and Social Development Bank
SWOT	Strength, Weakness, Opportunity, threat
TA	Technical Assistance
TOR	Terms of Reference
UN	United Nations
UNAMID	United Nations and African Union Mission in Darfur
UNCDF	UN Capital Development Fund
UNDP	UN Development Programme
UNHCR	UN High Commissioner for Refugees
UXO	Unexploded Ordinance
VC(I)	Value Chain (Integration)
VS&LA	Village Saving and Loan Association
WDA	Women's Development Association
WFP	World Food Programme
WUSC	Women's Umbrella for Saving & Credit

1. Executive Summary

In 2006, the Eastern Sudan Peace Agreement was signed, ending twelve years of **devastating conflict**. Kassala and to a lesser extent Gedaref states were left with very limited capacity, declining institutions, inadequate and decaying physical infrastructure, eroded human capital and shattered social structures. The influx of refugees to Eastern Sudan put additional stress on the already scarce natural resources, and the conflict coincided with a severe cycle of droughts, causing additional environmental degradation and depletion.

Expectations among the peoples of the East to see their historical marginalisation reverse through tangible **peace dividend** were high following the peace agreement, but implementation has been slow. Poverty in the Eastern states is widespread, economic inequality is significant, and human development indicators are among the lowest in the country.

The Government of National Unity (GoNU) has a **deep commitment to social development** and support to the poor, but while social transfers are very appropriate in some situations, they require ongoing subsidies. To enhance the sustainability of the public social development efforts, the Government endorsed microfinance as a crucial component of its financing strategy to support poverty reduction in 2006. Unfortunately, the focus on financing for social development has led to confusion, and the difference between inclusive and sustainable financial services and social transfers has not been sufficiently recognized.

On the one hand, the Central Bank has an **excellent Vision and Strategy** to facilitate the development of a Good Practice microfinance industry in the country. On the other hand, commercial banks are impatiently asked to allocate 12% of outstanding portfolio to "micro-finance" within restrictive recommended profit margins, and **large amounts of subsidized capital** for on-lending are made available for microfinance, in most cases without sufficient training and product adaptation. The **lack of capacity building** has been exacerbated by the delayed start-up of the Sudan Microfinance Development Facility co-funded by the Multi-Donor Trust Fund to provide technical assistance (and funding) to emerging microfinance providers.

This intense **supply-drive** may be the single biggest constraint to good microfinance development in Sudan today. Comparatively less attention has been paid to the quality of the financial services provided and the sustainability of the institutions providing the services. Nowhere else in the world has a supply-driven, government-subsidised approach to microfinance provision been successful and Eastern Sudan displays no particularities that would suggest it will be successful here.

The total *minimum* market for microfinance in Kassala and Gedaref states is estimated to comprise some 680,000 economically active adults in around 222,000 poor households, of which the majority reside in rural areas. The key access barriers to formal finance for this potential market is the urban concentration of banks, cumbersome documentation demands, excessive collateral requirements and the subsequent high transaction costs (transport, insurance, guarantors, etc.). The existence of an informal market for financing by traders at extremely high rates indicates that there is a **demand for specialized microfinance** in Eastern Sudan.

But the Eastern market **lacks specialized providers** of microfinance services. All current microfinance providers (MFPs), whether bank branches or NGO programmes, are by international standards **small and display serious weaknesses** in operational, financial, managerial and strategic management capabilities.

There are a **relatively high number of formal service providers**. Altogether 42 bank branches finance a small portfolio of SP 305 million in the two states, of which, however, only 75% is mobilised from deposits, and only a tiny fraction is microfinance. Banks in the two states reported a total of 3,690 microfinance contracts outstanding by June 2009, but the level of data reliability is so low that any estimate – whether based on reported or calculated data – should not be regarded as accurate until further validated.

In addition, around **five mostly humanitarian INGOs** have experimented with financial asset building as part of broader livelihood interventions in the East. Many attempts at providing 'seed capital' have ended with poor repayment results and most INGOs have handed over their remaining funds to local associations, hoping for better results. The NGOs are more familiar with the market segment of the poor but have been reluctant to adopt the business principles necessary to become sustainable microfinance providers. The INGO ACORD stands out as having run a relatively well-functioning microfinance program since the early 1990s. Now almost 20 years later, however, a decision has been made to phase out the ailing program.

Two **potential new MFIs are appearing** on the horizon with the decision of the Wali of Gedaref and the Ministry of Social Welfare of Kassala, respectively, to establish a microfinance provider as part of the Social Development Foundations (SDF) in the two states. Both SDFs have excellent track-records as *facilitators* of increased access by poor people and women in particular to social and non-financial services. They may not, however, be the most obvious sustainable microfinance service *providers.*

The banks offer **a broad range of Islamic deposit and financing products**, but only in a very few cases (ABS Aroma in Kassala and SSDB Gedaref) have standard products been adapted to the new micro-market. On the financing side *murabaha* (sales with mark-up) contracts have for long been the preferred product. In **no**ne of the bank branches visited during the Consultancy was there **evidence of adjustments** of staffing, incentives or delivery mechanisms. The Consultancy found no guidelines or formats available for customers, neither in Arabic nor local languages. Likewise, collateral requirements and pricing were largely identical for regular and micro-financing contracts.

Because of the lack of or delay in technical assistance, training and management buy-in at the beginning of the 'supply-push', microfinance in Eastern Sudan has come **off to a rocky start** with lack of adaptation and market orientation; slow disbursements, over-collateralisation; and high delinquency rates as a result. The current overall financing portfolio of banks is showing signs of great distress with an average overall default rate in Kassala of 14% and an equivalent 27% in Gedaref. Interestingly, the small portfolio of microfinance has done relatively better, even if it is over double the global benchmark at 11-13%.

A primary reason for this rigidity is the very centralised financial sector where most bank branches are given an annual budget with allocations for sectors and product types to implement. This leaves the **branches without much authority, flexibility or motivation to adapt** products and services to changes in the market place. Changing this extremely centralized system would not only give branches more liberty to interact with and adjust to their respective markets and exploit market opportunities as they may arise; it may also – if combined with performance-based incentives – improve the performance of the branches to the benefit of the banks as a whole. Decentralising and delegation would, however, have to be accompanied by significant capacity building. Additional capital allocations will not alone increase outreach or improve performance.

The **range of available insurance products is very wide** and a number of the current products could be adapted to the micro-market with a minimum of effort. The insurance providers are, however, hampered by the same centralized and top-down business model as the banks, and thus the ability and motivation of branch staff to develop, adjust and market products adapted to the local market are very limited. A more systemic use of insurances against uncontrollable risk (weather/harvest, fire/theft, medical issues/death) could serve to replace circumstantial relief grants as a more predictable, objective and thus equitable system of risk mitigation.

Financial services, whether Islamic or conventional - when done well - can be provided on a commercial basis, independent of donor or government support. Loans or credit lines operated through government-affiliated structures, however, tend to politicize credit decisions and discard sound financial management principles. The resulting distortion may prevent managers of financial institutions from operating in a sustainable manner and often leads to decapitalisation and low rates of repayments if clients perceive the financing as a gift. The confusion has been exacerbated by donor and government support without due acknowledgement of the basic '3S' approach to successful financial service provision: **S**eparate, **S**pecialised and **S**ustainable.

The provision of successful microfinance in a captured and 'depressed' economic setting like Eastern Sudan calls for high levels of market responsiveness, responsibility and prudence on the part of providers to carefully design products, adapt delivery mechanisms and assess the amount of finance available against the customers' business capacity and opportunities for investment to avoid over-indebtedness. Very few of those building stones for Good Practice microfinance are yet available in Eastern Sudan, and the attempts to drive forward expanded access to finance with carrots (subsidised credit) and sticks (regulatory directions) from central level have not produced the desired results.

The risk of availing more capital to weak managerial structures with little understanding of operational requirements for growth cannot be understated. In order to develop a sound, dynamic and growing microfinance industry in (East) Sudan, the (few) interested microfinance providers need to get **access to training, exposure and solid technical support** to successfully manage the entirely new methodology that is microfinance

The level of effort required to prepare banks and e.g. SDFs for providing Good Practice microfinance given especially the limited skill levels available may not yet have been fully internalized. **Improved capacity building** combined with results- and performance-based monitoring, and clearer reporting requirements more in line with international good practices would be a good starting point. **Management buy-in, intensive training and staff incentives**, as well as ongoing on-site technical assistance and mentoring, opportunities for exposure and exchange of experience with peers would seem necessary for microfinance to take root and become a successful new product line for (some) commercial banks in Eastern Sudan.

To help the process back on track, a **Re-alignment Plan** is being proposed to ensure that the fledgling industry in East Sudan can access the capacity building services it needs to restructure, re-design and adapt over the next six months. This would enable *interested* banks and other MFPs to be ready with appropriate products, procedures, pricing and performance monitoring systems to receive customers at the beginning of the next planting season where financing needs peak. As part of the restructuring plan, it is recommended that:

- **Immediate technical assistance be availed to the planned SDF MFIs** to ensure that their design is sound. The SDF MFIs proposed have the potential to become the first specialised MFIs in Kassala and Gedaref but they set out with a legacy of constraints. To become successful, these institutions need to adopt the three Ss, i.e. become Separate, Specialised and Sustainable;
- Competitive access by bank branches to resources for capacity building (training, TA, systems development, etc.) from a locally embedded **Microfinance Capacity Building Fund** that can help synergize efforts and monitor progress. The Fund may be placed at a strengthened CBOS office or co-locate with the Eastern Sudan Reconstruction and Development Fund. The Fund would work closely with the SMDF at national level;
- An **international tender** is issued for a specialised Islamic microfinance provider to set-up a sustainable demonstration model in Eastern Sudan

To begin the industry building process that will eventually bring forth a champion for Good Practice Microfinance, information is sorely needed at all levels by all stakeholders. It is recommended that CBOS MFU systematises its communication with stakeholders in a **Quarterly Bulletin**. A number of **other industry building measures** are suggested implemented at the state- or regional level to strengthen cooperation and coordination in the local market and build mutually beneficial horizontal linkages among stakeholders.

Microfinance cannot by itself reduce poverty. For people to be able to extract themselves from poverty, they need markets that effectively work for the poor by providing access to economic opportunities. In addition to specialised microfinance, there is a great need in East Sudan for **general and business development service market development; value chain integration** for micro- and small enterprises; and **mobilisation** of future microfinance clients. Such efforts are important contributors to poverty reduction and may be more attractive for grants-based funders and socially mandated government agencies to support.

2. Background and Introduction

The Government of Sudan is committed to supporting the expansion of sustainable microfinance in the north of the country through process managed by the Central Bank of Sudan.

For many years, a number of specialized and commercial banks have provided small financing contracts to farmers, pastoralists and tradesmen in the country, and donor-funded NGO-projects have been supporting community-based revolving funds, but a microfinance industry adopting internationally recognised Good Practices is only beginning to emerge.

In 2006, the Central Bank of Sudan (CBOS) took the lead in taking stock of the situation and designing a 5-year Strategic Plan to improve the outreach and quality of Good Practice-based microfinance. To better understand the constraints for the emerging industry and promote access to finance for poorer people, CBOS hosted a first National Consultative Forum on Microfinance co-sponsored by UNDP, the World Bank and IFAD in 2007. The Forum was able to:

- Examine and take stock of past and ongoing experiences in the sector within Sudan;
- Foster partnerships between potential microfinance providers in Sudan and identify synergies to allow practitioners to benefit from the ongoing activities, share information, data and enhance capacities;
- Enhance microfinance networking by establishing common platforms for collaboration.

In addition to the Strategic Plan of CBOS which saw a regulatory framework developed for microfinance and a dedicated Microfinance Unit established at the central bank, the Government of Sudan allocated USD 40 million through CBOS to match-fund credit lines for microfinancing by 8 commercial banks. For all other banks, CBOS recommended that 12% of their outstanding portfolio be allocated to the financing of micro- and small projects.

With the substantial amount of subsidised capital available, international development partners through the Multi-Donor Trust Fund engaged with the Government to establish Microfinance Development Facilities to bridge and close the significant gap in technical know-how and capacity to design, roll-out and manage Good Practice Microfinance. In 2008, the Frankfurt School of Management and Finance was contracted to set up the Sudan Microfinance Development Facility (SMDF) as an apex funding and capacity building facility for the north of the country. Delays marred its start and it has only recently become fully operational.

Due principally to the serious capacity limitations and the lack of exposure and demonstration models, the significant capital investments made in expanded access to finance have not yet borne fruit. Recognizing that it will take time for commercial banks and MFIs to understand the new market segment; adapt products, procedures, and pricing accordingly; adjust institutional set-ups; and build capacity to sustainably serve the needs of the poor and low-income population, the CBOS received support from UNDP and UNHCR to strengthen the provision of microfinance in Darfur and Eastern Sudan where large numbers of refugees, IDPs, conflict victims and rural and urban poor have historically been under-served.

As a first step to define the nature of such support and ensure that it would be complementary to the work of the SMDF while focusing on the specific needs of the markets in Eastern Sudan, UNDP and UNCR jointly funded the cost of a Microfinance Consultancy under UNDP's Livelihood and Sustainable Natural Resource Management Programme for Kassala and as part of UNHCR's Strategy for Self-reliance for Refugees. The Consultancy to be conducted by a team of one international and one national microfinance expert was to undertake the following activities (see TOR in annex 8):

- Document and review current microfinance programs being implemented in eastern Sudan by the NGO sector (identify type, scope, target population, selection criteria, etc.) with a specific focus on ACORD and its provision of loans to refugees in camp settings;
- Assess access to microfinance via the commercial banking sector in eastern Sudan;
- Assess demand for microfinance in Eastern Sudan;
- Provide recommendations on how to expand access to microfinance in eastern Sudan.

The Microfinance Consultancy was conducted during the period of 29 August – 25 October 2009 in Kassala, Gedaref and Khartoum states of Sudan. The international Consultant was greatly assisted in verbal and written translations by Mr. Mohamed Badawi assigned by the CBOS and by other staff of CBOS' Microfinance Unit and UNDP Sudan. Throughout the assignment, the Consultant was fortunate to meet with committed professionals, who shared their insights and assessments of the current situation and constraints, and took time from a busy schedule to attend meetings and provide information and feedback. The Consultant would like to extend her sincere appreciation for all the time and effort that was put into the assignment by all persons met.

3. Approach and Methodology

The Microfinance Consultancy had three main tasks to perform: an assessment of the demand; a review of existing supply; and recommendations on how to close any gaps between demand and supply. In addition, however, the TOR required a long-term technical assistance plan to support the industry development in the East and a Project Document (Proposal) for a Microfinance Program in Eastern Sudan (see Terms of Reference for the assignment in Annex 8).

In response to the TOR, the international consultant adopted a financial systems development approach, involving an assessment of the size and characteristics of the overall client market; of the existing microfinance retailers; of the business support infrastructure for these retailers (e.g. funding, training, TA, audit, IT provision); and of the enabling environment at macro-level, including policies, legislation and regulation pertaining to or affecting the microfinance industry, especially the Microfinance Regulatory Framework of 2007.

As the context in Sudan is complex and has important bearing on potential success or failure of Good Practice microfinance, the international consultant spent the first two weeks in Khartoum meeting with key stakeholders at the federal government level, and with providers of microfinance, technical assistance and funding in order to gain an overall understanding of the sector. Following an extensive search and compilation of public sources, a review of available publications, reports and other materials was conducted.

In preparation of the field work, individual questionnaires and interview guides for focus group discussions with micro entrepreneurs were prepared to aid the assessment of the demand in Eastern Sudan whereas interview guides were prepared for commercial banks, NGOs and funding agencies for the supply side review (all research tools are available from the Consultant on request). A work plan was drafted and consulted with UNDP, UNHCR and the Microfinance Unit of the Central Bank of Sudan (CBOS MFU), and contacts were made to various consultancy companies and educational institutes to gauge the availability of field research assistants and data entry personnel.

It became evident, however, that the Consultancy was taking place at a very inopportune time for the CBOS MFU whose management was overwhelmed with other important tasks during and after the Holy Month of Ramadhan and Eid. A national microfinance consultant could not be identified for the Consultancy, and instead CBOS MFU seconded a Young Professional Program participant to assist with interpretation and logistics during the field work. Research assistance was also not available, and the demand assessment thus had to be redefined. Instead, two recent market surveys from Kassala State served to validate the demand characteristics observed during the field work of the Consultancy, which included 10 focus group discussions with ASCAs, ROSCAs and other client groups as well as 5 individual interviews with micro entrepreneurs. To inform the supply review, a total of 14 bank branches; 9 NGO offices, 4 insurance companies and seven unions, associations and/or cooperatives were interviewed in Kassala and Gedaref respectively. To validate and further inform the demand and supply findings, interviews and meetings were held with state and locality government authorities and donor agencies and projects in the two states (see Work Schedule and List of Persons Met, Annex 9).

On 02 October, the Consultancy debriefed a joint meeting of UNDP, UNHCR, WFP and IFAD in Kassala State; on 18 October, a debriefing was held with UNDP leadership; and on 22 October, the Consultancy debriefed a joint meeting of CBOS, SMDF, UNHCR and UNDP staff and officials in Khartoum. Prior to the departure of the international consultant from Sudan, a draft report was submitted to CBOS MFU. This final report includes all comments and observations having been received by the Consultant as at the agreed submission date of 05 November 2009.

The Report is divided into eight sections. Sections one through three present the executive summary, background and methodology. Section four presents a summary of the political, socio-economic, legislative and regulatory environment for microfinance in Sudan. Section five presents an estimated quantification and characteristics of the demand in Eastern Sudan, while section six covers the findings in terms of outreach, performance and product range of suppliers. Section seven summarises the main constraints and challenges for the development of a microfinance industry in the East, whereas section eight provides the recommendations as opportunities and options for funders and regulators alike. A series of annexes are attached to the main report. As explained in section 6.2.2, the Consultancy did not find grounds to further develop a long term technical assistance plan specifically for the NGO ACORD, as it is phasing out of microfinance activities in the East. In response to the TOR, a draft project document for a microfinance capacity building project/component which could be incorporated in an ongoing effort or further developed into a new programme jointly funded with other donors will be submitted separately to UNDP and UNHCR, but the recommendations in Section 8 of this report are provided primarily for the benefit of CBOS, SMDF and the retail MFPs in East Sudan.

As the international consultant recruited for this assignment regrettably does not speak Arabic and was tasked to proceed without a national consultant on the team, the risk of misunderstandings, misinterpretations and general errors in the report is higher than usual, and the quality of the data obtained during the field work was mixed. While many efforts were made during the Consultancy to validate and triangulate findings, the Consultant remains responsible for any remaining errors.

Likewise, the views and recommendations expressed in this report are those of the Consultant, and do not necessarily represent the views of the central Bank or other government authorities in Sudan, UNDP, UNHCR, or other microfinance stakeholders in the Sudan.

4. The Setting for Access to Finance in Eastern Sudan

4.1. Country Context

Sudan is the largest country in Africa, comprising equatorial mountains, swamp (the Sudd), savannah, and semi-arid areas and desert in the north. Rich in natural resources, Sudan is home to some 39.1 million people of many religious, ethnic and linguistic groups. 30 million (77%) of the population reside in the North of the country, according to the census conducted in 2008. Of these, a total of 4.5 million people[1] populate the three Eastern states of the country: the Red Sea State that shares a border with Egypt and provides the country's only sea access; Kassala that borders Eritrea; and Gedaref that shares a border with Ethiopia. Gedaref and Kassala States occupy a fertile plain with vast water resources (Gash, Atbara and Nile rivers), which provide the foundations for both large-scale irrigated farming schemes and communities of small farmers. Nomadic pastoralists have been roaming the plains for centuries. In addition, the area is an important hub of the major internal and cross-border trading routes.

4.1.1 Brief Political History

At Independence in 1956, Sudan inherited a relatively paternalistic governance system from the British-Egyptian colonial administration and the volatile political system has retained an elitist and centrist bias over time. A perceived backwardness of Sudan's rural populace has been advanced as justifications for various systems of preferential representation in parliament and may help to explain the persistent centralization of political and hence economic power in the country[2].

The numerous elections and referendums held since Independence (see Box 1) have not so far produced the stable, legitimate and dynamic government that secret ballot is meant to encourage and the extreme centralization of power especially under authoritarian regimes appear to remain a major driver of conflict in the country[3]. The current President came to power in 1989 as the leader of the National Islamic Front, renamed in 1998 to the National Congress Party (NPC).

Box 1: Periodization of Sudan's political system since 1953

1953	Self-government election
1956	Independence
1956–58	First parliamentary period
1958–64	Military government of I. Abboud
1964	'October revolution'; fall of Abboud government
1964–69	Second parliamentary period
1969	'May revolution'; military officers seize power
1969–85	Military/one-party rule under Nimeiri
1973	Addis Ababa accord; peace settlement
1983	Bor mutiny; large-scale violence resumes
1985	'Intifada': fall of Nimeiri regime
1985–89	Third parliamentary period
1989	'Salvation Revolution', the *Ingaz*; military officers led by Omar al Bashir seize power
1989–2005	Authoritarian rule under the NIF, then the NCP
2005–	GoNU under CPA

Sudan's development has thus been marred by protracted internal conflicts (1956-72 and 1983-2005) and international isolation. The root causes of the conflicts relate access to resources, economic opportunity and power between the centre (Khartoum and adjoining states straddling the Nile River)

[1] This figure was released by the census council of Sudan based on the April 2008 population census.
[2] Rift Valley Institute: Elections in Sudan: Learning from Experience, 2009.
[3] Ibid.

and the periphery (the South; Darfur; the 'Three Areas' - Abyei, South Kordofan and Blue Nile State; and the East) driven by ethnic, social, and economic rifts[4]. Poor governance, economic and political disparities, the discovery of oil in the South, as well as internal and regional power politics have also fuelled the conflicts.

In Eastern Sudan, the 1990s saw a rise in ethno-politics. The establishment of a federal system in 1994 cost the states dear as social costs were now to be borne locally, even if the revenue from mining and border trader went largely to the federal government. Discontent culminated in the formation of the Eastern Front from the Beja Congress and the Rashaida Free Lions which declared war on the central government in 1994[5]. The conflict coincided with a severe cycle of droughts which has caused widespread environmental degradation and depletion. The influx of refugees to the area put additional stress on the already scarce natural resources.

The conflicts are estimated to have cost some 2 million lives, while displacing over 4 million people[6]. Some 420,000 Internally Displaced Persons (IDPs) are estimated to remain in Eastern Sudan of whom around 95,000 are supported by World Food Programme (WFP) and other funders. Since the late 1960s, droughts, famine and political upheaval in neighbouring countries resulted in a large influx of refugees to Sudan, at its height estimated at 1-2 million people. Some 240,000 refugees from Eritrea, Ethiopia and Somalia are estimated to remain in the country and have settled, primarily in the Eastern states[7]. It is believed that a significant number of refugees have become Sudanese. After 40 years, UNHCR continues to assist some 58,700 of these people in 12 camps in Eastern Sudan[8].

The Comprehensive Peace Accord (CPA) signed between the chief warring factions in 2005 marked the end of the civil war in Southern Sudan. It was followed by the Darfur Peace Agreement (DPA) signed in May 2006, but violence and lawlessness in the region continues despite the promises of the DPA and the efforts of the UN-AU Mission in Darfur (UNAMID). The Eastern Sudan Peace Agreement (ESPA), signed in October 2006, brought relative stability to the eastern front and improved commercial relations with Eritrea. The ESPA guaranteed a ceasefire, and provided for a special fund for reconstruction and development; demobilization; and the transformation of the Eastern Front into a political party, but progress has been slow, and the ESPA has not yet delivered on the wealth sharing expected from the agreement.

As a result of the CPA, Sudan's governance structure consists of two governments, the Government of National Unity (GoNU) at the federal level which is seated in Khartoum and has a NPC majority, and the relatively autonomous Government of Southern Sudan (GoSS). A decentralised mode of governance is in place under both governments with a system of semi-autonomous legislative, judicial and executive government structures at State- and Locality (county) level. Local politics have continued to be dominated by national parties, central control over civil service positions and by central allocations of resources to the regions. The budgetary and hence political control by the centre remains strong, especially over the poorer states[9].

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[4] World Bank: IDA Interim Strategy Note for the Republic of Sudan, March 2008.
[5] Kassala State and UNDP: Kassala State Situation Analysis, April 2009.
[6] Sharanjeet Parmar: "An Overview of the Sudanese Legal System and Legal Research", GlobaLex, January 2007.
[7] OCHA: Displaced Populations Report, July - December 2008, December 2008
[8] B. Lippmann and A. Karim: Self-Reliance Strategy for Refugees in Eastern Sudan, Final Report. UNHCR, February, 2009.
[9] Sharanjeet Parmar, op.cit.

4.1.2 The Economy

The conflicts left many parts of the country, including the East, with very limited capacity, decline of institutions, inadequate and decaying physical infrastructure, eroded human capital and shattered social structures. Once regarded as the potential bread basket of the Arab world, Sudan went from being a net exporter in 1981 to becoming a net importer in 1985 of its main staple, sorghum. It remains a food deficient country today, ranked 150 of the 182 countries listed in the UNDP Human Development Index (2007).

Despite the devastating conflicts and skewed resource distribution, Sudan has maintained a sustained record of macroeconomic stability since 1997, and annual real GDP growth averaged about 5% in the 1990s, based chiefly on the agricultural sector which employed around 80% of the work force and commanded some 42% of GDP in 2000, now down to one third. The key export commodities include livestock, gum arabic and sesame[10].

Table 2: Structure of the Economy

Structure of economy (% of GDP)[11]	1997	2007
Agriculture	46.8	28.3
Industry	14.6	30.7
Manufacturing	8.8	6.1
Services	38.6	41.0

Sudan's per capita income (including oil) rose from $506 in 2003 to $1,139 in 2007[12]. Economic growth averaged some 7% per year during 2000-2006 and reached 10% in 2007 – one of the highest growth rates in Africa - bolstered by higher oil production, a good harvest, and a continuing boom in construction and services driven by foreign investments and rising domestic demand. Since then, however, fiscal expansion (public sector growth and investments), including new spending related to the CPA, and lower oil revenue resulted in high fiscal deficits in 2006 (4% of GDP) and 2007 (3.5%)[13].

In 1999, Sudan began exporting oil, resulting in its first trade surplus since Independence and investments started to flow into the country, particularly from China. Oil accounts for 60% of government revenues and 95% of exports (2008). Managed by the National Petroleum Commission (NPC), the Oil Revenue Stabilization Account (ORSA) was exhausted in 2006 to help cover the fiscal deficit, and withdrawals continued through 2007, further depleting deposits and rendering the ORSA unable to provide relief from future revenue shortfalls without significant replenishment[14]. The slump in oil prices at the end of 2008 has taken its toll on the economy. Foreign exchange reserves have fallen sharply, not least because the government was slow to respond with a flexible exchange rate policy and tightened fiscal policy to the decline in oil prices. This contributed to the deterioration in the macroeconomic situation and stagnation in short-term oil production compounds this problem[15]. Overall real GDP growth is projected at about 4% in 2009 (and 5% in 2010)[16].

In addition, Sudan's external debt remains large (USD 33 bn or 58% of GDP in 2008) and arrears (USD 24 bn in net present value) constrain access to longer-term development finance. The current

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[10] World Bank: Interim Strategic Note, March 2008.
[11] World Bank: Sudan at a Glance, 2007 http://devdata.worldbank.org/AAG/sdn_aag.pdf Please note that percentages do not add up to 100.
[12] World Bank: Country Profile Sudan, March 2009.
[13] IMF Staff Monitored Program Sudan - Note, June 2009 and IMF: Staff Monitored Program Sudan Country Report 09/218, July 2009.
[14] World Bank: Interim Strategic Note, March 2008.
[15] World Bank: Country Profile Sudan, Mar 2009.
[16] IMF Staff Monitored Program Sudan - Note, June 2009 and IMF: Staff Monitored Program Sudan Country Report 09/218, July 2009.

foreign exchange squeeze has increased the difficulties of serving the large arrears outstanding with international creditors, including IDA (USD 480 million) and IMF, and while Sudan is potentially eligible for debt relief under the HIPC initiative, it cannot access concessional loans until arrears have been cleared[17].

In the 1990s, Sudan went through a period of hyperinflation (133% in 1996), but the average annual inflation dropped to 17% by 1998 and has averaged less than 10% throughout the current decade. Sudan revised its consumer price index with an expanded basket and broader coverage of rural areas in September 2008. This revised the inflation rate upwards to 15% (December 2008) commensurate with world market food price increases, after a peak of 22% in August 2008. IMF expects the average inflation to decline to 9% in 2009, reflecting lower world food prices and tighter financial policies[18].

Corporate taxation has been prolific if not hard to avoid in Sudan. Banks and other financial institutions pay 35%, while most other companies pay 10% or 15%. A variety of incentives, including accelerated depreciation allowances and extended tax holidays further reduce the tax burden for many companies[19]. In Eastern Sudan, where livestock remains the only viable export commodity, however, it has been the target of a plethora of federal and local taxes since the mid-1990s. Livestock is probably the most highly taxed commodity in the Sudan; traders pay up to 20 categories of taxes between the points of purchase to final exit, which are now being consolidated as part of the tax reform. IMF is advocating for a change in the many blanket government subsidies to a more targeted social safety net scheme as part of an ongoing comprehensive tax policy review[20].

In the World Bank 'Doing Business' index, Sudan ranks 147 of 181 economies (2008). The system for registering property receives a high score, but the cost (51% of GNI per capita), duration (39 days on average) and procedures (10) to start a business in the country may not directly encourage further formalization. While other business facilities are improving, however, Sudan shares the bottom rank of 181 of 181 with Rwanda and Eritrea on the ease with which businesses can close. Weaknesses in the bankruptcy laws and administrative bottlenecks in the bankruptcy procedures keeps assets and human capital from being reallocated to more productive uses and may stifle economic development, as it deters investments, shrinks access to credit and increases non-performing loans and financial risk because creditors cannot recover overdue loans. This may be a serious impediment to the revitalization of a more market-oriented financial sector[21].

4.1.3 The Financial system

Sudan operates with two financial systems: exclusively Islamic finance in Northern Sudan and conventional finance in Southern Sudan[22]. The financial system is supervised by the Central Bank of Sudan (CBOS), which is responsible for establishing macroeconomic, monetary and credit policies; regulating and supervising the banking industry; issuing currency; and acting as the bank of GoNU. It has a right to determine minimum profit levels, deposit reserves, ceilings for volume of credit and activities to which credit is provided, and to receive annual 'budgets' and monthly balance sheets for the banks it supervises. CBOS manages the clearing house of Sudanese banks[23]. In addition, CBOS is

[17] World Bank: Interim Strategic Note, March 2008.
[18] Ibid.
[19] FIAS: Sudan Review of administrative barriers to investment, June 2006.
[20] IMF: Sudan SMP for 2009-2010, June 2009. See also S. Pantuliono and M. Babiker: Addressing chronic livelihoods vulnerability in Red Sea State, Sudan, Oxfam GB, February 2006.
[21] World Bank: Doing Business, Sudan Country Profile for Sudan, 2009.
[22] Meloni, C., Bott, M. and Hansohm: Microfinance In Sudan - An Assessment Of The Current Status Of The Industry. Paper for the First National Consultative Forum on Microfinance Khartoum, November 2007.
[23] Bank of Sudan Act 2002

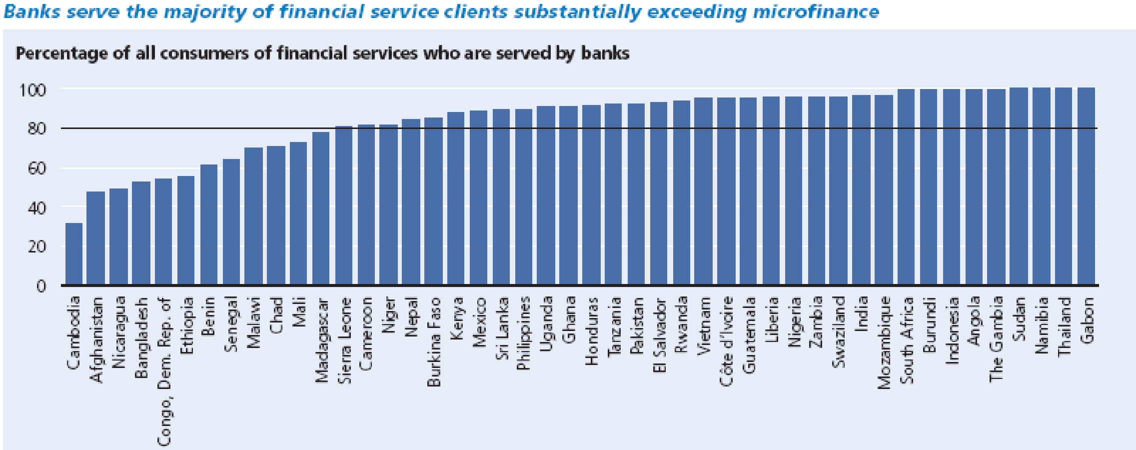
charged with the "promotion and development of banking in a manner that will achieve balanced economic and social development in pursuit of economic stability"[24].

The Bank of Southern Sudan (BoSS) is part of CBOS but has the power to license financial institutions operating in the 10 Southern States. Due to its supervisory and public banking functions, CBOS has 12 branch offices. The Eastern states are served from a branch in Port Sudan (for Red Sea State) and one in Gedaref (for Gedaref and Kassala states).

CBOS oversees an institutionally diversified financial sector comprising 33 licensed banks of which 26 are registered as commercial, including two state-owned (SOCBs), two branches of foreign (Gulf-based) banks, and 22 joint-venture (JV) banks. Five additional banks – 1 JV 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. The bank branch network, while concentrated in the central riverine region of Khartoum, still number 522[25]. Accordingly, by African standards, bank usage in Sudan is relatively high at 144 bank accounts per 1000 adults (see Figure 3)[26].

Figure 3: Bank usage in Africa

Banks serve the majority of financial service clients substantially exceeding microfinance



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 40 companies; some 22 foreign exchange companies (the central bank supplies foreign exchange to bureaus and commercial banks to meet private demand[27]); 15 insurance companies; and 4 national funds, including the Pensioners Fund, the National Social Insurance Fund, the Industrial Finance Fund and the Bank Deposit Security Fund[28].

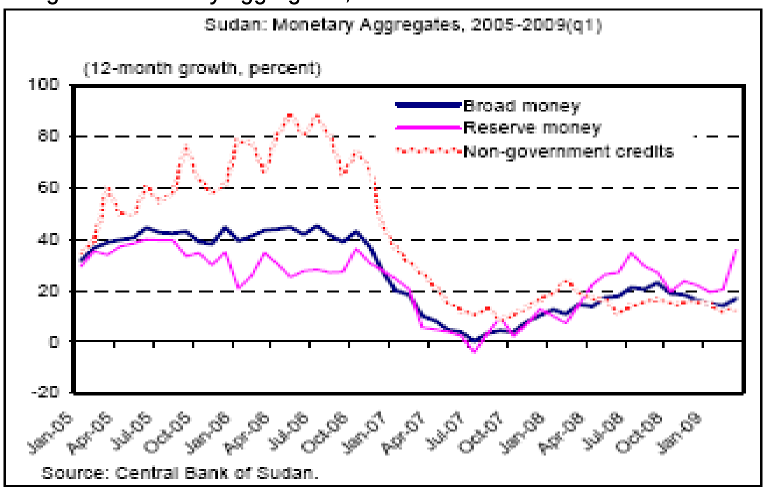
Insurance is a particularly well developed industry in Sudan, where the first Shariya-compliant (*takaful*) insurance company was established in 1979. In 2006, net insurance premiums received by the industry exceeded gross claims payments to customers by 21%[29].

[24] Central Bank of Sudan Act (2006) and Annual Report from Central Bank of Sudan, 2007.
[25] http://www.cbos.gov.sd/arabic/id/bankingsystem/spread.pdf
[26] Getting Finance database in World Bank: Banking the Poor, 2009 from where Figure 3 is also taken.
[27] IMF: SMP Sudan Program Note, July 2009.
[28] Listing from CBOS' website: http://www.cbos.gov.sd/english/id_e/banks/banks.htm which may not be completely up to date.
[29] CBOS: Annual report 2007.

The total assets of the banking sector (including South Sudan) stood at around SDG 26.1 bn (USD 10.4 bn) as at end 2007. Total deposits reached SDG 13.9 bn (USD 5.5 bn), of which 88% were from the private sector. Of these deposits, SDG 5.6 bn were mobilized in current accounts. 93% of this deposit base was used for lending in 2007 (20% for import, 17% for local trade, 10% for industry, 7% for agriculture and only 3% for 'social development' including microfinance. Of the total lending, 58% was *murabaha* contracts in 2007 [30].

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, remained more subdued in 2008 than the year before, as funds made available through government arrears clearance reduced businesses' demand for credit. By March 2009, growth of private sector credit had slowed to 13%, in line with a drying up of credit lines from foreign banks (See Figure 4).

Figure 4: Monetary aggregates, Sudan



The financial sector is dominated by one, very large and very troubled SOCB, the Omdurman National Bank (ONB). The government has pledged to restructure and privatize the bank, which accounts for 28% of all lending (2008) and the majority of non-performing loans. A plan for restructuring is expected published by end 2009[31].

Overall NPL in the banking system is 22% (end 2008) down from 26% the year before and provisioning against this debt, while increased to 15%, remains insufficient. The CBOS has pledged to require banks to increase provisions by 2% above their 2008 levels[32].

Figure 5: NPL and CAR in Sudan

Sudan: Financial Soundness Indicators
(In percent)

	Dec-07	Dec-08	Mar-09
Asset composition and quality			
Gross NPLs to loans	26.0	22.3	23.5
of which: Omdurman Bank			
NPLs net of provisions to gross loans	22.2	19.0	18.8
Loans provisions to NPLs	14.6	14.9	19.9
Capital adequacy			
Regulatory capital to risk-weighted assets	22.50	10.50	...

Source: Central Bank of Sudan.

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 totalling 1.5% of GDP between September 2006 and January 2007. During the year of 2007, CBOS increased its capital contribution to banks by 74% while it's

[30] Ibid. See Annex 1 for an overview of Islamic financing instruments.
[31] MoFNE and CBOS: Sudan Memorandum of Economic and Financial Policies, June 2009.
[32] IMF: SMP 2009-2010, June 2009 and CBOS and MoFNE: Memorandum of Economic and Financial Policies (MEFP) to IMF, June 2009.

lending to banks increased 18%[33]. Even so, the average capital adequacy ratio of the banking sector fell below the minimum required level of 12% of risk-weighted assets to 11% at end 2008, largely on account of ONB (see Figure 5)[34].

The banking industry meets in the Sudanese Bankers' Association which hosts meetings and advocates on behalf of the sector[35].

4.2 Poverty and Inclusive Markets in Sudan

While economic growth has been strong in recent years, it has not been broad-based and may even have been accompanied by rising inequality between regions and between rural and urban dwellers. A more pro-poor allocation of public expenditures for expanded access to basic services and a more balanced (inclusive) pattern of growth emphasizing traditional rain-fed agriculture and small business will be vital for enabling poverty reduction, lowering inequality, and mitigating conflict by delivering a peace dividend[36].

The infusion of foreign exchange from oil exports and large inflows of FDI drove a steep 40% appreciation of the real currency exchange rate during 2005-2006. This raised significant competitiveness problems for the traditional agricultural exports, and the rural producers and traders were doubly hit by droughts and other supply-side constraints to production. While contributing significantly to overall national wealth, the oil-based growth has in effect impoverished areas dependent on livestock exports and agricultural production[37].

The large urban-rural and regional disparities are closely related to conflict, isolation, public spending patterns, displacement, and chronic poverty. Per capita GoNU spending is about USD 280/year but has been concentrated around Khartoum, central states and the major urban centres (including Gedaref), boosting employment and tax revenues and thus enabled these areas to spend more on service delivery. Relatively little of this wealth has reached the poor and the remote, marginalized areas.

The GoNU has been unable to agree on a poverty line for the country, and hence the extent of the problem – while broadly recognized as significant - has not been quantified. Sudan has yet to finalize and publish a national Poverty Reduction Strategy Paper (PRSP), which is now expected by the end of 2009[38]. Poverty, particularly rural poverty, thus continues to be a major development concern in Sudan. Economic growth, while not the only ingredient, is a precondition for poverty reduction. Micro- and small sized enterprises (MSEs) constitute the largest segment of the informal economy in Sudan, providing income and employment for a majority of the people at the Bottom of the (economic) Pyramid (BOP). Therefore, expanding opportunities for and productivity of MSEs is crucial to spur rural and urban economic growth that is pro-poor.

It is fair to say that of the three Eastern States, Kassala is the least developed - poverty is chronic and widespread, economic inequality is significant, and human development indicators are among the lowest in the country[39]. Using definitions established by the Zakat Foundation (SDG 15/day/household) and by CBOS in its effort to define the poor as microfinance clients (a monthly

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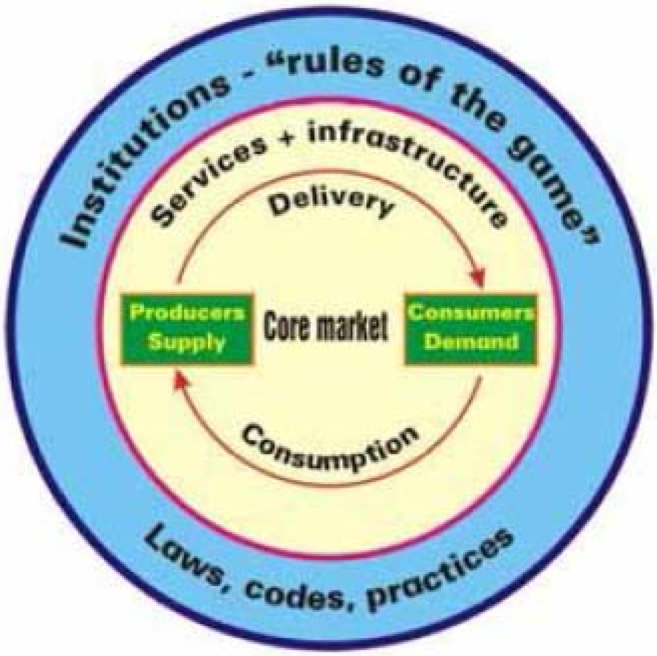
[33] CBOS: Annual Report 2007.
[34] IMF: SMP Sudan Program Note, July 2009.
[35] International Banking Systems Journal/IBSJ Supplements/IBSJ Middle East Supplement: Market Overview – the Complex Patchwork, Feb 2007.
[36] World Bank: Interim Strategic Note, March 2008.
[37] Ibid.
[38] CBOS and MoFNE: Memorandum of Economic and Financial Policies (MEFP) to IMF, June 2009.
[39] Ibid.

income not exceeding twice the minimum wage or SDG 500/month), Gedaref state operates with a poverty rate of 53%[40], while Kassala state authorities estimate a poverty prevalence of 70%[41].

Fig 6: Components of a Functioning Market[42]



For markets to work for the poor, they must first work. In Sudan, as in many other developing and transition countries the foundations for private sector activity are not fully in place or legitimized, the 'rules of market operation' and the legal and regulatory institutions necessary to support them are weak, and business environments may hamper rather than promote entrepreneurship and investment. Large state-owned enterprises or state-controlled sub-markets stifle entrepreneurial energy and initiative, taking advantage of weak institutional environments to protect monopolistic positions. The result is that markets, where they operate at all, tend to favour existing elites and reinforce existing patterns of inequality and social exclusion[43]. Even where markets are creating growth, they are not creating jobs and reducing poverty at a commensurate rate[44].

Markets are deeply embedded in a set of non-market, social and political institutions: the way in which the poor participate in markets is conditioned by economic, political, social and cultural factors. 'Inclusive Markets' are defined broadly as 'markets that result in expanded choice and opportunity for the poor and produce outcomes that benefit the poor'.

- For the poor as entrepreneurs and employees, such outcomes will mean increased returns on goods sold, improved access to labour markets and increased opportunities for 'decent work.'
- For the poor as consumers, they will mean increased choice and affordability for essential goods and services, including access to financial services that help reduce risks and vulnerability[45].

However, for the very poor, basic needs (food, housing, clothes, health, and education of children) need to be met to some degree, before the resources to participate in economic activities can be mobilized. Where enterprises in rural communities have not yet been established, and where the majority of the community survive on subsistence farming or pastoralism with very little cash flow, credit services is <u>not</u> the most appropriate initial service. Social protection, literacy (education), health and infrastructure (drinking water, irrigation, sanitation etc.); and the mobilization of community resources (human, social and economic capital through savings) to articulate, prioritize and demand

[40] Interview with Gedaref Minister of Social Welfare Mr. Abdelgadir Mohamed Ali on 4 October, 2009.
[41] Interview with Kassala Director General of Women and Social Welfare Maria el Khidir on 14 September 2009.
[42] DFID: Making Markets Work Better for the Poor – an Introduction to the Concept', 2005 as quoted in UNDP: Private Sector Strategy – Promoting Inclusive Market Development, September 2007.
[43] UNDP: Private Sector Strategy – Promoting Inclusive Market Development, September 2007.
[44] Malte Lubker: "Labour Shares", in ILO Technical Brief No. 10, ILO, 2007.
[45] UNDP: Private Sector Strategy – Promoting Inclusive Market Development, September 2007.

basic services remain essential preconditions for poor people to take advantage of entrepreneurial opportunities.

As such, the core services availed through local development or governance projects are crucial to the continued development process in rural Eastern Sudan, especially among the 'ultra-poor' and socially excluded population segments. Only when basic needs have been met to some degree, and the poor are mobilized, do demand- and enterprise development and market linkages as supported e.g. by Practical Action and ACORD in Eastern Sudan become key for the poor to engage in income-generation through entrepreneurship, and thus lift themselves out of poverty.

4.3 Microfinance in Sudan

4.3.1 The Policy, Legal and Regulatory Framework for Microfinance

The GoNU and GOSS have both endorsed microfinance as a crucial component of their financing strategies in support of the 'social dimension' or poverty reduction. In 2006, CBOS commissioned a situational analysis of microfinance in the country[46], based upon which a National Vision for the Development and Expansion of the Microfinance Sector in Sudan was drafted, consulted and adopted. The Vision paper outlined the potential and challenges in the market, the options for support to development of a microfinance industry and the principal strategies available. Fully Good Practice-compliant, the Vision (goal) adopted is to: "*facilitate sustained access to financial services for the economically active poor in rural, semi-urban and urban areas by expanding and developing the microfinance sector in a cost-effective, gender sensitive and sustainable manner*"[47].

In pursuing the Vision, a series of strategies were agreed and a work plan adopted, which included:

- Microfinance licensing and regulation for banks and MFIs;
    - Licensing for NGOs as MFIs with the Humanitarian Aid Commission (HAC) and of cooperatives (under the Cooperative Law of 1999)
- Reform of the existing specialized financial institutions to promote microfinance provision by banks;
- Linkage banking including whole-sale mechanisms and a re-evaluation of the effectiveness of directed credit;
- Promotion of a broader range of financial products, including *musharakah* investments both by banks (in micro-enterprises) and by clients (in bank investments for dividends);
- Study and promotion of non-conventional/social collateral including guarantees and support to land titling, e.g. registration of *Hashab* gardens, etc.; and
- Promotion of micro-insurance.

To oversee implementation, the CBOS established a dedicated Microfinance Unit (MFU) in March 2007, fully responsible for executing the strategy. Similarly, an MFU was established in Bank of Southern Sudan. To ensure broad buy-in and awareness raising, the First National Consultative Forum on Microfinance was conducted with donor support in November 2007[48]. A first progress review of the implementation of the strategy was conducted in November 2008[49].

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[46] UNICONS: Situational Analysis of the Status of Microfinance in Sudan, Mar 2006.
[47] CBOS and UNICONS: A Vision for the Development and Expansion of the Microfinance Sector in Sudan, July 2006.
[48] See Forum Report on First National Consultative Forum on Microfinance: Microfinance Best Practices in Conflict-affected Countries – Challenges and Opportunities for Sudan, November 2007.
[49] UNICONS: Evaluation of Implementation of the Strategy for The Expansion and Development of the Microfinance Sector in Sudan, Nov 2008.

While many of the constraints listed in the Situational Analysis and Vision of 2006 remain valid today, some barriers to microfinance development have been lifted. During its first 2 years of operation, the CBOS MFU upheld high momentum, no doubt buoyed up by the GoNU declaration of 2008 as the Year of Microfinance in Sudan:

- A regulatory framework for microfinance was adopted and disseminated;
- Policy and implementation guidelines were developed and disseminated to microfinance providers (MFPs) along with licensing requirements and reporting formats;
- The Law on Humanitarian and Voluntary Work was amended with HAC, officially permitting local and international NGOs to conduct commercial activities, including microfinance; and
- Studies were commissioned on legislative challenges and collateral constraints, and a resulting Circular[50] encouraged MFPs to use more non-conventional collateral types.

CBOS defines microfinance as financial services to poor people. Poor people are defined as people with an income not exceeding twice the minimum salary (currently SDG 500/month) and whose productive assets excluding land do not exceed a value of SDG 10,000, "provided he is not a regular employee in any organization and not less than 18 or more 60 years of age"[51]. This latter salary-related restriction would exclude a significant potential market segment of low-income wage-earners that are normally considered prime microfinance clients. Micro-financing is restricted to a maximum of SDG 10,000/contract (USD 4,000).

In accordance with international good practice, the current regulatory framework for microfinance[52] distinguishes between non-deposit taking MFPs on one hand, and microfinance banks or non-banks (institutions) which have to be licensed by CBOS to mobilize public deposits on the other.

- 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[53];
- 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 as a 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'[54]. Only microfinance banks are allowed to take public deposits, but non-deposit

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[50] CBS circular No 5/2008, dated 10/3/2008
[51] CBOS: Microfinance Regulatory Framework, July 2008.
[52] CBOS: "Microfinance Regulatory Framework", July 2008 and "Policies for the Year 2009, the Financing Policies for the Activities of the Social Dimension", 2009.
[53] Promoted by the Businesswomen's Association of Khartoum State, the Family Bank is the first microfinance bank licensed under the Microfinance Regulations and started operations in July 2008. The Bank is registered as a public company, with CBOS, Khartoum State, the National Social Insurance Fund and the Zakat Chamber as its main shareholders. UNICONS: Review 2008. Op. cit.
[54] CBOS: Microfinance Regulatory Framework, July 2008.

taking MFPs may be allowed to accept compulsory savings and take voluntary savings up of a maximum of SDG 1 million[55]. MFPs must report and seek prior approval for expansion plans and curiously, CBOS also regulates work hours[56].

The only area in which the microfinance regulatory framework falls a little short of international good practices is its loan loss reserve and provisioning regulations that copy commercial banking rules and are thus not stringent enough for microfinance. The regulations allows banks not to provision at all until arrears are past 91 days, and suggest an overall provisioning of only 1% of outstanding portfolio. For the less collateralized microfinance portfolio, that could prove too lenient. The framework uses prudential capital adequacy ratios and limits on unsecured lending which reflect Basel II requirements for commercial banking and may deter new microfinance entrants or transformations, as the requirements may not be well understood.

Some of the key components prioritized in the CBOS Vision and Strategy to provide a more enabling environment for microfinance have not yet been implemented and would appear to require urgent attention. These include:

- Establishment of a central database and performance monitoring system for MFPs
    - The Review mentions that a database within CBOS MFU has been established. This could, however, not be verified.
    - Based on 40 years of international experience, good practice performance reporting standards are available which could be readily adapted for implementation in Sudan.
- Coordination and information to MFPs and stakeholders at large
    - Confusion remains about what microfinance is; can; and should or should not do. MFPs and the broader group of microfinance stakeholders urgently need increased awareness raising, unambiguous information, and clarity, and increased collaboration among providers would facilitate expansion of outreach and sounder performance.
- Consideration of a private "Information Credit Bureau" (ICB) or credit reference service.
    - Instead, microfinance customers have been included in the centralized system for coding of commercial borrowers, which includes very detailed and perhaps irrelevant data[57] and delays the processing time of an application by at least 7-14 days.

The Vision work plan as stated is impressive in its application of Good Practices and while there is room for improvement in the regulatory framework, it should not in itself deter industry growth. Any current causes of concern are related to initiatives outside of the Vision work plan, and to the ability of the CBOS MFU to stick to the Vision in the face of political pressures.

In 2008, a "Sudan Pilot Microfinance Project" was launched, which allocated SDG 115 million to *musharakah* partnerships (effectively credit lines matched by subsidized CBOS funds dedicated for microfinance lending)[58]. To access this cheap source of funding, banks are required to establish microfinance units. This has been done by at least nine commercial and specialised banks at head office level, but not necessarily in the branches to which funds are being allocated, where capacity to implement microfinance is still very limited. In addition, the general banking policy for 2009 encourages all banks not participating in the Pilot project to allocate 12% of their portfolio to microfinance either directly managed by specialized departments or units for microfinance (at head offices), or through the establishment of specialized branches or subsidiaries. Banks are also encouraged to engage in awareness raising; in simplification of procedures; and particularly in the

[55] In Islamic banking 'savings' (as opposed to deposits) describes a semi-liquid product with no returns.
[56] CBOS: Microfinance Regulatory Framework, July 2008.
[57] The coding data are extremely detailed to meet Anti-Money Laundering (AML) and Know Your Customer (KYC) requirements but given the tiny microfinance portfolio that carries no systemic risk, a slightly more lenient regime for microfinance could perhaps be considered.
[58] Meloni et.al., op. cit.

application of non-conventional collateral and technologically assisted services.

Even with limited enforcement mechanisms for these recommendations, there is thus an exceptionally large pool of funding available for microfinance delivered through banks, but due to the delays in the establishment of a facility for capacity building (see below) and a general belief in monetary incentives, very little training or technical assistance has so far been made available to bankers who are asked to provide a unknown methodology of financing to a new market segment without having to risk too much of their own capital. This unintended "funds first – quality later" situation may be the single biggest constraint to good microfinance development in Sudan today.

4.3.2 The Support infrastructure for Microfinance

The support infrastructure for the finance sector include financiers (whole-sale lenders) and technical service providers (consultants, audit companies, IT companies, trainers etc.) as distinct from the providers of training and business development services to the micro-, small and medium scale enterprises themselves.

The Frankfurt School of Finance and Management was initially called to Sudan based on its core competency of bank training. In collaboration with a local consultancy firm, it adapted and delivered a basic bank training course in 2007, which has now successfully been spun off to the Sudanese Higher Academy for Finance and Banking. The standardised 5-day training for bank staff is continuing and while the need for such induction training is high, it is not sufficient.

Particularly for downscaling banks, international experience suggests that managerial buy-in is what secures – or risks – success, and thus exposure of bank managers may be important. In addition, ongoing and on-site technical assistance, mentoring and/or trouble shooting would appear essential for microfinance to take root and become a successful new product line for (some) commercial banks. In addition, general awareness and exchange of experience would be important. The microfinance providers (MFPs) among the formal banks have not coalesced in a specialized sub-group to facilitate such shared learning. While efforts are being made to bring non-bank MFPs together in a Sudan Microfinance Network (SAMI), this network does not yet appear to have attracted banks.

In 2008, the Frankfurt School of Finance and Management was contracted to manage the "Sudan Microfinance Development Facility (SMDF)", meant to be an apex funding and capacity building provider for the emerging industry in Northern Sudan, as co-funded by the Multi-Donor Trust Fund (MDTF). With the dearth of capacity and experience with good-practice microfinance, the services of the apex institution should be in great demand but its start-up was marred by severe delays and apparent difficulties in delineation of functions with CBOS' MFU, perhaps exacerbated by the project's decision to incorporate as a company while maintaining its physical location inside the CBOS. To gain and maintain legitimacy and advance industry development in the emerging market, the SMDF must necessarily 'lead by example' and apply good microfinance funding principles[59] and practices in all aspects. Given the crucial importance of management buy-in at all counter-part levels in Sudan, the structure of a more generalist project management overseeing the technical work of microfinance specialists at SMDF is possibly not the most appropriate. It is, however, hoped that the Facility can put the start-up difficulties behind it and make up for lost time by attracting and supporting high-level technical assistance to the retail and meso-levels of the industry and strategic input to the policy level in addition to its whole-sale funding.

Other business services for the banking sector appear scarce and not of sufficient quality in Sudan, and most JV banks appear to have technical agreements with service providers abroad or in-house.

[59] The Good Practice Guidelines for Funders of Microfinance developed and endorsed by the member countries of CGAP are available in Arabic at: http://dev.cgap.org/gm/document-1.9.2741/donorguidelines_ar.pdf

While the IT industry is booming, there seems to be less interest in accounting systems, MIS and data management services for banking institutions among private sector providers. Auditors also appear scarce – perhaps because demand is suppressed, given that CBOS inspectors perform audits of banks. The telecommunication industry is expanding rapidly in Sudan and services of relevance for the banking industry are being developed, including EPOS systems. While Sudan benefits from an excellent cellular network, mobile phone banking has not yet reached Eastern Sudan[60].

The biggest funder of microfinance in Sudan is the Government of National Unity through the Microfinance Pilot Project (see section 4.3.1) as an attempt to incentivise the provision of financing to small businesses and the poor[61]. The Agricultural Bank of Sudan (ABS), Farmer's Commercial Bank, the Savings and Social Development Bank and the Real Estate Commercial bank have received the largest shares of the funding, ABS alone availed almost 30% of total allocations[62]. State-level authorities are also contributing funds to microfinance through banks in many states, including in Kassala and Gedaref.

Through the MDTF, donor agencies have invested USD 5 million in the SMDF. Outside of the SMDF, however, donor assistance to microfinance in the North has been less forthcoming, primarily due to the general delay in the shift from a relief to a development approach, compounded by the banking embargo of Sudan that disincentivises donor agencies from engagement. At a low level of effort, UNDP has included preparation of microfinance interventions into a broader private sector development approach being designed, and UNHCR has supported livelihood activities for refugees including revolving financing funds.

IFAD has for long included microfinance activities in its broader rural development projects, and through an impressive process of directly applying lessons learned, it is currently supporting some of the most innovative and inspirational microfinance activities in Eastern Sudan. Under its Gash Sustainable Livelihoods Regeneration Project in Kassala State, IFAD has partnering with the Agricultural Bank of Sudan in an effort to extent appropriate microfinance services to small scale farmers and poor people in the project area, which spans 3 localities. The Bank provides all capital for financing, whereas IFAD has provided funds for the re-opening, staffing and running of a bank branch in the area until it reaches breakeven. Based on a customer-centred approach and with the use of client feedback via water user associations, women's development associations and the media, the bank branch has adapted its products and procedures to better suit the needs of the clients. As an example, it runs a mobile unit to more remote communities.

In addition to the UNDP, both the World Bank's Community Development Fund (CDF) and the European Commission are supporting livelihood development activities in Eastern Sudan, notably by small-scale infrastructure (schools, clinics, etc.) and through NGOs. The CDF may broaden its mandate to include institutional capacity building efforts over the coming year, whereas the World Food Programme is also considering a more market-based approach in its support to food supply.

In general, a more concerted and better coordinated approach by funders to the development of inclusive markets in Eastern Sudan would clarify the gaps, improve coherence in addressing such gaps, and might also serve as an example for the many governmental structures that are operating in parallel. However, the current situation where the nascent industry is being flooded by cheap capital

[60] The importance of cellular phones for microfinance development is described in Arabic in the CGAP publication: http://www.cgap.org/gm/document-1.9.2716/Brief_MobilePhones_AR.pdf
[61] UNICONS: Review of Implementation, 2008, op.cit.
[62] CBOS – MFU, monthly report, September 2008 reported in Unicons, Review, Nov. 2008, op.cit.

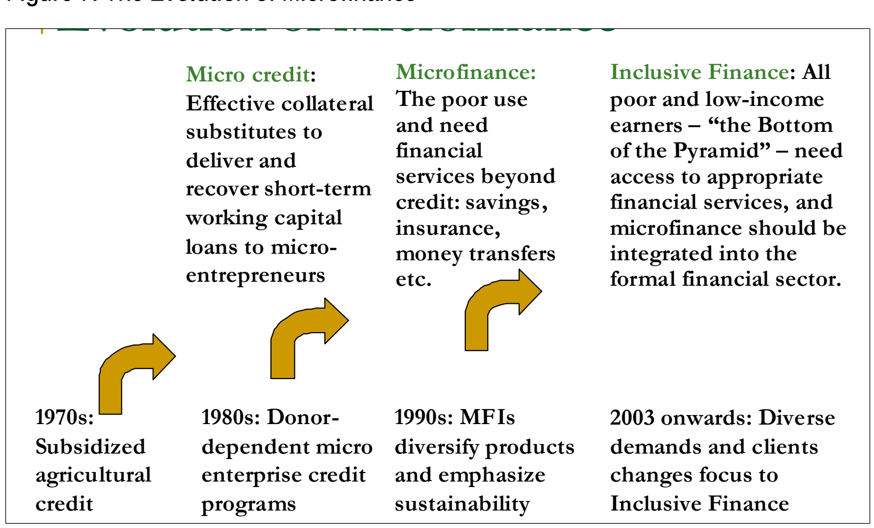
and does not have access to sufficient technical assistance does not bode well for further international funding support.

4.3.3 The Role and Contribution of Microfinance

Microfinance services include micro credit, savings, money transfer, and insurance products. Over the past 40 years, microfinance has developed into a specialized method of providing these financial services at sustainable rates to the economically active poor households, who cannot access finance from commercial banks in the formal sector, be it for socio-cultural, systemic, geographical, or other reasons. This is also the intent in Sudan, but the current microfinance providers (MFPs) are primarily commercial banks and have had difficulties adapting products and procedures to effectively serve poorer customers.

Micro-credit became popular in the 1980s as a system of credit delivery using effective collateral substitutes to deliver and recover short-term working capital loans to poor micro-entrepreneurs based on the successes of Grameen Bank in Bangladesh. Contrary to beliefs, we learned that the poor (especially women) have better repayment habits than most conventional bank customers.

Figure 7: The Evolution of Microfinance



In the 1990s, we learned from the poor that consistent and convenient access to increasing credit and other financial services is more important than the price – and that microfinance therefore does not need subsidies to be successful. The chief motivation for repaying a loan is the promise of future access to another loan and this is often re-enforced with social collateral such as trust bonds and group guarantees. This explains why microfinance can operate successfully in the informal sector without physical collateral, enforceable contracts, and commercial courts. The laws of microfinance are embedded in good operating practices and re-enforced by social contracts. Many MFPs emerged and, adjusting their pricing, began to emphasize sustainability through cost-coverage to decrease their dependency on external funding. As NGOs or other semi-formal providers, the majority did not attain substantial outreach and remained largely outside the purview of prudential financial regulations.

Inclusive finance now summarizes the two aspects of inclusion sought by the industry: the access not just by micro-entrepreneurs, but by all poor and low-income earners – "the Bottom of the Pyramid" (BOP) – to appropriate financial services; and the integration of microfinance into the formal financial sector. Today, inclusive finance remains focused on providing appropriate, market-responsive and demand-driven financial services to the poorest segment of a given population in a sustainable manner, but recognizes that the funds needed to secure this access far outweighs any donor and government budgets. In order to access the private capital markets, microfinance has had to professionalize and demonstrate that financial services to the poor can be provided as professionally, safely and profitably as regular banking. Many NGO-MFIs have transformed into microfinance banks and some commercial banks and financial cooperatives have downscaled to serve BOP. Inclusive Finance describes the present-day sector-wide development strategies that focus on:

- opening the financial services markets to increasingly poor and geographically remote customers;

- integrating the providers of sustainable microfinance into the formal financial sector to allow more access to capital and better protection of poor people's savings; and
- increasing the legitimacy and professionalism of the microfinance industry, without compromising its social mission[63].

Microfinance was developed in cash financing environments (also in Bangladesh) but is not inherently conventional or Islamic and the methodologies can be adapted to work well within both financial systems - the focus is on the specific market segment of the poor and low-income people and they can be served wither way. But microfinance does go a little against the grain of the Muslim (and Christian) tendency to pity the poor. Microfinance is a service provided to strong, independent entrepreneurs who may be poor – but who are considered well able to manage and grow their businesses. It is not a meritable handout to dependent beneficiaries. Like microfinance everywhere, Islamic microfinance strives to maintain a balance between profitability and service. It is not merely a perceived profitable venture seeking to capitalize on the unfortunate situation of the poor masses. At the same time it should not create a dependent society which expects everything free and is by its very nature unproductive[64].

Microfinance thus is focused on the 'double bottom line' of serving the poor sustainably. The vision of an inclusive financial system is client centred. It is based on the assumption that financial services play a critical role in reducing poverty by enabling poor people to accumulate and manage assets, conduct financial transactions, manage cash flows, invest in their businesses, and reduce their vulnerability to external shocks. Target clients of the microfinance industry use and benefit from small savings and loans to *grow* rather than establish their micro-businesses. From the perspective of poor clients, the key motivator is access to (rather than price of) reliable and continuous financial services. Sustainability is key to ensuring that the poor have *permanent* access to financial services to help them take advantage of opportunities and manage risks, as opposed to 'one-off' loans or 'stop-and-go' credit available as and when local funds succeed in raising external capital.

Microfinance does not set out to require ongoing subsidies, but acknowledges the forty years of global experience and documentation that enables new microfinance institutions to break-even in 3-4 years. Financial services, whether Islamic or conventional - when done well - can be provided on a commercial basis, independent of donor or government support. Loans or credit lines operated through government-affiliated structures, however, tend to politicize credit decisions and discard sound financial management principles. The resulting distortion may prevent managers of financial institutions from operating in a sustainable manner and often leads to decapitalisation and low rates of repayments if clients perceive the financing as a gift. The confusion has been exacerbated by donor and government support, without due acknowledgement of the basic '3S' approach to successful financial services provision: **S**eparate, **S**pecialized and **S**ustainable.

Separate

The Government of Sudan has a deep commitment to social development and support to the poor. While social transfers are very appropriate in some situations, they require ongoing subsidies. Since 2006, microfinance has gained popularity as a means to enhance the sustainability of these public social development efforts. Unfortunately, the focus on financing (credit) for social development has led to confusion and lack of differentiation between financial services and social transfers among a broad range of actors. This mix-up has meant that expectations of microfinance provision are not always compatible with accepted good practice for microfinance, especially the importance of sustainability.

[63] See CGAP Donor Brief no. 11, March 2003. http://www.cgap.org

[64] Islamic Micro Finance: A Practical Perspective, M.H.M.Hanan, Muslim Foundation for Culture and Development, Sri Lanka and Abdul Kany, Muslim Commercial Bank, Sri Lanka

Most actors in Sudan seem to interpret microfinance as the provision of subsidized credit to the poor and quantitative 'coverage targets' have been promoted in response to a perceived large demand for 'financing'. Commercial banks are asked to allocate 12% of outstanding portfolio to "micro-finance" and large amounts of subsidized capital for on-lending are made available. This intense supply-drive by GoNU extends to several donors, INGOs and NGO programmes. Comparatively less attention has been paid to the quality of the financial services provided, the sustainability of the institutions providing the services, and – in particular for the very poor in remote areas - the ability of the borrowers to utilize the financing for gainful enterprise, earn a profit and repay the loan rather than increasing their debt.

Specialised

Financing in particular is being provided around the world without sufficient knowledge of or attention to good practices – but the short-term losses, and the longer-term unsustainable impact of such schemes ultimately harm the very clients that they were meant to benefit. The experience from past failures proves that direct provision of services by subsidized and non-profit bodies tends to result in limited outreach and unsustainable impact. This fact is, however, sometimes overlooked in the quest to combat poverty by availing cash to the poor through any available channel. Because money is a commodity well-known and managed by almost everyone, the technical skill and specialization necessary to provide this business service successfully is often not adequately recognized. Either it is seen as something everyone can do, or it is considered to be 'micro-banking'. In Sudan, the low repayment rates provide examples of exactly these constraints. Lack of training and experience in microfinance has been cited as the major factor limiting the development and expansion of bank micro-finance programs[65].

Sustainable

Microfinance is not simply small-scale commercial banking; it is a development approach with a social mission and a commercially viable financial bottom line that uses tested and continually adjusted sets of principles, practices and technologies. The key to successful microfinance lies in the ability of the provider to cost-effectively reach a critical mass of clients with systems of delivery, market responsiveness, risk management and control that can generate a profit to the institution. Typically, this profit is ploughed back to ensure the long-term survival of the institution, i.e. the continuous provision of services demanded by its clients. The two long-term goals of microfinance are thus *substantial outreach* and *sustainability*. In Sudan, focus appears to have been primarily on the 'sustained income generation' of the customer's 'project' (or enterprise). In microfinance, however, the focus needs to be on the sustainability of the microfinance *provider* to ensure that customers will have continuous access to the financial services they demand.

In order for an inclusive financial sector to contribute to the overall goal of poverty reduction, it is important to invest in MFPs that can serve the Bottom of the Pyramid (BOP) to ensure that their technical skills and systems of delivery are sound, safe and strong enough to meet the demand for credit and other financial services, as it increases over time. This means maintaining a high portfolio quality (PaR of less than 5%), and attaining financial self-sufficiency (being able to cover all real and indirect costs of operations by income earned from the operations). To do so, financial services providers need to expand their customer base to a sustainable scale, while strengthening their systems. It is estimated that a feasible growth rate in Eastern Sudan is 15-20% per year.

Microfinance can be an effective and powerful instrument for poverty reduction. But it must be provided by institutions who strive to become effective business entities by developing a strategic vision for viability and the necessary professional skill and capacity to accomplish the vision set.

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[65] UNICONS: Situational Analysis of the Microfinance Sector in Sudan, March 2006.

5. The Demand Market in Eastern Sudan

5.1 Market Economics in Eastern Sudan

The economies of Gedaref and Kassala States depend largely on agricultural and agro-pastoral activities and casual farming labour. The main agrarian products are crops (sorghum, sesame, millet), fruit and vegetable (water melon, onions, ocra, banana and citrus) and livestock. Agriculture contributes 75-78% of GDP for the states with services contributing 17-20%[66] Large publicly funded investment projects such as the Tokar and New Halfa Agricultural Scheme, the New Halfa Sugar factory, and the mechanized (irrigated) farming in the upstream of the Gash and Atbara create seasonal employment and export earnings. But the damming of rivers and other barriers built to provide irrigation have also restricted access to pasture land and reduced water flow to downstream areas, affecting especially the pastoralist communities. The viability and pursuit of traditional pastoral economic strategies such as transhumance have been hampered by the adverse climatic conditions over the past decade, the additional pressures on the land and pastures and the general environmental degradation. In addition, the deregulation of land use and the abolishment of customary rights to land as promulgated in the Unregistered Land Act of 1970 limited access to prime land by small farmers and nomadic pastoralists alike[67].

Outside of the large mechanised farming industries, the rural value chains in Kassala and Gedaref appear flat and of low value. There are traditional industries in construction (lime, plaster and brick-making), food processing (grinding, milling, oil production, packaging, etc.) connected to major agricultural schemes, other artisanal enterprises and trade. Economic activity and cash circulation is particularly limited in the border localities of Hamesh Koireb and Telkuk.

In the urban centres, petty trade, services (internet cafes, computer training centres, print shops, etc.) and food processing and production (bakeries, butcheries, etc.) are typical sources of income and employment. Many markets are busy and whole sale trade must be a lucrative business. Product supply is, however, limited and price sensitive (rather than quality conscious), and cheap Asian (Chinese) produce dominate urban markets, to some extent displacing local wares, such as the traditional hoes, axes and rakes of. artisanal blacksmiths[68]. On the outskirts of towns along the highway connecting Khartoum and Port Sudan, vehicle repair, vulcanization and maintenance is a growing enterprise, along with petrol provision. Both urban and rural trade appears of limited variety (copycat behaviour among traders and limited input supply stream restricting variety).

The price levels of Kassala in particular, are inconsistent with a market functioning based on the laws of demand and supply. The Grain Markets Survey 2006/07 conducted with assistance from FAO and WFP as well as the weekly sorghum prices collected by FAO for all of Sudan confirm that crop price levels in the otherwise depressed economy of Kassala are consistently higher than in the rest of the country. This includes locally grown produce which sells at higher prices in the local markets than at the regional markets in e.g. Port Sudan (see Box 8)[69].

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[66] Indicative figures from the Annual Economic Report of Gedaref State, 2008 (figures as at end 2007).
[67] S. Pantuliano and M. Babiker: Addressing chronic livelihoods vulnerability in Red Sea State, Sudan, Oxfam GB, February 2006.
[68] Ibid.
[69] Interview with FAO Kassala on 21 September 2009.

Box 8: Anecdotal evidence of market capture

Examples of a captured market

Kassala state is a main producer of sweet **banana.** In the main market of Kassala, 1 kg of banana sells for SDG 1.5-2. In Port Sudan – after transport costs are added, however, Kassala bananas sell at SDG 1 per kg.

Just before the rains, many small farmers of rainfed land sign salam contracts with banks to access the input needed and pay back in kind at harvest. The nominal value of **sorghum** at planting time in 2008 was SDG 55/sack and the repayment is set at the number of sacks equivalent to the total value of inputs. At the last harvest when the farmers needed to repay the bank, price had risen to SDG 90/sack – but the number of sacks to be repaid remained unchanged. That's a profit of 63%.

Farmers of rainfed land only have a short window of opportunity to plant and thus need loans promptly. The procedures in many banks take up to a month. Farmers hence borrow from large traders and 'officials' (who have recently invested in land), even at higher rates.

These traders and 'industrialists' are alleged to speculate in the market to keep the cost of input supply high. Similarly, cross-border smuggling is alleged to keep prices high and reduce tax income. Any role of the Strategic Grain Reserves of the Government in this market capture could not be ascertained, but strategic purchase and sale from Reserves could be used to decrease the effect of local cartel price setting.

In addition, anecdotal evidence from many sources consistently suggest an annual price pattern of depressed prices at the start of the planting season (when supply would be assumed low) but *rising and high prices* at harvest time when supply would be abundant – and small farmers would be wanting to sell crops and repay *salam* loans to traders and banks. Such a price pattern suggests a captured market ruled by cartel price setting rather than by demand and supply. In the border states of Kassala and Gedaref, it is also possible that the rife cross-border smuggling contributes to the high price levels by artificially increasing seasonal demand without a corresponding tax contribution.

Breaking artificial price controls set by cartels can be hard. An essential element is the strengthening and broadening of access to market (price) information. FAO has supported a good initial attempt at a mobile phone based price information system for producers which should be adapted and offered[70]. In some cases, direct intervention in demand and supply by government, e.g. through strategic grain reserves, have provided a temporary respite in the market for producers and consumers respectively, but all too often, market interventions by government results in distortions similar to those caused by cartels. Enforcement of price liberalization, curbing of the cross border smuggling, and government regulation against cartels will be essential to fully control the problem.

Pro-poor economic growth requires a widening and diversification of the economy that enable a growing number of the poor people at the 'bottom of the pyramid' to participate in the market. The challenge is to catalyze rural market development and diversification through productive investments in small and medium-end goods and services, to facilitate productive investment of the remittances currently flowing back, and to support informal sector businesses in linking to and moving up the value chain.

5.2 An Attempt at Demand Quantification - How big a Market?

Of the total population of Eastern Sudan of 4.5 million people, some 3.2 million people reside in Kassala and Gedaref states, of whom 47% are women[71]. Some 54% of the population or 1.75 million people are in the productive ("economically active") age group as defined by CBOS (15-60 years of age) making up the labour force. Participation in the labour force is markedly higher for men (71%)

[70] The system, developed by Sudani, was initially tested in English and will need to be operationalised in Arabic to be effective. Interview with FAO in Kassala, 21 September 2009.

[71] MoFNE: Census figure, 2008.

than women (32%)[72]. Of the total work force, some 14-15% are public sector employees, while an additional 20-22% of the work force receives wages or salary in the formal private sector[73].

The total economically active population of 1.7 million people could be considered the total market for financial services. Of these, the non-poor and the around 35% formally employed wage earners could potentially access formal banking services. Income generation in the informal sector is therefore often used as a proxy to quantify the people at the 'bottom of the (economic) pyramid' (BOP) who are typically excluded from access.

Agriculture and the informal sector is estimated to provide income for some 64-70% of the labour force[74], or around 1.2 million people in the two states, the vast majority of whom (at least 72% in Kassala and 67% in Gedaref) are living outside of the urban centres. This figure corresponds in broad measure to the calculated poverty rate provided by the state authorities, according to which some 1.1 million economically active people or a total of 352,600 households in the two states would be considered poor (see Annex 2).

Not all poor households can benefit from financial services. Along the Eastern border of Kassala in particular, a significant number of people appear to be excluded from the cash economy, using barter as the chief means of acquiring and discarding assets. Without an income generating activity, financing in particular can over-indebt households, making them poorer. Adjusting for these factor by 25% due to the current low level of economic activity in rural East Sudan, we reach a total minimum market estimate of 222,000 poor households demanding and able to utilize microfinance services: 381,000 adults in 112,500 poor households in Kassala state, of which 274,500 (72%) reside in rural areas, and 300,000 adults in 109,500 poor households in Gedaref, of which 73,500 (67%) are rural (see Figure 9).

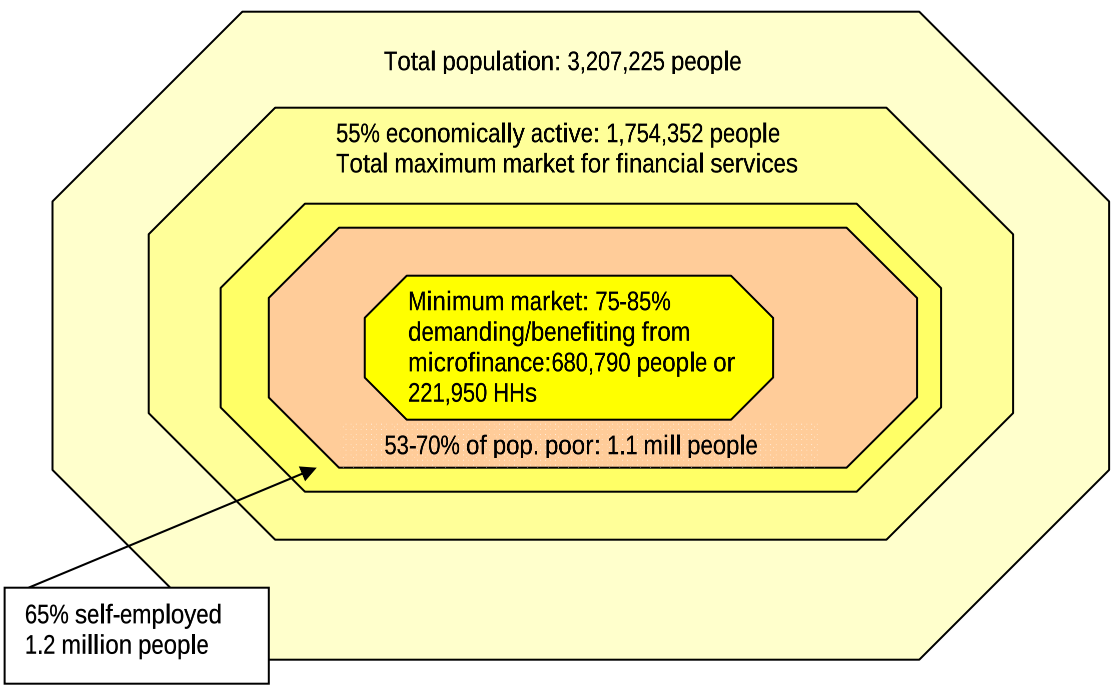

Figure 9: Estimated Market Size for Financial Services in Kassala and Gedaref

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[72] ILO statistics projected for 2008 from http://laborsta.ilo.org/STP/guest

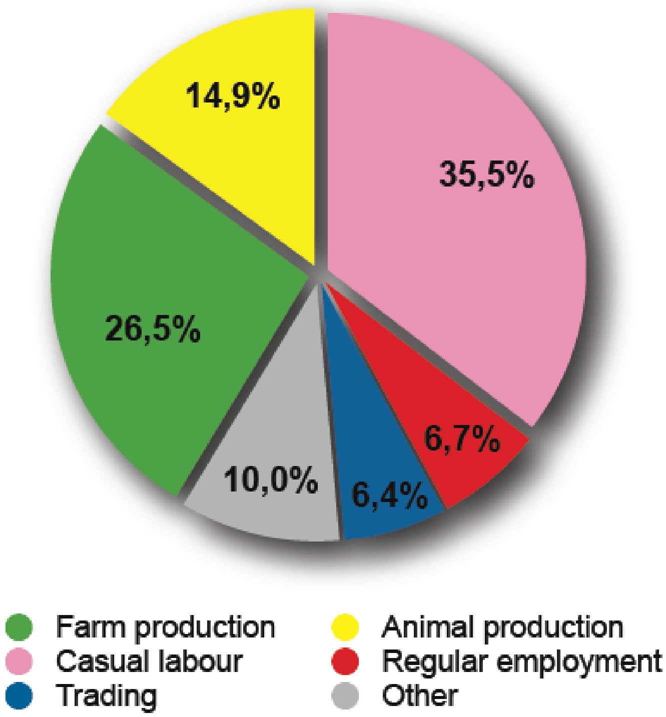
[73] National Health Insurance statistics provided by MoSW in Gedaref and by NHI in Kassala, September 2009.

[74] Layla O. Bashir, MOFNE: "Enabling Environment for private- sector led growth", Presentation for Sudan Consortium, Mar 2007.

5.3 Market Characteristics – Who are the Customers?

In ethnically diverse Kassala, 9% of the population belong to the nomadic pastoralist groups of Beja, Beni Amer and Rashaida, against only 1.4% in Gedaref[75]. The dominant ethnic group in Kassala is the Beja - a confederation of tribes united by a common language, *TuBedawiye*, and the *diwab* structure, linking each lineage to common ownership and use of land. The three main groups making up the Beja are the Bishariyyn, the Amar'ar/Atmaan and the Hadendawa. Many of the Beni Amer, while similar to Beja groups, speak a different language, (*Tigre'*) and are organized more long caste lines[76]. Kassala is also home to a large number of Nubians, Sukriya as well as some 68,000 IDPs mainly from the Nuba Mountains and Southern Sudan and 95,000 former refugees, primarily from Ethiopia and Eritrea who reside in shanty areas and camps[77]. The mainstay for the largest part of the population – subsistence farming and pastoral herding – has been very badly impacted in the past decade, but the root causes are much older.

Figure 10: Income generation/coping strategies
% households in indicative survey sample[78]



Like other pastoralist societies, the Beja economy is based on multiple resources or coping strategies and imply the involvement of some members of the family in economic activities other than livestock keeping, including agriculture, fishing, mining, firewood collection, charcoal making, sale of products like milk, ghee, mats, baskets and leather goods as well as labour migration to town. Several of these coping strategies are shared with the sedentary farming communities (see Figure 10).

Many rural farming communities suffer from poor agricultural and livestock production capacity as well as lack of basic social services such as health, education, water supply and production related services. Harvest losses, pest infestation and declining land fertility and yield combined with the lack of access to relevant inputs have led to increased poverty and vulnerability levels. However, lack of sufficient water remains the main obstacle for the improvement of people's livelihoods and their food security situation in Kassala and in parts of Gedaref.

Coping strategies for rural farming households include casual labour (often in the urban areas), firewood and charcoal production for sale, fodder sale, remittance receipts and other non-farm related activities but have in some areas been stretched to the limit and are failing to keep pace with the

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[75] Population Census, 2008. Preliminary published data.

[76] S. Pantuliano: Comprehensive Peace? Causes and Consequences of Under-development and Instability in Eastern Sudan. NGO Paper, 2005.

[77] UNST & UN RCO Sudan, "East Sudan Analysis and Priorities, September 2007.

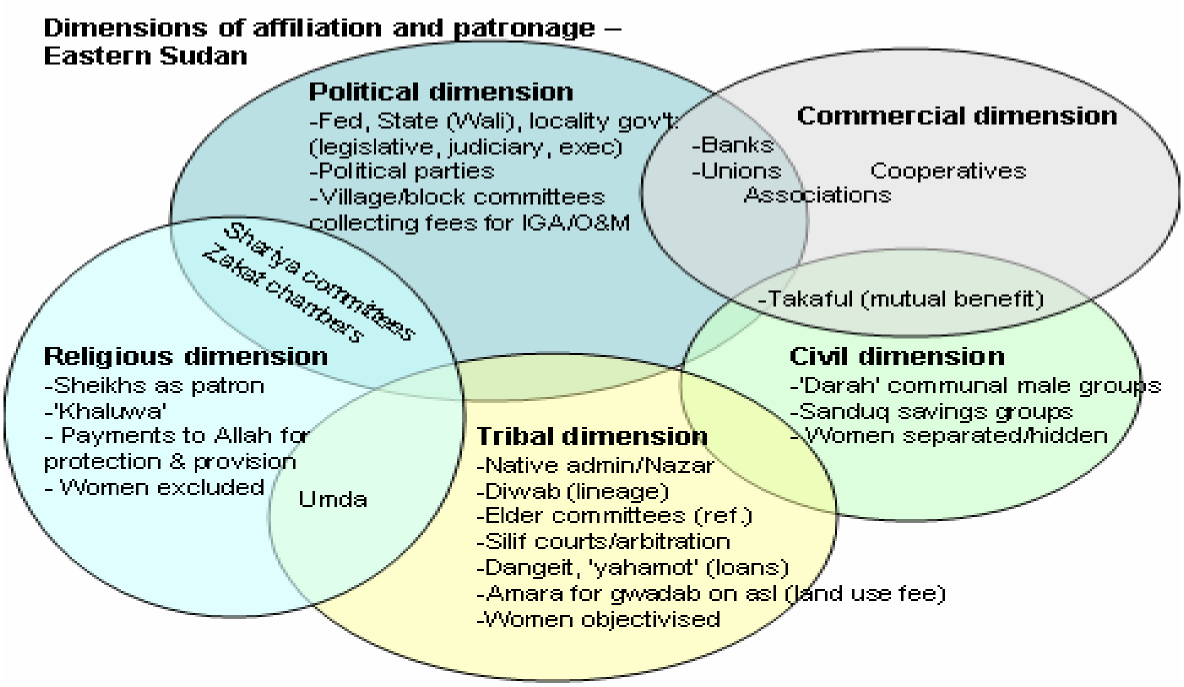
[78] German Agri Action: Base Line Survey, 2009, which surveyed 600 households in Rural Kassala Locality reflected in this figure, along with communities in Hamesh Koireb and Telkuk.

demands for basic livelihood requirements[79]. In such situations, households will seek assistance from their support networks.

Sudanese society is very relationship-based and it is important to ‘belong’. Subsequently, most people would be able to define themselves in relation to a complex mesh of affiliation which influences livelihood choices, prospects, and upward and outward mobility. Position and relationships in the political, religious, cultural/tribal, civil and commercial dimensions can determine interest, ability, and success in life. Most of these relationships appear hierarchical and top-down, and thus they foster subordination and obedience, perhaps in exchange for protection and access to resources – the classical patronage exchange. Over time, however, this consistent affiliate pressure appears to have developed into an unattainable dependency on outside relief aid and on hand outs from influential community leaders, similar to feudal patronage systems[80].

Fuelled by political, cultural and religious leaders believing in a need to lead the “unenlightened masses”; by government and charities in well intended programmes to e.g. support the poor; and by donor agencies and humanitarian NGOs in their quest to improve the lives of refugees and IDPs, the pervasiveness of this “relief mentality” and the passive subordination it creates runs counter to the entrepreneurial, self-sufficient and self-managed development approaches which are crucial to the regeneration of sustainable livelihoods and a vibrant market economy. The transformation from dependent passivity to self-reliant entrepreneurship is possibly the greatest challenge to sustainable development in Eastern Sudan.

Figure 11: Dimensions of affiliation and patronage



Relationships in the **political sphere** appear most important and can control access to jobs, titles, means and resources. Positions being filled as payment for past or future favours create and prolong patronage and dependency relations which may at times override merit. The security apparatus is also influential in Eastern Sudan and does not always operate under the full control of the political

79 Based on German AgriAction: Base Line Survey 2009.
80 German AgriAction: Base Line Survey 2009.

authorities. The **religious power structure** is extremely strong in places and correlates with lack of access to education and exposure. The Islamic principle of compassion for those poorer than yourself is sometimes applied misleadingly to generate and prolong dependency based on homage and gratitude. The outlook of a commanding sheik on development in general and financial services in particular can determine the level of demand. Unfortunately, some of the most influential sheikhs are also the most traditionalist, advocating against what would otherwise be deemed positive change (girl's education, health services, improved nutrition, training and usage of banking services).

In the local economy, a person's ethnic (tribal) background thus powerfully influences his or her livelihood pattern[81]. The **cultural or tribal affiliation** remains important, and locally, tribal leaders' influence is still strong. But the traditionally strong decision-making system to ensure fair resource allocation and dispute settlement appears to be waning with an increase in political influence and external economic shocks having made it more difficult for this system to reward subjects and thus be seen as useful and meriting respect. The related 'cultural segmentation' appears as strong as ever, organizing ethnicity in what appears to be an intuitively understood hierarchy with the people of central, riverine Sudan, *awlad al-bahr* (people of the river) at the top[82]. Age old **civic structures** generally base themselves upon the mutual benefit of cooperation, and may be strengthening as households are increasingly required to look out for themselves in a harsher economic environment. These structures may promote the demand for financial services, and can provide the social trust bonds that microfinance uses as collateral for its small loans. They may also serve as platforms for training and other services to customers.

Structures of affiliation based on **commercial relations** are perhaps the newer of the many systems of affiliation and while widespread, may not command as much influence over people. The controlled ('captured') markets of Kassala in particular, however, will certainly influence the ability and motivation for people to engage in economic activity and take risks. Top-down and centre-out control and patronage is still evident in subsidised Government projects and large enterprises which also stifle entrepreneurial energy. The 'functional' and 'popular' unions (of farmers, pastoralists, cooperatives, labour, women, youth, etc.) relate to the political sphere but are used to control access to the commercial scene, e.g. by requiring membership and certifications. Cooperatives and associations are generally less politicized and carry less weight. Many of the consumer cooperatives that flourished in the 1970s all but expired during the hyper inflationary economy in the 1990s when savings and investments were lost, and later attempts by the Government to revive these structures as delivery channels for support (e.g. tractors to agricultural cooperatives, subsidized goods to trade cooperatives, etc.) have weakened their independence and promoted the "relief mentality". Associations, NGOs and projects promoted by e.g. Women's or Youth Unions tend to suffer the same bias, having been captured as 'delivery channels', but some associations established based on local needs and shared efforts have remained strong and more business-oriented in approach. In general, however, the commercial sphere and entrepreneurial acumen in Kassala state in particular appears deflated and shrouded in inertia, and nostalgia for older and better times is prevalent.

As earning a living from rainfed (small holder) agricultural production and pastoral livestock has become harder, more people have migrated to the urban centres and turned to petty trade and service provision for their livelihoods. One recent market study in Kassala found a total of 10,300 micro- and small enterprises (with 1-3 employees on average) in 28 markets around the state. As none of these enterprises were on-farm or home-based they clearly only represent a fraction of existing businesses but nevertheless the sample provides important and scarce market information. Of the enterprises

[81] MoFNE of Kassala State and UNDP: Kassala State Situation Analysis, April 2009.
[82] Robert O. Collins: A History of Modern Sudan, University of California Santa Barbara, May 2008.

identified, some 68% were in agriculture and agro-pastoral sectors; while 21% were in trade and services[83].

A sub-sample of 400 of these urban MSEs was interviewed for the study. Of this sample of MSEs, 16% were women-owned, but of these owners only 37% were married – whereas 64% of the 86% male entrepreneurs in the sample were married. This could indicate that women will be more inclined to run non home-based businesses out of need when on their own, possibly to feed a family. 39% of women in the sample had no formal education – against only 5.5% of the males. At the other end, however, 15% of women and 43% of males had university degrees – indicating that entrepreneurship does not in itself correlate with lack of education. Illiteracy in the sample was about 10%.

In the sample of 400 enterprises, 74% were licensed which speaks to the well enforced market access systems in Eastern Sudan. Only half were permanently established, however, and 70% were start-up businesses. 40% of the sample enterprises were found to be run by youth[84] – indicating perhaps a lack of alternative employment, but also warranting a softening of the current CBOS criteria for microfinance customers who are required to be over 18 years of age.

Of the sample MSEs, 14% had multiple sources of income, including another business (trade) or agriculture. 15% of the sample received remittances or transfers (including pensions). The average profit per month for women-owned enterprises in this sample was SDG 551 or just above the poverty threshold, while male-owned businesses generated an average profit of SDG 755/month[85].

5.4 Demand specification - What do Potential Customers want?

Albeit small and skewed towards urban trade business, the sample of 400 micro-entrepreneurs in Kassala provide important insights into the characteristics of demand for financial services– and finds that suppliers need to become a lot more customer-oriented and demand-driven in order to meet the needs of the entrepreneurs at the bottom of the economic pyramid.

Only 15% of the sample had obtained finance from sources other than the business but only 5% had applied for (and received) bank finance. Most (31%) would not use banks because they feared losing their collateral in case of default. Of those that stated they had knowledge of financial institutions, the providers with the highest name recognition was the INGO ACORD (26%), followed by the high-end commercial Faisal Islamic Bank (17%) the Islamic Cooperative Bank (15%) and the Savings and Social Development Bank (12%)[86].

Confirmed also by many entrepreneurs and focus groups interviewed during the Consultancy, many sample entrepreneurs perceived the application process to be long and complicated and the financing terms to be unfavourable. Instead of bank financing, entrepreneurs had borrowed from family or friends (77% of sample). Financing obtained ranged from a low of SDG 593 – 1,072 from friends and family to SDG 10,000 from banks, but the average financing received was SDG 7,000. 65% of this sample stated that they would be willing to pay 10-20% mark-up on financing from a bank. Interestingly, 20% of the sample would pay up to 50%. This indicates a real price-insensitive need for access to finance, enabling financial service providers to focus more on quality and appropriateness of products, provided CBOS does not strictly enforce its recommended 9% mark-up as a ceiling for banks.

[83] Zanad Consulting Group: Market Study of Microfinance in Kassala State. Kassala State Ministry of Social Welfare, Social Development Fund, July 2009. Unofficial translation.
[84] Ibid.
[85] Zanad Consulting Group: 2009, op.cit
[86] Ibid.

Current microfinancing contracts (max. SDG 10,000) thus appear to meet the demanded loan size; charge acceptable mark-up rates (the nominal range for *murabaha* contracts is 9-12%) but clearly the processing terms and conditions are not satisfactory to potential clients. Market sensitivity indicators (factors that customers emphasize as important to them) included:

- speed and efficiency of service
- relevance of financing purpose and product
  - There is demand for financing of household expenses (31% of sample), including education, home improvement, emergencies and consumer goods;
  - Equally there is demand for working capital for new businesses (27%)
  - In addition to in-kind financing, there is anecdotal evidence of a demand for cash loans which may require design of comprehensive financing packages including *qard* and *murabaha* or *musharakah* type contracts
- simple procedures
- adequate loan amount (among females, SDG 1,300 and among males SDG 3,400), and
- reasonable financing terms
  - demand included financing over 1-6 months (by 33% of sample) with monthly repayment instalments, typical for micro-traders with fast turn-over, as well as financing over 12-24 months (by 77% of sample)m with monthly instalments (preferred by 68% of sample)
  - 50% of this sample stated that they could provide personal guarantors as surety.

11% of this sample had a bank account. A high 45% of the sample actually reported to save money, but 68% deposited savings at home. Given the risks associated with saving cash at home, this indicates a high reluctance to use banks. The reasons provided by this sample of potential clients indicate sophisticated sensitivities. The parameters important for savings included:

- Liquidity (freedom of withdrawal) – 27%
- Safety of deposits - 25%
- Dividends/returns on investment – 20%

With these priorities, entrepreneurs in Eastern Sudan mirror microfinance clients everywhere else in the world, and a small-balance "inverse *musharakah*" (deposit) product whereby many small investors rely on the expertise of the bank to generate a profit to be shared could meet the demand for returns on investments. Such accounts could be provided for specific purposes as well, e.g. for children's education (SSDB used to have a *Imaad* account for this purpose). Banks with debit cards and ATM facilities would be well placed to offer small-balance liquid accounts and could as in many other countries, offer incentives to attract small-balance account holders in the form of competitions and prizes. The entrepreneurs and ASCA members met during the Consultancy did **not** generally confirm the savings trend given in the sample. It may be prudent not to assume that such a high percentage of the general target clientele is ready, able and willing to save.

In terms of non-financial services, the sample suggested a demand for health (medical) insurance (25% of sample – a very high percentage which confirms the high level of awareness of *takaful* insurance in Sudan) and asset insurance for enterprise supplies and stock (18%).

Encouragingly, given the crowding-out by government and donor projects of training services in Eastern Sudan, 38% of the market study sample of 400 enterprises was prepared to pay for *relevant* training. This provides an inroad for commercially oriented public and private sector providers if funders (government and donor agencies) extract themselves and their subsidies from the commercial transaction and assist in the linkages of demand and supply instead.

6. The Supply of Microfinance in Eastern Sudan

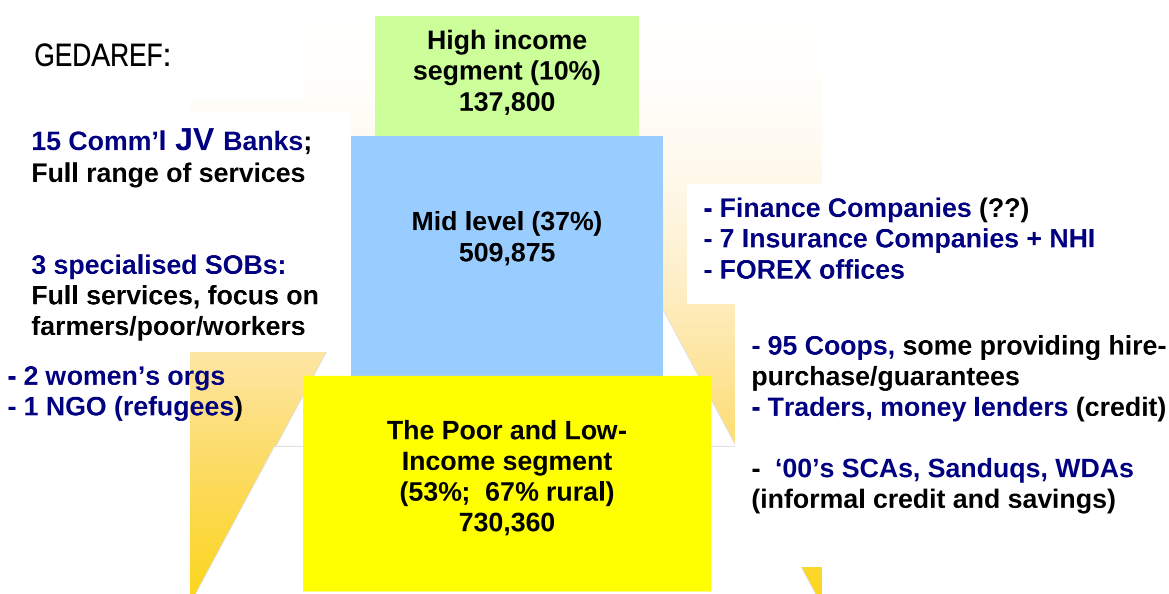
6.1. The Structure of the Supply Market

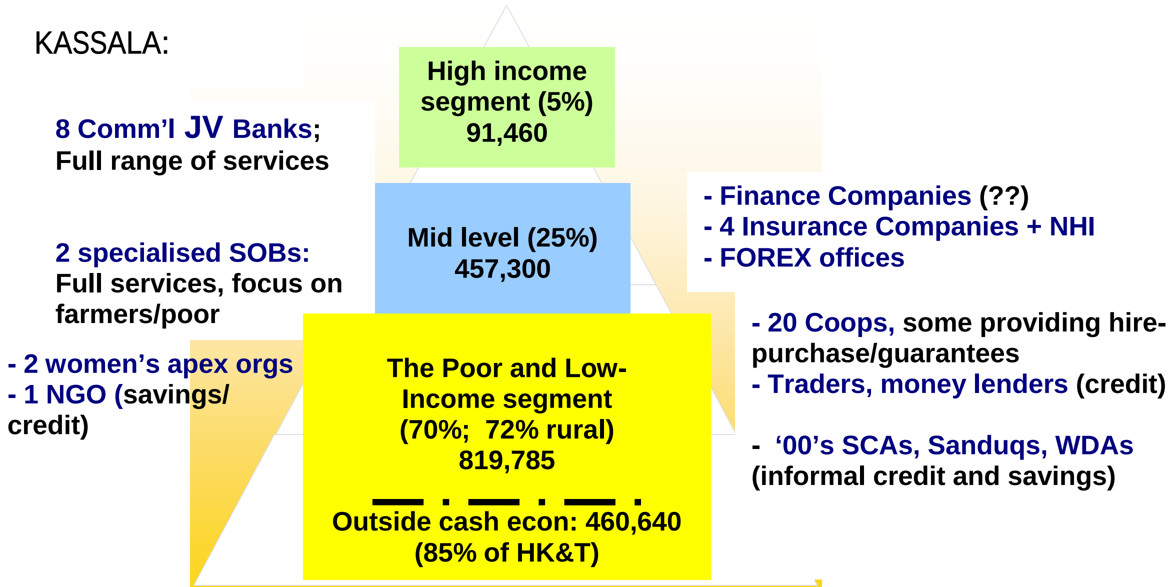
Because of the limited outreach of banks, commercial buyers and traders have historically been filling the 'credit gap' in between seasonal sales for many people – at very high cost to the customers. To some extent, cooperatives and unions attempted to replicate this function over the past 20 years, generally with poor results. More recently, financial services in Eastern Sudan are provided by two types of institutions: commercial banks and non-financially specialized NGOs. With one exception, neither type of financial service provider appear very familiar or comfortable with the new push for microfinance exerted along the top-down affiliate structures of external supervision (central bank), funding (federal and state government and donors), as well as along internal lines of command (head offices).

Divided between reluctant bankers and multi-purpose NGOs, the Eastern market lacks specialized providers of microfinance services. Without specialization, well-intended providers may not have the capacity, training or systems to design, deliver and monitor microfinance provision sufficiently. This could result in failure, not just for the suppliers attempting to provide the new service, but for the future of the entire market as the basic premises of microfinance are not adhered to and repayment discipline thus lapses. In any case, the outreach of the current providers still remains very low. For a provisional map of location of suppliers' branches, see Annex 3.

Broadly speaking, the different financial service providers focus on each their segment of the market, as depicted in Figure 12. However, none of the providers are yet covering a substantial part of their preferred market segments neither in terms of geographic outreach nor by numbers, and in fact some of the bank branches in particular have very small financing portfolios. Most rural geographic areas are severely under-served. Competition is only just beginning in the urban centres among the commercial banks, and is not yet apparent in the fledging microfinance portfolio.

Figure 12: Core Market Segments of Suppliers by category and location





6.2 The Key Suppliers – Outreach and Performance

6.2.1 The Banks – Reluctant Microfinance Providers

A total of 19 commercial (state-owned and JV) and specialized banks have branches in Kassala and Gedaref States. Commensurate with its higher level of economic activity, Gedaref state has a total of 25 outlets of all 19 banks. The vast majority (19) of outlets are, however, located within walking distance of each other in downtown Gedaref city. 10 of the 19 banks also have branches in Kassala State. The Sudanese-French Bank is the only bank that has located its branch outside of the main town of Kassala (in the town of the agricultural scheme that it presumably serves), whereas 9 of the remaining 16 outlets are in Kassala town. Geographically, thus, the bank branch network is highly concentrated.

Altogether, the 42 bank branches have invested a portfolio of SDG 305 million in the two states as at August 2009, and have mobilized a total of SDG 229 million in deposits (75% of portfolio)[87]. The specialized and state-owned Agricultural Bank of Sudan (ABS) has the largest branch network in the area. ABS also has the largest aggregate outstanding portfolio at SDG 142 million (SDG 95 million in Gedaref and 47 million in Kassala) or 47% of the total bank portfolio. In terms of deposit mobilization, however, ABS had only 19.5 million (8.5% of total) and is thus heavily reliant on 'allocations' from its head office. One other specialized bank, the Savings and Social Development Bank (SSDB) is among the five largest banks in the area (see Table 13).

Only a small fraction of this portfolio is microfinance. Four of the five largest banks in the two States (except for the Sudanese-French bank) have signed *'musharakah'* partnership agreements with CBOS under the Microfinance Pilot Project. As an example, part of ABS' 'allocations' from its head office is a 50-50% matching line of credit from microfinance totalling SDG 10 million for Kassala and 2 million for Gedaref. All other banks are requested by the CBOS to allocate 12% of their total portfolio to micro- and small-scale financing[88]. This is clearly proving hard for most banks, even the ones set up specifically to serve poor people, such as the Savings and Social Development Bank.

[87] Bank data received from the end August 2009 report from CBOS, Gedaref office and validated where possible at interviews with bank branch managers.
[88] CBOS: Banking Policies 2009.

Table 13: Five largest banks in area, data reported as at end August 2009

Bank	# branches	Total Portfolio outstanding '000 SDG	Total deposits mobilized '000 SDG	Allocated in partnership with CBOS for MF '000 SDG	Reported outstanding in microloans '000 SDG
ABS	9	141,920	19,513.34	12,000	2,423
ICDB	4	54,766	35,618.48	300	156
FCB	4	20,063	19,436	2,250	1,912
Sudan-French	2	18,341	14,078.99		0
SSDB	3	14,901	17,941.7	5,000	3,041
Total for 5 banks	22	249,991	106,588.5	19,550	7,532
Workers Bank	1			200	
Animal Ress	1			350	73
Real Estate	1			15000	7,200
% of total for all	52%	82%	46%	56%	51%

All branches visited during the Consultancy confirmed the very command-economic, top-down and supply-driven approach to banking that is apparently the norm in Sudan. While some branches will review their markets and propose an annual 'budget' to their head offices, most branches are given an approved annual budget which has certain allocations for various economic sectors and product types. This leaves the branch without much authority, flexibility or motivation to adapt products and services to changes in the market place. Time and again branch staff confirmed that "they are just implementing" policies and decisions set at the central level in Khartoum and have no reason to get to "know their customer". Changing this extremely centralized operational mode would not only give branches more liberty to interact with and adjust to their respective markets and exploit market opportunities as they may arise; it may also – if combined with performance-based incentives – improve the performance of the branches to the benefit of the banks as a whole.

Decentralising and delegation would, however, need to be accompanied by significant capacity building and possibly replacement in some branches. Additional capital allocations will not alone increase outreach.

The accumulated volume of microcredit provided by banks throughout north Sudan as at September 2008 amounted to SDG 58.5 million, extended to 21,303 clients giving an average contract size of SDG 2,746[89]. Three quarters later (as at end of June 2009), the total number of microfinance borrowers reported by banks to CBOS under the *musharakah* partnerships has increased to 26,244 or by 23%[90]. In an organically growing market where growth is based on demand, an annualized growth rate in the number of borrowers of 31% would be substantial and applaudable. In Sudan, where growth is driven by supply of cheap funds and other incentives but where deep capacity gaps remain, such a steep increase is worrying, as the quality of the financing provided may not be satisfactory.

As at June 2009, the total number of micro-financing contracts outstanding in banks in Kassala and Gedaref was reported to be only 3,690 or 14% of the total in Sudan, 1,853 loans outstanding in Kassala[91]. The total number of contracts reported by the five biggest microfinance providers in Kassala when visited by the Consultancy in September was 2,845 – or a proposed growth in contract outreach by 54%. Some of the branches visited by the Consultancy during September-October 2009 were, however, unable to provide an updated estimate of the number of contracts outstanding, but

[89] CBOS MFU Monthly Report for September 2008 quoted in UNICONS: Evaluation of Implementation, Nov 2008, op.cit.
[90] World Bank secondment Dr. Gaffar Abdalla Ahmed Khalid: Outreach analysis of Microfinance in Sudan, June 2009, CBOS MFU August 2009.
[91] Ibid

reported either a cumulative number or the value of the outstanding portfolio. The level of data uncertainty is so high that any estimate – whether based on reported or calculated data – should not be regarded as accurate until further validated.

Table 14: Debt Collection of Banks

Bank	Overall avg. default (90 days) in % of outstanding portfolio	
	Kassala	Gedaref
ABS	21.8%	27.2%
Animal Ress		49.1%
Barakha		27.6%
Export Devt	2.1%	8.7%
Faisal	1%	37.3%
Farmer's Comm	80.6%	18.3%
Sudan-French	1.7%	58.7%
ICDB	5.7%	3.3%
Islamic Bank	0%	27.6%
Nilien Bank		34.6%
ONB		51.8%
Real Estate		0%
Saudi		65.3%
SSDB	11.5%	24.5%
Shamal		16.6%
Tadamon	0%	0%
Workers		5.5%
Overall avg.	13.8%	26.8%

This low level of data compilation, recording and reporting capacity may explain why the otherwise fairly comprehensive reporting formats published on the CBOS website[92] for microfinance provision do not appear to be in use by bank branches in Eastern Sudan. Neither the CBOS office in Gedaref nor the bank branches themselves appeared to be aware of the formats, but use a simpler one-page summary format for microfinance reporting which does not include the formulae for calculations required and may therefore include significant errors and misrepresentations.

But the problems of data and portfolio management are not confined to microfinance. The current overall portfolio is already showing signs of great distress (see Table 14). The problems of debt collection appear to be related especially to agricultural loans (90% of defaults in Kassala and 60% in Gedaref). This may relate to the significant government-funded schemes providing agricultural machinery (tractors) to farmer's associations with very generous grace periods – and subsequent very poor repayment performance. Defaults affect *murabaha* contracts (43% of all arrears in Gedaref and 42% in Kassala) and *salam* contracts the most (37% in Gedaref and 56% in Kassala).

Murabaha contracts allow for banks to attach the sold item as collateral and to repossess it in case of default, and *salam* contracts can be augmented by weather-based harvest insurances. In addition, most banks require guarantees from personal or institutional guarantors (cooperatives, unions, associations, ministries) so it is not evident why these products would perform so poorly in terms of repayment. Part of the problem appears to be a misguided attempt at assisting poor borrowers by providing very long (in some cases extreme) grace and repayment periods[93].

Several banks also mentioned the significant repayment problems caused by a no doubt well-intended 'bail-out' process for the poor by the "State Default Commission", the Ministry of Social Welfare and/or the Zakat Foundation:

- In some cases, banks have taken defaulted borrowers through the court system and to prison convicted of the criminal offence of letting a personal check bounce. From the bank's perspective, this practice serves primarily to warn other potentially wilful defaulters and set an example. However, in both Kassala and in Gedaref, the Ministry of Social Welfare (Social Development Foundation), HAC or the Zakat Foundation have acted to release the defaulters from prison and forgive the debt. While a compassionate act for the individual, this sends a very clear and misguided message to the community of borrowers: "you need not repay your loan". As an example of how disconnected borrowers can become from repayment, at least one union

[92] http://www.mfu-cbos.gov.sd/html/res/File/Forms%20for%20micro%20finance.pdf
[93] The repayment rate in the ABS microfinance partnership portfolio with CBOS which began in January 2008 was zero % in September 2008, the reason reported being a 3 year grace period (!) for the horticultural activities financed. Unicons: Review of Implementation, Nov 2008.

president is currently due to go to prison as he has provided a personal guarantee for a member who has defaulted.

- In other cases, poor borrowers have appealed to the 'Default Commission' or the Zakat Foundation themselves: If a poor borrower defaults through no fault of his/her own, s/he can appeal and, if found worthy, receive a certificate of 'redemption' which specifies that the Foundation/Commission will pay 70-100% of the defaulted loan to the bank on behalf of the borrower. Unfortunately, the system appears to suffer from ineffectiveness as most banks insist they see the certificates but not the reimbursement from the Government. So the bank's default rate grows; the borrowers in question remain black-listed by banks; but the message to borrowers remains: "do not worry about repayment, the government will bail you out".

The practice of debt forgiveness is no doubt a politically popular and individually satisfying practice, and it cements the political patronage system in an area that has been at war with the government of Khartoum. However, the short-term gains pose immense risks to the long-term establishment and development of a sustainable financial services system, as they compromise the basic repayment discipline without which financial services cannot be sustainably provided.

Against the maximum benchmark for microfinance of 5% portfolio at risk (i.e. percentage of portfolio amount outstanding contaminated by any arrears and not just the amount in arrears), the overall average repayment rates for the two Eastern states are dismal. But interestingly, the small portfolio of microfinance has done relatively better than the rest. Compared to the high overall delinquency rates (see Table 14), the default rate for small (micro) loans in Kassala as at end August 2009 was 11% and the rate in Gedaref was 12.6%. This may be worth pointing out to bankers that are worried about the repayment capacity of the poor.

The lack of attention to basic recording and financial management at branch level reflects the structure and modus operandi to the banking enterprises that dominate the Sudanese market: branches are not considered profit centres but rather treated as funded cost units – not unlike the NGO offices with whom they might compete. Balance sheets are not completed at branch level, and all equity remains at the head office. When the branches are asked by the CBOS regional offices to report 'profit and liquidity' therefore, these reports are confined to the stating in absolute amounts the balance of revenue after deduction of operational expenses for the period in question. Even at this level, one branch in Kassala and 8 branches in Gedaref states were operating at a loss in August 2009.

All in all, the branches of banks in the two Eastern states do not appear to have had sufficient training and technical assistance to effectively take on a new portfolio of micro-enterprise financing. They may have been provided with cheap capital and a none too discrete nudge from the central bank, but without the tools of the microfinance trade, the banks are not going to fare well trying to implement this new methodology for a new market segment. Staff seemed very unfamiliar with the new market. Pre-conceived ideas abounded but exposure has been limited both to the market segment and to Good Practice microfinance. Management buy-in, intensive training and staff incentives, as well as ongoing on-site mentoring would be necessary to ensure a large and high quality microfinance portfolio.

6.2.1.1 A Promising Example of Microfinance by a Bank

One of the smallest bank branches in the area is also the most innovative as regards the introduction of well-managed microfinance. The Aroma town branch of the Agricultural Bank was re-opened in mid 2005 with institutional assistance – but no credit lines – from IFAD's Gash Sustainable Livelihoods Regeneration Project in Kassala State. The branch has six staff and commands only 3% of the outstanding bank portfolio in Kassala State, but it makes up for its limited volume in its flexible product design and quality customer care. The branch serves around 1,500 individual and 166 group-based customers in rural Aroma, the north and south Delta region and a few communities in Telkuk[94] – the only bank that has any outreach in the border localities.

As at June 2009, the portfolio outstanding amounted to SDG 3.3 million providing an average contract size of SDG 2,190 or USD 875 – well below the GNI per capita. Individual financing contracts of SDG 500 – 4,000 are made, but initial contracts are kept low to accommodate the very targeted approach to poor customers that the branch has spent 3 years and several false starts cultivating in collaboration with IFAD. The branch offers *salam* contracts for crop production and livestock fodder; *mugawala* contracts to pay for irrigation water user fees; and a specially adapted *murabaha* (sales) contract with *musharakah* (investment) features for women's groups. In addition to financing contracts, compulsory and voluntary savings accounts are available, but with no dividends. Even so, the branch has mobilized SDG 1 million in deposits as at Aug 2009[95]. The branch is also able to provide remittance services for customers. The Aroma portfolio and market segment may lend itself well to pilot testing of M-banking once mobile phone banking arrives to Eastern Sudan.

IFAD has provided support to refurbish, furnish and equip the very basic branch office, and has provided the vehicle that makes up the 'mobile unit' of the branch. But IFAD has not provided capital for onlending and hence financing risks remain the responsibility of the bank. Combining innovative and flexible banking with media savvy and group formation as the basis for alternative collateral (savings, group guarantees), the loan portfolio of ABS Aroma is probably the closest Kassala has to demand-driven, market-oriented microfinance, and any study visits that the over worked branch staff can manage to host should be welcomed by other bankers in the region.

That said, also Aroma has problems to resolve going forward:

- The branch loan tracking system and MIS is not computerized and in ABS (as in all other banks visited during the Consultancy) there is no familiarity with the basic reporting requirements and ratios used in microfinance. This makes it hard to monitor performance and document progress. A proper basic course in financial analysis and performance monitoring combined with the installation of a computerized loan tracking and MIS system would appear a minimum investment in better monitoring;
- Arrears past due 30 days is 11.3% and Loans at Risk (LaR) is 16%. Portfolio at Risk (PaR) could not be calculated based on available data, but a LaR rate that high is clearly worrisome for such a small portfolio;
- While the branch was operationally sustainable at least up to end of 2008, it reports not to be breaking even as at end August 2009 with the current rate of return on contracts (mark-up, fee, profit margin) of 12% p.a.[96] This seems surprising and may be due to poor data processing.

The portfolio at ABS Aroma may yet demonstrate the viability of sound microfinance in Eastern Sudan. Branch staff and support staff from IFAD have already realized that microfinance by itself is an insufficient and often not even helpful intervention in the remote, rural areas where the micro enterprise opportunities are few, business turn-over is minimal and market linkages are weak. Market development is essential to further support the small businesses that have emerged, and coordination and synergizing with other value chain integration projects should be sought. In addition, the basic literacy, good governance/leadership promotion and other basic services provided by the IFAD project to the communities, e.g. through water user groups and women's associations must continue in parallel with the financial service provision.

[94] As at June 2009. Background information on financial programmes – data collection on site from Aroma branch and interview on 24 September 2009.
[95] CBOS Gedaref data for the month of August 2009.
[96] According to CBOS Gedaref data for the month of August 2009

6.2.2 Non-Bank financial service providers

In Eastern Sudan, there are as of yet no specialised microfinance institutions that offer financial services to poor and low-income people based on the internationally recognized good microfinance practices.

The mostly humanitarian NGOs in the region are more familiar with the market segment of the poor but have been reluctant and unprepared to adopt the business principles necessary to become sustainable microfinance providers. Some INGOs have realized a need for a longer-term development approach and have experimented with the provision of 'seed capital', but most of these efforts have ended with poor repayment results. Most INGOs have handed over their remaining funds to local associations, hoping for better results in terms of revolving funds actually revolving. Among the INGOs in Kassala and Gedaref, ACORD stands out as having succeeded in designing and running a well-functioning microfinance program since the early 1990s. Now almost 20 years later, however, a decision has been made to phase out the ailing program.

6.2.2.1 The ACORD INGO Microfinance Program

While a multi-facetted development NGO, ACORD has been an active stakeholder in the development of a microfinance industry in Sudan. It started and urban microfinance program in Port Sudan which was later spun-off as the microfinance NGO PASED. A similar program was started in Kassala in 1991. During its hay days, ACORD provided financing in the range of SDG 200-2,000 in *murabaha*, *musharakah, mudaraba, and ijaraa* contracts as well as *qard* loans for durations of 1-10 months from its four urban outlets in Kassala town. *Murabaha* and *ijaraa* purchases were marked-up by 3% per month, while partnership contracts yielded a profit of 10-20%. Personal post-dated checks were required as collateral for larger loans, while a personal guarantor sufficed for smaller loans.

This program survived – if barely – the hyperinflation of the late 1990s which seriously devalued capital, and emerged from the droughts and floods of the past 5 years, which wiped out 50-60% of its portfolio. The capital was not augmented after 1997, and staff cuts have had to be implemented.

While the approach and general delivery mechanism of the small, urban ACORD program appears relatively sound, the INGO seems to have lost the appetite for microfinance. The Kassala environment is particularly difficult due to the very high levels of government subsidies allocated to microfinance. In addition, ACORD has not sought a CBOS registration and even with a such, the Federal level agreement made in 2007 between CBOS and HAC to allow INGOs to implement microfinance does not seem to have reached the HAC office in Kassala[97] and INGOs in general report of harassment. As at end of 2008, around SDG 1.3 million is outstanding in some 2,400 loans that are partially backed by SDG 23,000 in compulsory savings[98]. In 2009, Italian Cooperation funds were accessed to finance a phase-out of the program in order for ACORD to focus on its non-financial development activities.

ACORD's microfinance program is one of the only repositories in Kassala of well–trained loan-officers and supervisors who understand the micro enterprise market and the financial products that this market may need. It would be a great shame to lose this valuable resource. The phasing-out should thus focus on three aspects:

[97] The Commissioner of HAC stated in an interview on 29 September 20098 that "INGOs are not supposed to work in finance – they should be doing humanitarian work only. ACORD is a particular problem as they are sending people to prison".
[98] Data received from ACORD Kassala in September 2009.

- Providing a smooth transition of any active clients (i.e. clients without arrears) to a new financial services provider;
- Ensuring that a list of defaulted clients is shared with other providers in the area so wilful defaulters will not be 'handed-over' to other financial service providers;
- Retention within the very small and nascent microfinance industry of the valuable resources that ACORD's program management and staff represent for training, for capacity building and possibly for direct mentoring of staff in new MFIs.

6.2.2.2 Cooperatives and Unions

The cooperative movement in Eastern Sudan dates back to the colonial period with for example the Tokar Credit and Marketing Cooperative established in 1948 pre-financing outgrowers of cotton and selling the harvest in bulk to Britain. Firmly based on cash lending principles, however, cooperative credit activities almost disappeared with the Islamization of the North Sudan financial system in the 1980s. Instead consumer cooperatives (for goods and input supply) were actively developed and supported by government during the 1970-90's, with at least one Cooperative Union (secondary structures or apexes) formed at State level. With economic liberalization in 1992, the government subsidies dwindled and production cooperatives were promoted, especially in agriculture. A few of these manage *murabaha* finance contracts for members, i.e. deliver farm inputs at planting time against repayment with mark-up at harvest time, but rarely outside the banking system. In most case, the unions provide guarantees for members to a sector-related bank (e.g. Farmer's Union to ABS and FCB, etc.).

As in many other countries, however, the externally promoted cooperatives have largely fallen apart, and the consumer cooperatives lost their competitive edge in the 1990s hyperinflation. While many members still have shares invested in cooperative (*musharakah*) projects, only a very few of the consumer cooperatives have bounced back. With the demise of the cooperatives[99], the Department of Cooperatives in the State Ministries of Finance that in principle supervise them, appear to have slumped too. Very little information on cooperatives was available when the Consultancy visited, and none of it was recent.

The structure of professional and popular 'unions' may to some extent have replaced the cooperative movement, but is distinctly more 'compulsory' in nature and has closer ties to the political dimension. All Unions are registered with the Ministry of Labour or Ministry of Justice and in addition with their respective line ministries (e.g. Ministry of Agriculture for Farmer's Union, etc.). Membership, while voluntary, is necessary to obtain the professional Certificates that document status as e.g. a farmer, a worker, or a pastoralist, and these certificates are in turn required for bank financing. For that simple reason, the unions have more members than cooperatives, but even the Unions appear to have trouble motivating members to pay their dues[100].

The Unions do not themselves appear to provide financial services to members, but they act as crucial facilitators, in particular providing necessary guarantees for members' bank loans. As part of their advocacy work, Union leaders may also be members of the "Default Commission" to defend defaulted members.

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[99] Of the 325 cooperatives in Kassala State registered by MoFNE, some 20-30 remain active, according to officials of the Cooperative Union of Kassala, interview on 30 September 2009.

[100] As an example, around 20% of the Farmer's Union members in Kassala paid their subscriptions last year. While there may be 20,000 members of the FU, only some 3,000 have an account in ABS (and hence access to finance). Interview with leadership of FU, Kassala, 29 September 2009.

6.2.2.3 Multi-purpose NGOs and CBOs

An estimated 20 NGOs support relief and development efforts in the broadest sense, primarily through donor-funded projects across Eastern Sudan (excluding Red Sea State). A total of 18 International NGOs are registered in the UN contact list for Kassala as at June 2009, of which 5 have been or are supporting microfinance directly or as part of livelihood services provided through national NGO partners.

In Kassala, linkages between NGOs and INGOs are strong but appear primarily informal, and no formal coordination forum was seen for livelihood or microfinance services outside of the very broad and very relief-focused UN Cluster for Livelihoods chaired by FAO. Women's groups and local associations are linked in two separate apex organizations, the INGO sponsored Kassala Women's Development Network and the Women's Umbrella supported by MoSW. In Gedaref, by contrast, the Oxfam-Novib funded Ma'an Network has brought together 9 local NGOs of which two provide financial services, but no international NGOs working in livelihoods appeared to be based in the state.

The INGO Practical Action (P.A.) is funded by British charities and the EC and focuses on technological adaptations to improve urban livelihoods. P.A. has been operating in Kassala and Gedaref since 1994 and has by now handed-over its finance activities to local NGOs/CBOs, notably women's development associations.

Box 15: An example of a well intended project with an insufficient financing model

The case of Sawa Sawa:
Sawasawa Self Help group for Housing was established in 2006 and now has 200 members living in the Wau Nur IDP settlement slum on the outskirts of Kassala town which is home to some 8,000 people of many different ethnic groups, regions and cultures of Sudan. Members pay SDG 5 joining fee and a SDG 1/month subscription, which keeps the small office of the NGO running although all executives are volunteers.

The INGO Practical Action trained some of the members in construction in 2006 and helped design a permanent concrete house for slum dwellers to replace the straw huts (tukuks) traditionally used. The first 4 houses were built by and for members of Sawasawa and were a big success. Sawasawa registered as an NGO and received a small seed capital fund for a 'revolving housing fund'. The house models available vary in price, but average SDG 5,000 for a 1-room house with no amenities. Members wishing to avail themselves of a new home must deposit a down-payment of 20% of the total cost of the house in Sawasawa's account with SSDB. The balance plus a 2% mark-up is repaid in monthly instalments of minimum SDG 150/month over 30-42 months. So far, 17 houses have been built, and 13 applications are pending, because with the long repayment periods provided, the NGO doesn't have enough capital to finance the construction of more houses and doesn't want to borrow for fear of not being able to repay, if members default. The housing project is a great idea – although perhaps new houses should include a water point and sanitation (currently unavailable in the settlement), but the financing model has not been viable.

Approaching livelihoods from a micro entrepreneurial angle, P.A. has been instrumental in analysing value chains and supporting the adaptation and application of technology and training to improve the value of existing goods or develop new goods, including agricultural handtools and ploughs for black smiths; specialized cutters and improved kilns to produce charcoal from mesquite trees; and low-cost cookers for bottled (LPG) gas to improve health and save fuel costs.

All training provided has, however, been free and opportunities for 'training of trainers' in the private sector may have been missed. P.A. has ventured into financial services provision by mobilizing and training potential micro entrepreneurs as community savings groups (along the lines of the traditional, informal *sanduq*s).

Once training and group formation is complete, P.A.'s model initially included the provision of external credit (up to 90% of cost) through the group to finance the member's micro enterprises (MEs). Each member is meant to repay from enterprise proceeds to the group (association), leaving the group with the means to continue top finance to new members' MEs. In 2005, P.A. helped establish of an apex association for all of the supported women's groups, the Kassala Women's Development Network, which currently has 13 branches. This network has now taken over the management of the training and 'revolving funds' and continues on the same terms, offering training (in food processing and business skills) for free, and providing up to 90% of budgeted start-up costs for branch-members' enterprises. Contracts are signed between the member and the branch, and between the branch and the Network. Usually, a 2% margin is applied to the budget and the repayment term is 3-6 months.

P.A. has supported a large number of such groups in five localities of Kassala and Gedaref, and may be expanding further with new EC support. While the entrepreneurial side of the model is refreshingly innovative and focused on value chain improvements, the financing model may not in fact be as effective as hoped for:

- 90% of enterprise investment as 'cold' (externally injected) money could jeopardize (on-time) repayment discipline among group members, although group pressure may ensure eventual repayment[101];
- At the current levels of limited financing, members will be unable to access increasing financing packages, and most MEs will be unable to grow;
- The 13 branches of the Network currently pay SDG 10/month (total 1,560/yr) and a one-time subscription of SDG 50 (total SDG 650). In addition, the Network is earning a little from the rental of a shop and a car. Executive committee members estimate the Network's running costs are SDG 500/month and that each training (30 pax, 3 days) may cost SDG 10,000. In order to run 5 trainings and the office for a year, the Network would thus have to generate SDG 53,140 in revenue from financing contracts, which at 2% would require SDG 2.66 million in contract value. The system is thus unsustainable and will require ongoing external funding, as currently designed. It may be more appropriate for the Network to cultivate closer linkages to the commercial banks for its branches to finance members MEs while working on revising the pricing for training.

The same could be recommended for the program of UNHCR for which ACORD has been an Implementing Partner since 2007, delivering livelihood services in 12 refugee camps in Kassala and Gedaref. While the service contracts may have kept the INGO funded, they reflect the supply-driven service delivery approach of a humanitarian donor agency for targeted beneficiaries and the financial component does not adhere to microfinance good practices.

Now in its third year, the program aims to "achieve self-reliance by implementing livelihood activities" and for 2009 requires ACORD and its sub-contractors to deliver a total of 4,400 financing contracts ('loans') in 9 camps in Kassala and Gedaref, specifically to 1,800 male farmers, vegetable producers and livestock breeders; 700 female micro entrepreneurs; and 900 women refugees in 18 ROSCAs – all pre-selected by UNHCR and COR[102] (thus significantly increasing adverse selection risk). The loans are provided following a training intervention, which is free for the selected beneficiaries; and involves vocational skills as well as credit management.

The contract formulation demonstrates well the lack of distinction between the specialized business of financial service provision which is microfinance, and the grant-based and project-oriented service provision to beneficiaries with which UNHCR and other funders, including Government, are more familiar. Training, start-up kits and support to refugees for businesses of farming, livestock keeping, services or trade can be delivered as one-off grants or costed services without the complication of credit, repayment and fund management. And unless a specialized microfinance provider is available

[101] As at end September 2009, the Network reported to have SDG 16,000 outstanding and SDG 2,000 (12.5%) in arrears. Interview with KWDA Network, 27 September 2009.
[102] Agreement between UNHCR and ACORD of 23 February 2009, Annex A: Sub-programme description

and enabled to design microfinance services in response to a demand, it is often better to provide such support without a credit component, which only serves to complicate matters.

But if the objective is to 'establish sustainable community funds" as stated[103] then other measures need to be taken. Globally, the injection of external funds into community managed loan funds have proved to fail so consistently that this model of microfinance support is never a prudent gamble. The track record of externally funded group funds is so poor that funders should simply abandon them as vehicles for poor people's finance"[104]. Unsurprisingly therefore, also the loan funds in the refugee camps are struggling. In several ROSCAs, savings have been abandoned and members are complaining that the SDG 100 ($40) interest-free loan they have received is not sufficient to either start or expand a business. Without fees or savings, however, the loan fund is unlikely to grow to meet the increasing demand unless the external funding is perpetuated. External funds will, however, always be considered part of the 'relief package' to which refugees in camps are particularly accustomed, and repayment discipline may be difficult to enforce. Only by requiring 'hot' (owned/saved/paid) money to build the fund will these ROSCAs be able to grow their portfolios; extend larger loans to members and revolve the capital.

PLAN Sudan has been supporting income generating activities in Eastern Sudan since 1989. They started supporting agricultural cooperatives and farmer's associations by providing a loan guarantee fund to SSDB who then lent to farmers, but repayment rates failed. They also experimented with a livestock bank (animals for households to improve nutrition and income) in cooperation with ABS which was discontinued when repayments failed. Then PLAN supported "revolving funds for women groups" seeking support from ACORD to form and train 50 women's groups in savings and lending processes. In 2009, 7 of these groups remain. Rather than continuing to provide external funds directly to the associations, PLAN transferred capital and management of the financing and training to the Women's Umbrella – a MoSW supported apex organization of 325 women's groups in Kassala. Each of the PLAN supported groups has received SDG 4,250 via the Umbrella as external *qard* loan to their ROSCA, but the Umbrella has added a small fee to cover losses. Lately, PLAN has been promoting Village Savings and Loan Associations based on a pilot test in North Kordofan[105], but it is not decided if the program will be implemented in the East as well. If so, PLAN may be well advised to contact and work with existing *sanduq*s which appear to exist in all communities rather than create new ones.

In Gedaref, two of the nine local NGOs supported by the Oxfam-Novib funded Ma'an Network have focused on income generation for women along similar lines. The Women's Development Association is an apex for 27 groups. The Women's Umbrella for Savings and Credit (WUSC) is an apex for 43 groups. Both provide group formation, skills training, savings and credit management training, and access to bank credit for women (see Box 16).

Box 16: A promising financial intermediary

In what appears a slightly more demand-driven approach, WDA and WUSC in Gedaref build on existing sanduqs that are used to savings small amounts. If the sanduqs are small, the WUSC open membership up to other women in the neighbourhood, however, jeopardising self-selection.

Once formed, the new groupings become Saving and Credit Associations (SCAs) registered with WUSC and later with HAC as a CBO. With own stationary and seal, these SCAs can now open a bank account. WUSC has facilitated a loan to a member SCA from Farmer's Commercial Bank, whereas WDA has successfully linked women's associations to ABS and SSDB. By lending on behalf of their member groups, the apex organizations have removed the documentation obstacle from the lending process[1]. By intermediating the loan and acting as 'loan officers' for the banks, monitoring and collecting payments, the women's organizations are demonstrating the viability of the market to the banks. Next step must be for the banks to remunerate this service and recognize that the 100% repayment rate on these loans would not have been achieved without their efforts.

[103] Ibid.

[104] Richard Rosenberg and Jessica Murray: "Community-based Loan Founds: Which Ones Work?" CGAP Focus Note, April 2006.

[105] PLAN: Village Savings and Loan Associations (VS&LAs), Undated paper received from PLAN, Khartoum.

6.2.2.4 State-owned MFIs?

New entrant MFIs are appearing on the horizon with the decision of the Wali of Gedaref and the Ministry of Social Welfare of Kassala, respectively, to establish a microfinance provider as part of the Social Development Foundations (SDF) in the two states. These efforts are no doubt inspired by the establishment of a microfinance program by the SDF of Khartoum State, which is regarded as very successful in serving the poorer population segments and facilitation their 'graduation' to the newly established Family Bank.

The SDF in Gedaref is an extension of the Takaful Fund established in 1993 which provided interest free (qard) loans to productive families. In 2008, its structure was revised, new staff were hired, and policies drafted to accommodate a facilitation role vis-à-vis microfinance provision by commercial banks using its capital of SDG 1.5 million to co-invest with SSDB and other banks in loans to small farmers, pastoralists and other vulnerable population groups. Staff of the SDF are involved in group mobilization, training and linkage of clients to banks. The SDF facilitates access to collateral by borrowers (e.g. by issuing guarantees) and monitors borrowers. As the outreach of commercial banks is not growing as fast as desired, the SDF is now considering a more active role as a provider of microfinance services and has obtained a preliminary license from CBOS. This plan is being supervised by a State-level Consultative Committee for Microfinance established in 2008 by a Governor Decree.

In Kassala, the State Legislative Council has approved a strategy for combating poverty which includes improved provision of microfinance services. While banks and NGO programs have been providing some such services, these were felt to be scattered in nature and lacking impact. The MoSW has been experimented with funding loans to the poor through the SSDB during 2006-08, but repayments have been poor. A Social Development Fund is considered to be a way to concentrate and focus efforts to provide better financial services to the poor. Based on a market study, a work plan has been developed and submitted with an application for licensing to the CBOS. An Advisory Board for the SDF has been established, comprising the Head of the ACORD microfinance program.

Both SDFs have excellent track-records as *facilitators* of increased access by poor people and women in particular to social and non-financial services, and the Gedaref SDF has also experimented with the facilitation of access to financial services through linkages with banks. They may not, however, be the most obvious choice as a sustainable microfinance service *provider*. It is neither obvious nor documented, however, that the SDFs as governmental organizations with a broad social agenda would be interested in performing the arduous task of transforming themselves in part into providers of market-responsive, sustainable and donor-independent microfinance, as foreseen in their application for MFI licenses to CBOS. The two SDFs share characteristics that on one hand places them centrally in the critical field of microfinance market facilitation, but may hamper their ability to effectively and sustainably deliver microfinance:

- They are government-funded. When microfinance is provided by governments, repayment rates often suffer because customers feel public funds belong to them, or that they are entitled to governmental support. This is particularly true in a patronage environment like Eastern Sudan;
- They are staffed by civil servants. While the SDF staff in Gedaref have been involved in charity work until very recently, the SDF MFI is Kassala is being staffed by secondment from the MoSW and MoFNE. For both, it will require considerable training and 'reprogramming' to inculcate the business-orientation necessary for a microfinance programme to become efficient and sustainable;
- SDF management is part of the ministerial line structure. Political interference whether in credit decisions or in staff recruitment, promotion and transfer processes is one of the most frequent reasons why governmental microfinance programs fail. In a private company, the Board of

Directors are responsible for protecting management from such external interference, which is one of the reasons why private companies generally function better in the financial sector. In the SDFs, this protection would be difficult to provide;

- The current and proposed organizational charts reflect departments, not a microfinance institution. Both SDFs are currently structured with a research and PR division; 1-2 'front offices' (one unit for capacity building and one unit for microfinance in Kassala and a combined unit for non-financial and financial services in Gedaref); and a joint 'back office for admin and finance. This structure violates the "3S" principles of successful microfinance: Separate, specialised and sustainable:
  - Using the same structure for grants-based service provision (SDF) and microfinance (MFI) will confuse clients and will lead to lack of repayments. While the MFIs may be funded by government, its capital must be perceived as 'hot' (owned by customers) and not as government handouts (cold) [106];
  - Managements must have access and control over their own administration as finance to develop conducive recruitment, performance monitoring for staff and incentive systems to develop, inculcate and maintain customer-care and business orientation
  - The MFIs must be designed and operated on the basis of Good Practice Microfinance if they are to succeed as permanent, reliable and convenient providers of financial services to the poor and low-income populations.

The MoSW in Kassala and the SDF in Gedaref are already involved in the essential tasks of microfinance market development, i.e. group mobilization, basic training of clients, financial literacy, access to market information, enterprise development, market linkages and linkages between clients and banks. These market development and facilitation roles of the SDFs are very much needed and should be expanded to include more value chain integration work, coordination, and overall market research. It is not evident, however, that the government funded departments will be able, successfully and sustainably, to provide microfinance services themselves. Embarking on this endeavour will require significant, early and deep technical assistance.

6.2.3 Informal finance

Mutual support is a venerated principle in Sudan and subsequently, mutual financial support schemes have flourished for centuries across the country. The elaborate networks of informal group structures familiar with the pooling of cash for mutual benefit provide excellent building blocks for the expansion of access to finance. Their abundance also suggest less of a need to establish new community group structures, as has otherwise been a focal area of some NGOs. INGOs and donors. In many communities, it would seem more important to identify and build on existing structures. There is anecdotal evidence that the '*sanduqs*' of the past may have suffered in areas of intense conflict, e.g. Darfur, but in Eastern Sudan sanduqs appear widespread and well attended both in urban and rural environments, arranged e.g. among neighbours, business partners, employees in a given work place, etc.

The *sanduq*s are basically accumulating or rotating savings and credit schemes founded on the principle that members add contributions to a common pot on a regular basis (some *sanduq*s have minimum savings requirements per week or month, others leave it up to members) and in sequence, each member is given the usage of the total fund for a specific period of time (in some *sanduq*s

[106] Capital generated through local savings feels 'hot' because it comes from one's neighbours. Defaulting on loans from savings feels like stealing from neighbours, and borrowers are more likely to take repayment seriously. 'Cold' money is outsiders' money, usually from donors or governments, and is often treated with less respect. If there is little negative reinforcement preventing people from defaulting, such as the fear of losing collateral, then repayment of cold money may not be a priority, even if the money will go back into a revolving fund for other members of the community to use.

members must apply and the project must meet with the approval of the group, in others usage is up to the member as long a repayment is prompt) and must pay back the funds to the pot for the benefit of the rest of the group. As highlighted in section 6.2.2.3, the basic model has been augmented in some areas and groups, e.g. by shifting the savings contributions to investments (*musharakah*) in joint projects and then sharing the profit from these projects (dividends).

Similar to cash *sanduq*s, pastoralist communities traditionally build up reciprocal social security systems around primary sources of wealth to reduce problems of food security, especially during times of hardship. Mutual financial assistance among the Beja would seem to include access to both land and livestock credit:

- Herd redistribution at *diwab* (lineage) level appears an important risk mitigation strategy, and the Beja have customary rules which encourage wealthy livestock keepers to transfer some head of the stock to *diwab* members in need of support, especially during periods of drought or food insecurity. A regular gift of animals would be termed '*tait*'. But '*dangeit*' or '*yahamot*' redistribution would indicate a loan of animals, especially milking goats but also riding camels, provided to poorer diwab members or neighbours. The borrower can use the milk but must return the animals (repayment) and their offspring (mark-up) to the original owner once the period of difficulty is over or their agreement has come to an end;
- Similarly, *Asl* is the customary right over a piece of land and its resources inherited from the ancestors for the entire lineage; *amara* is the usufruct right given to non lineage members to use pasture, water and cultivable land (rental) against the payment of a tribute called *gwadab* (fee) [107].

It is very likely that the other pastoralist tribes have similar systems of 'credit' and 'service contracts'. But none of these traditional financing systems are rarely sufficient when there is an urgent need for cash or input and time is of the essence, for example in the small window of planting time at the beginning of the rainy season. This urgency, the limitations of traditional finance, and the long, cumbersome procedures of the banks located in the main towns pose severe challenges, especially to small farmers trying to produce crops on rainfed land and is often exploited by traders or buyers that have the cash needed but also charge very high rates (48-100% mark-up on *murabaha* and *salam*-like contracts are reported).

Specialised microfinance can fill the gap between reluctant banks that are ill equipped to cater for the market segment of the poor, and the informal financiers that prey on the poor and charge usury rates. The existence of an informal market for financing at extremely high rates indicates that there is a demand for specialized microfinance in Eastern Sudan.

6.3 Range of products and services

6.3.1 Financial products

In principle, most bank branches in the East offer the entire Islamic product range of both deposit and financing contracts (see Annex 1 for an overview). The extent to which a given product is provided, however, appears determined more by the planning department at head office than by the market in which the branch finds itself, and this renders the Sudanese financial services industry much less flexible than it could be.

On the financing side *murabaha* (sales with mark-up) contracts have for long been the preferred product, as it is relatively easy, profitable and well-known. In its annual Banking Policies, CBOS is restricting *murabaha* financing in a number of ways, chiefly to encourage other financing modalities.

[107] M. Babiker and S. Pantuliano: Addressing chronic livelihoods vulnerability in Red Sea State, Sudan. Oxfam/Humanitarian Policy Group, February 2006.

Retail banks are asked not to exceed a mark-up of 10% of the sales price; to restrict *murabaha* financing to 30% of the portfolio; and to record and report arrears in the *murabaha* portfolio at 30 days past due rather than the 90 days past due permitted for the rest of the portfolio. However, this has not led to any great diversification in the portfolio of the banks in Eastern Sudan (see Table 17). In this regard, the very limited capacity to introduce and adequately manage any new products at branch level should not be underestimated.

Table 17: Dominant product type offered in Eastern Sudan as at end August 2009.

Bank	# Branches	Portfolio outstanding '000 SDG	Sector with largest investment	% of portfolio in murabaha contracts		Largest other product
				KSA	GEF	
ABS	9	141,920	Agric	77	47	Salam
Animal Ress	1	1,017	Trade		85	
Khartoum	3	0	-	-	-	
Barakha	1	2,350	Trade		100	
Export Devt.	2	5,206	Trade	58	6	Musharakah
Faisal	2	8,273	Trade	100	92	
Farmers Comm	4	20,063	Agric	52	43	Mugawala/Salam
Sudan-French	2	18,341	Other/trade	100	70	
ICDB	4	54,766	Agric/other	20	60	Musharakah/Mugawala
Islamic Bank	1	1,278	Agric	100	18	Salam
National	1	0	-	-	-	
Nilien Bank	1	290	Trade		82	
ONB	1	9,754	Other/trade		17	Other (Mugawala?)
Real Estate	1	8,585	Housing		98	In interview, mugawala was mentioned
Saudi	1	467	Trade		27	Salam
SSDB	3	14,901	Other	96	68	Salam
Shamal	1	7,420	Trade		36	Musharakah
Tadamon	2	7,101	Agric/small(!)	100	76	
Workers Bank	1	3,404	Trade	52	43	Salam/other
Total	42	305,136		76%	57%	

Almost all banks and NGOs (e.g. ACORD) require ID or national certificate, certificate or residence and other identification documentations, which IDPs, refugees and even some of the nomadic communities have difficulties producing. In addition, the 'professional ID' specific to Sudan, i.e. the Farmer's Certificate or Trader's license or Pastoralist Certificate is required. The ID-requirements are complex but are not fully within the control of the MFP – much is required due to the extension of the customer coding system to all – including microfinance – clients. In no bank branch were guidelines or formats for customers seen in any language but Arabic. Due to the administrative paperwork required, getting financing can be an expensive and long process which is not well adapted to poor customers who may have limited formal education.

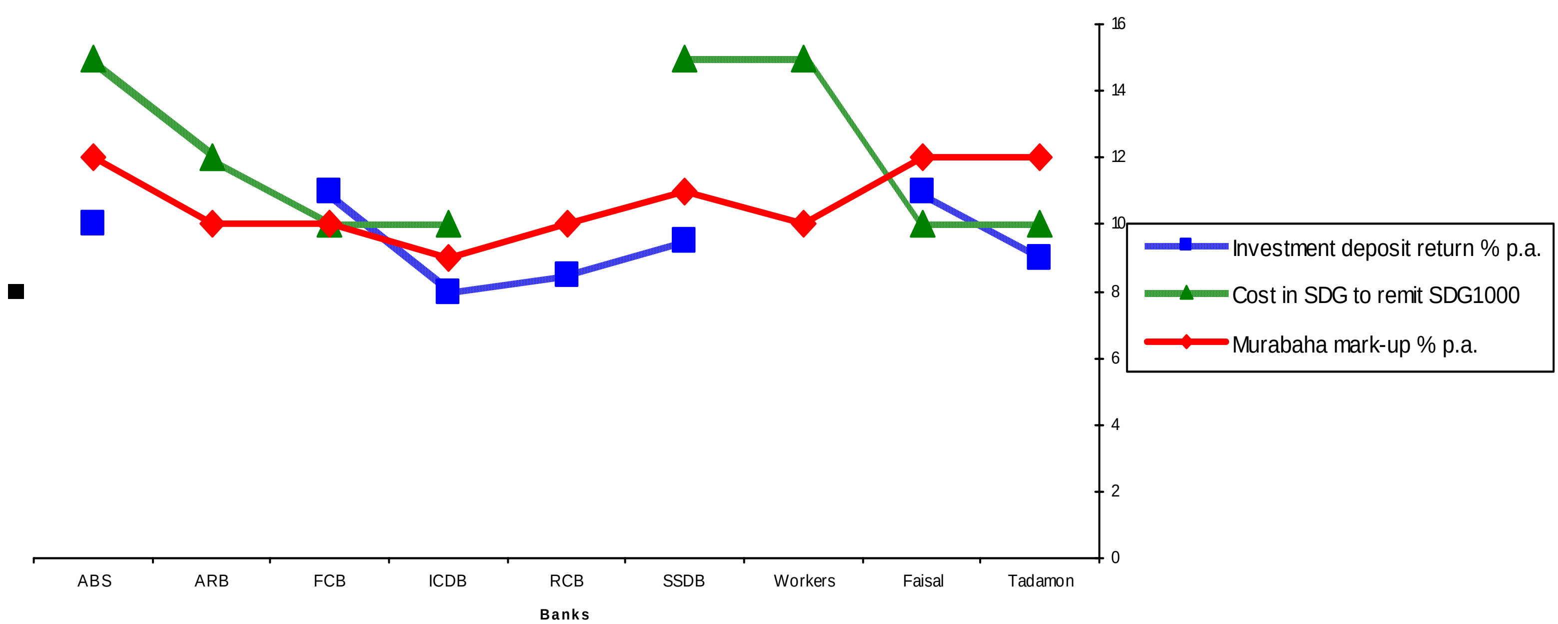
The collateral requirements are also very conventional and cumbersome in most banks, and thus not adapted to microfinance contracts. A personal guarantee (typically post-dated checks from an account opened with the bank) and a third party guarantor (a community leader, union or association leader, sheikh, *Umda* or similar person of high standing in the community and known to the bank is normally required. On top of this, borrowers are often required to pay for insurance, either an asset insurance for the period during which they will be repaying an item bought by the bank (*murabaha*) or a collateral insurance for the valuable pledged as collateral in case of default. Most banks require the customer him/herself to get the insurance issued from a recommended insurance company (transaction cost), but a few banks will process the insurance paperwork for the customer and just add the cost to the financing costs. The collateral requirements are thus a barrier to access to finance for poor people. As commendable exceptions, ABS in Aroma, Kassala has introduced a promissory note, compulsory savings and a ‘known guarantor’ as sufficient collateral for its microloans, whereas the group loans are backed up by a group guarantee. Similarly, SSDB in Gedaref agreed to wholesale a group loan to the Women’s Umbrella Organization for member associations thus waiving the majority of the ID-requirements that the association members would be unable to provide.

All bank branches offer current and savings accounts for customers. Only one bank provides a return on savings accounts, which should give it a huge competitive advantage, given the price sensitivities on the demand side. Even without returns, however, the total deposits are significant and people must therefore see a benefit in keeping savings in the bank. Checks are widely used, and checking accounts are therefore important. For borrowers, the requirement to open an account also encourages deposits. Most banks, but not all branches offer investment accounts as well. With very high returns in some banks (generally 9-12%, but up to 25% p.a.) these term investments are attractive, but would not in general be accessible for the poor, due to their illiquidity and the minimum balances of SDG 100-5,000.

All bank branches offer remittance services to their own and other bank branches anywhere in Sudan, but no branch will provide international transfers, except one bank which has entered into an agent agreement with Western Union. Remittances are seasonal and appear an important business line for many banks. Most of the banks in the East have 1-3 ATM services, which is alleged to be a CBOS requirement. Servicing of ATMs must be difficult, as almost all banks have located their ATM at their branch and only one branch had an off-site ATM – at a ministry. While debit cards are being promoted, only one bank was found to also have EPOS services.

There does not seem to be any delegation of pricing authority to the branch level of banks and subsequently little competition on price. Prices of all products (deposit returns, financing contracts and remittances) appear set at central level as they vary very little (see Figure 18). In addition, the lack of price differences and the at times obvious mismatches between costs and pricing suggests that banks are not costing out their products but rather implementing any price recommendations that they receive from the CBOS or from head offices – again confirming an extremely rigid and supply-driven approach to what should be a very market-oriented industry. Several banks confirmed that they had not costed out their products and thus did not know whether a given product was breaking even or not.

Figure 18: Prices vary very little across providers – selected sample



6.3.2 Non-Bank Services - Insurance

At least 5 major insurance companies have branches in Kassala and Gedaref including the state-owned Sheikhan and Sudan Islamic Insurance, as well as the privately owned National Company for Cooperative Insurance, partially owned by ICDB, and the Islamic Insurance Company owned by Faisal Bank. A number of smaller companies also operate there. The National Health Insurance (NHI) is government owned and serves as a 'social security system' rather than an insurance company per se in offering its important service to poorer employees and their families, some of which are creatively 'sponsored' by corporations and/or professional associations.

With a commanding market share, Sheikhan is the largest insurance provider in the East. Some market segmentation is recognised, but like competition, this appears to be based more on relationships and linkages in the commercial sphere (banks have purchased shares in insurance companies) than on open market competition. As opposed to banks that display large billboards to increase name recognition, marketing in the insurance industry seems much more subdued.

The range of insurance products potentially on offer is very wide and a number of the current products could be adapted to the micro-market with a minimum of effort (See a sample in Table 19).

The insurance providers are, however, hampered by the same centralized and top-down business model as the banks, and thus the ability and motivation of branch staff to develop, adjust and market products adapted to the local market are very limited. All product development resources appeared centralized at the head offices and the branches have little if any marketing and information materials about the products on offer. Market development is also hampered by a curious confusion of issues related to *collateral, guarantees and insurance*, which may be linguistically founded, but which mixes up the different types of risk and the placement of mitigation responsibility.

Like all business, banking carries a given risk. Because risk is inherent (internal) to the very business of banking, risk assessment, mitigation and management is normally at the core of bank staff training, specialization and incentive systems. To manage internal risks, banks may have early warning systems with 'risk triggers' and 'risk owners' specially assigned to monitor determined risk triggers so as to give the bank as much time and as many options as possible to evade, manage, mitigate or eliminate a risk. In seeking to mitigate the internal (controllable) risk of a given financing contract, the bank may require collateral from the borrower. One such collateral requirement could be a guarantee from a person or institution. Likewise, a bank may seek to lower external (uncontrollable or force majeure) risk by under-writing or insuring a given (part of) portfolio.

In Sudanese banking, however, risk acceptance and hence the responsibility for assessing, mitigating and managing risk does not seem to be very eagerly embraced. Collateral is often exceeding the value of financing; often multiple guarantees are sought (personal, institutions, by 'a prominent person'); and in addition, external insurance is sought to cover what could be argued to be internal (inherent) risk to the business. This may be a deliberate and interim risk mitigation strategy until banks build up the necessary capacity to manage risk without an external 'safety net'. But this 'externalization' of risk promotes evasiveness of risk responsibility, either to higher-ups or to other entities, e.g. the insurance company, the Zakat Foundation, the Government, CBOS, etc).

Table 19: Examples of the range of insurance products available

Type of Insurance	*Company*	*Applicability for MEs*	*Indicative cost*
Vehicle insurance		Limited	
- 3rd party liability	Sheikhan		SDG 100/yr
- Comprehensive	Islamic Insurance		2% of car value
(also for trucks and tractors)	Nat. Cooperative Insur.		
Agric/harvest Insurance		High	
- Normal value of harvest in spite of drought/flood/insects	Sheikhan Islamic Insurance Nat. Coop. Insurer	(50% Gov't subsidy in GEF)	7% of est. harvest price/fd 3.5% if irrigated land SDG 50/feddan
Asset Insurances			
- Land & real estate (homes/shops): Theft/fire/damage/political risk	Sheikhan	Medium	0.5% of purchase pr.
- Assets as collateral: Theft/damage during repayment (equipments/machinery, vehicles)	Islamic Insurance Sheikhan Nat. Cooperative	High	0.5-1% of value 2% of value, Govt 2-5% for PS/NGOs 4% of value
- Supplies and stock in storage	Sheikhan Islamic Insurance Nat. Coop. Insurer	Medium	3‰ value of goods/yr 0.7% of value if collateral
- Cash in hand/transit	Sheikhan	Relevant for MFIs	
- Livestock Against death and theft of cattle (and offspring), sheep, goats, poultry. Requires tagging, stabling & vet. cert.	Sheikhan Islamic Insurance Nat. Cooperative Ins.	High	5.3-10% of price/year 5% of purchase pr/year
Medical insurance			
- Life	Sheikhan		SDG 36/yr/pers.
- Group insurance by employer	Sheikhan Islamic Insurance		2-4% of sal/month
- Group insurance (takaful). Cover determined by grp.	Islamic Insurance	High	0.75% of cover/pers/yr
- Government health insurance (for government and formal sector employees; sponsor scheme exists for poorer employees)	National Health Insurance	High	4% employee sal & 6% employer top-up/month Or SDG 15/month/pers. For family unit coverage
Micro Insurance		High	
- Harvest/crop - credit life/default - medical by NHI? - asset	Sheikhan Sheikan Also considered by: - Islamic Insurance as proposed by Faisal Bank - 'Default insurance considered by Zakat Foundation to replace current pay-out system.		7% of harvest price/fd (for rainfed) 0.5% of value
Re-insurance (re-takaful)	All insurers	Relevant for MFIs	

Internal and external risks and assumptions should be clearly distinguishable. In banking, default is largely an internal (controllable) risk, minimized through good customer care that builds customer loyalty; careful project appraisals and approval procedures; effective monitoring; and early action ("zero tolerance') in case of delinquency. But in Sudan, it appears that regular, controllable, internal banking risk has effectively been classified as 'force majeure' and requires external insurance. Thus, Sheikan Insurance Co. has developed a 'default insurance scheme' specifically for microfinance to which the Family Bank (of Khartoum), ABS and the Animal Resources Development Bank have signed up. The scheme provides last-resort cover in case of delinquency[108]. Such an insurance would not be necessary in an industry familiar with the repayment capability of its borrowers and confident of its own risk assessment capacity. This may indeed be the reason why an additional solidarity fund (*Sanduq Takaful*) proposed by the CBOS MFU was rejected by the Insurance Supervisory Board. The issue was still pending by November 2008[109].

Rather, external (force majeure) risks should be covered for the industry. A more systemic use of insurances against uncontrollable risk (weather/harvest, fire/theft, medical issues/death) could serve to replace circumstantial relief grants and charity as a more predictable, objective and thus equitable system of risk mitigation, e.g. credit-life ("default") insurance, NHI medical scheme and harvest insurance. Rather than subsidizing the commercial transaction of the financing agreement between bank and borrower, funders could look to avail such insurances at a lower price and with less documentation requirements to poor people, for example through associations.

- If more small farmers are able to afford insurance against droughts and floods, not only would they be guaranteed an income even in case of a failed harvest, they may also be better able to repay banks so that delinquency rates decrease;
- Rather than repaying banks based on individual appeals to the Compassion Committee in case of default – a system which it seems is difficult to implement – the Zakat Foundation could help more poor people access better functioning insurance schemes by subsidizing research, development and roll-out of micro-insurance products;
- For population groups that are at risk of particular exclusion, e.g. IDPs and refugees, an insurance coverage card can be a first step to document identity and thus 'belonging' to a community.

7. Main Microfinance Constraints in Eastern Sudan

In general, microfinance – the sustainable provision of financial services to the poor - is not well understood in Sudan. Microfinance as a currently popular term is indiscriminately used to reflect almost any type of support to poor people, be it grants-based (free), subsidized, commercially viable or usury. It could be argued that the institutionalization of Islamic compassion, represented by the Zakat Foundations, and age-old patronage systems compound to confirm 'support to poor beneficiaries' as a meritable pastime for more well endowed people, thus protracting and deepening dependency structures. In addition, the widely held conviction that Sudan "is different" and does not need to learn from international experience may delay the market development process.

There can be very good reasons for social transfers and charitable schemes in support of the poor, and in cases of severe liquidity problems, a case can be made for government credit lines to banks, but these should not be labelled microfinance. Forty years of continuous global learning has provided ample evidence that for microfinance to work, its basic principles must be adhered to – the **litmus test remains that if Good Practices cannot be applied, microfinance is not the best response**. Greater clarity and awareness raising about what Good Practice Microfinance[110] is and how it differs

[108] Unicons: Review of Implementation, op.cit., Nov 2008.
[109] As reported in the Unicons Review of Implementation, op. cit., quoting the CBOS MFU Monthly Report of June, 2008. It was not possible for the Consultancy to get an update on the current status of the proposal.
[110] Please see http://dev.cgap.org/gm/document-1.9.2741/donorguidelines_ar.pdf for Good Practice Funding guidelines for donors in Arabic.

from grants-based poverty reduction measures would help delineate the space for inclusive financial service market development as per the CBOS Vision statement.

Microfinance market development does take time as capacity needs to be built. The Government through CBOS has tried to speed up the development process, first by requiring banks to provide financing to poorer people, then by incentivicing banks with generous amounts of subsidized capital. But nowhere else in the world has a supply-driven, government-subsidised approach to microfinance provision been successful and Eastern Sudan displays no particularities that would suggest it will be successful here.

A large section of the poor are yet to access financial services, and the private sector actors who may be able to provide a demonstration effect in the market place are being displaced. The banking system only reluctantly disburses financing to smaller projects, and the capital currently outstanding is at risk of being lost. In the process, repayment discipline is not being reinforced. The risk of availing more capital to weak managerial structures with little understanding of operational requirements for growth cannot be understated. Slow disbursement rates; over-collateralisation; high delinquency rates; and lack of adaptation and market orientation suggest that a radical change of approach is required for microfinance to be successfully introduced.

There are challenges related to the immediate need to stem the haemorrhage of capital from banks that may not yet know how to provide microfinance; to strengthen and train intermediary structures in performance monitoring and reporting; and to ensure that “the poor” are not blamed for the slow disbursement, which is primarily a supply side problem of limited capacity.

7.1 Institutional Constraints at retail level

At the bank branch or NGO program level, all of the microfinance providers (MFPs) currently active in Eastern Sudan are by international standards small and display serious weaknesses in operational, financial, managerial and strategic management capabilities.

7.1.1 Limited microfinance capacity

Within the **extremely centralized banking system** of Sudan, very limited decision-making authority is delegated to the branch level. Branches appear without any influence on available capital for financing or discretion in terms of credit decisions, procedures, pricing, research and adaptation to their local markets. Operating funds, including capital for financing and microfinance in particular is allocated in annual ‘budgets’ from the head office to each branch. Some banks appear to allocate budgets based wholly on non-market (“scientific”) terms, e.g. the area of cultivable land in a state determining the financing allocation for agriculture. This **top-down approach** discourages any demand-orientation at branch level and would explain the lack of information about and interaction with local markets and thus customers in the field. It may also delay the availability of capital for financing, which in an agrarian economy depending on rain, can spell disaster. Farmers in Eastern Sudan, for example, were aware of a credit line having been made available within a bank in 2008, but the procedures had delayed disbursements beyond the planting season.

Limited both by head office policies and CBOS regulations (the origin of these limitations is often not distinguished), branches thus have very little incentive or motivation to adapt their portfolio to exploit opportunities in their specific market. Inversely, the level of banking training and experience currently required for branch management may not be commensurate with additional delegation of authority in many banks, particularly SOCBs.

Almost all of the banks have been and are relying very heavily on Government funding whereas the NGO programs are totally donor dependent. This **supply-driven provision of subsidized funding** to branches that may not have received training or exposure on how to effectively use the funding is unlikely to be well invested. Despite a high level of external support, most financial institution staff has not yet achieved the level of capacity that would enable them to steer a successful financial service provider ahead. The **level of technical skill and knowledge about good practices appears insufficient**, also among the banks, INGOs and government officers promoting microfinance.

Not least because of the lack of training, motivation and incentives, implementation is very slow and reluctant in most banks. The few banks that have a large micro-portfolio also have high arrears rates, indicating a focus on disbursement of cheap capital to meet political objectives rather than attention to good repayment and thus profitable banking. Inevitably, the customers are blamed for non-performance – but that is not altogether fair. Rather, the training and experience of the personnel in commercial banks as well as in most non-bank programmes is insufficient and unsuitable for servicing poor clients and there is a **lack of exposure** to international, state-of-the-art microfinance practices.

While eight banks have accepted the new credit lines ('partnership contracts') made available from CBOS for microfinance, few have adapted their structure, procedures, systems or staffing to provide microfinancing, and specialised microfinance units at branch level are very rare, at least in Eastern Sudan – of a total of 14 bank branches visited during the Consultancy, one had received some training. Hence, the same limited number of conventionally trained investment officers are asked to manage a portfolio of small loans to an unfamiliar market segment. The lack of technical expertise, exposure, specialization and experience with microfinance results in microfinance being attempted implemented as conventional banking, only at smaller scale[111].

Because of the lack of training, specialization and adaptation to the segment that can be served profitably by low-value, high-volume financing, the mismatch between supply and demand remains high. Customers complain of lengthy procedures, untenable eligibility and collateral requirements and documentation. Bank staff complain of customers' inability to meet requirements and the high transaction costs to process small loans as conventional finance. Until microfinance is recognized as a specialized banking methodology with its own particular procedures and delivery mechanisms, it is unlikely that it will be provided profitably or even successfully by the banks.

7.1.2 Lack of Costing and Pricing

Most bank branches and NGO MF programs complain that microfinance is costly – but there is **little documentation and evidence** to suggest that costs are higher in Eastern Sudan than should be expected in the market – or indeed higher than the revenue. Banks are losing money due to delinquency, but no branch visited by the Consultancy was able to present a cost-price calculation that documented the widely held claim that the 9-10% profit margin recommended by CBOS on *murabaha*-contracts is insufficient to cover costs. Several providers, instead, suggested that micro-*murabaha* would break-even at a 12% profit margin. The CBOS recommendation would not forbid such an adjustment. There does seem to be a felt need for cross-subsidisation in the banking portfolios, which is not a problem per se, but becomes a constraint if a **lack of proper costing** induces banks to charge higher than necessary fees on other products. For example, the revenue incurred by banks on salam contracts seems very high. From the customers' point of view, the nominal value agreed at the signing of the contract is very much lower than the market price for produce at the time of repayment (harvest). But due to the terms of the loans, repayment has to be made at harvest - and in any case the farmers has no appropriate storage place for the harvest, so

[111] As observed also in the CBOS Implementation Review, November 2008.

have to sell. From the bank's perspective a high profit on *salam* may offset a loss on murabaha – but this should be transparently documented.

The Consultancy could identify no characteristics on the demand side that would suggest a need for price control. Indeed, customers in one survey were willing to pay significantly more than currently charged by banks to access financing. MFPs should thus be enabled to cover their costs in order to grow their portfolio, but their argument would be greatly strengthened if they would cost their products accurately and propose pricing accordingly. As costs would necessarily vary with area and market, costing and **pricing should be decentralized** to the branch level. To implement this level of decentralization will require additional **training** of branch management and staff[112].

7.1.3 Performance recording, reporting and monitoring

Most MFPs report to CBOS or a donor or their head office about their activities, but the **standardized globally accepted ratios for microfinance** that any portfolio funder should demand **are not required – or even known**. CBOS made an attempt with the elaborate microfinance reporting formats posted on its website, but these have not been enforced through the CBOS branch to the banks in Eastern Sudan and were generally unknown. In addition, they do not include all of the standard microfinance ratios that enable good portfolio monitoring. Instead a very brief one-page reporting format for the microportfolio is generally provided by banks in Gedaref (less so in Kassala where monitoring is necessarily less as there is no CBOS branch). Like most donor reports, this reporting format focuses on the funding volume disbursed. It does not state numbers of financing contracts or saving accounts which would enable analysts to verify average contract balance; the Portfolio at Risk measure for debt collection is not used – and generally not known; nor are any profitability *ratios* required. The result is a **very poorly monitored portfolio**. Further, the capacity challenges and the strict command hierarchy in the banking system appears to discourage branch level staff from any analysis of the results in the format. This disempowerment challenge is to a certain degree valid also for CBOS branches.

The MFPs' financial statements – or lack of same - also demonstrate this gap in operational capacity. Many do not appear to record, report or consolidate even a basic balance sheet or income statement, and do not (and are not required to) report the most basic microfinance performance indicators. It would be important to ensure that financial statements are required, and that operations and projections are adjusted for in-kind subsidies as capacity is built in this area. While a few banks and most non-bank MFPs also offer business development training and support to their clients, **none appear to price these non-financial services**. Clients are not charged for the services, and they are not costed in the financial statements. Financial statements, when existing, are therefore likely to over-estimate performance.

The level of effort required to prepare banks and e.g. SDFs for providing Good Practice microfinance given especially the limited skill levels available may not yet have been fully internalized. Improved capacity building combined with results- and performance-based monitoring, and clearer reporting requirements more in line with international good practices would be a good starting point.

7.2 External Constraints at the Retail level

The market for financial services is dispersed across the **sparsely populated Eastern region**. Poor infrastructure, physical distance from central points of commerce, and the additional mobility

[112] A series of excellent microfinance training toolkits are available from MicroSave at http://www.microsave.org/content/imicrosaveis-training-toolkits including a detailed training toolkit on costing and pricing.

restrictions caused by security concerns, UXOs and mines in the border areas are barriers to accessing product and service markets for micro- and small enterprises (MSEs) and MFPs alike. For MFPs, the **cost of reaching people** by setting up microfinance outlets within reasonable distance of people's residences is high; and the limited infrastructure outside of the main city centres compounds the problem. The technological solutions available to overcome some of these constraints, e.g. mobile phone banking[113], have not yet been introduced in Eastern Sudan. For MSEs, **high transaction costs** and limited market information flows discourage market entry, preventing them from becoming active participants in the formal economy. In particular, subsistence farmers and rural micro-entrepreneurs are not in a position to accept the high opportunity costs and risks of entering a new market without reasonable assurances of revenue generation.

The **high level of subsidies** in the economy has distorted the commercial market for services to MSEs that make up banking customers as well as for the MFPs themselves. The direct provision of services and business support by government, donors and donor-funded entities in Eastern Sudan has decreased the incentives for productive investment, limited outreach, and resulted in unsustainable operations. Programmes are often supply driven, "pushed" without adequate consideration of potential market demand or sustainable "pull" for promoted goods or services. In addition, the price patterns especially in Kassala suggest a captured market ruled by cartel price setting rather than by demand and supply.

The historical legacy of external patronage and pervasive subsidization of real costs of services, inadvertently perpetuated by donors and government funds after the peace agreement, has left the population somewhat disempowered. This disempowerment is reflected in inflated demands for and subsequent disenchantment with government support; unrealistic expectations of support 'due' by merit of past hardship, and to a certain extent **disengagement from self-reliant – and self-financed - development.** The combination of difficult markets for income generating businesses and a certain expectation of external 'rescue' may be contributing to the slow expansion rate of microfinance and the high levels of arrears that many banks are experiencing.

The banks themselves get caught up in the patronage system when the Zakat Foundation is unable to process reimbursements in time. **Defaulted farmers** that have received a Zakat certificate can then still not get another loan from the bank because the bank has not been paid back by the Zakat foundation. Some 300 small farmers in Kassala are estimated to be out of the production cycle because of this problem[114], and a solution needs to be found.

These external constraints, while noted, do not present insurmountable hindrances to successful delivery of microfinance – or financial services in general. Operational costs will be higher than in more well-endowed environments, but methodologies can be adjusted to better accommodate the market. It may take microfinance in Eastern Sudan significant time to reach sustainability, but it is not an impossible task. In particular, the market demand characteristics are similar to those of many other successful microfinance markets, and there are tools and guidelines readily available for MFPs to facilitate training and implementation[115].

7.3 Constraints for Microfinance Industry Development

With 42 bank branches for a total maximum market of 1.7 million, the financial services system in Eastern Sudan could become inclusive with the addition of a few specialized microfinance providers

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[113] See http://www.cgap.org/gm/document-1.9.2716/Brief_MobilePhones_AR.pdf for an overview of this technology in Arabic.
[114] Interview with Union of Farmers of Rainfed Land, 29 September 2009
[115] See for example: www.sanabelnetwork.org and www.arabic.microfinancegateway.org

either as subsidiaries of the current bank branches or as Microfinance Institutions (MFIs). But as most banks will remain reluctant and ill equipped to deliver retail microfinance in future, there is a **lack of trained financial intermediaries** in the market place in Eastern Sudan. The associations, chambers and cooperatives in which MSEs are organized and which act as their representatives suffer from weaknesses in management as well as organizational capacities to promote microfinance[116] and are often unprepared to negotiate with bankers. In addition, their **mandates and the legal basis** on which they function (incorporation, articles of association) may not be conducive to their role as financial intermediaries. The agreement reached by CBOS and HAC at central level to enable NGOs and INGOs to conduct commercial activity was a great step forward, but state level officials remain unaware of the revised legislation. While good examples exist of associations and networks having performed the 'microfinance specific' part of the financial service delivery for a bank (e.g. selecting clients, appraisal business proposals ("projects"), guaranteeing financing, monitoring outstanding loans and securing repayments), none of these services have yet been paid for by the bank who received the service. Only one Network met by the Consultancy had succeeded in negotiating a whole-sale loan to a member association. If, however, associations and similar structures were trained in financial management, banks would be able much more effectively to ensure access to finance by the poor through wholesale financing of such intermediary structures.

By directly intervening through **subsidised credit lines** in retail financing, a government may harm rather than encourage current MFPs to increase outreach, and may lead people to borrow or lenders to lend for more risky activities which will end up failing. As experienced also in Sudan, the channelling of capital as risk-free or low-risk (cheap) credit lines leads to large defaults and results in contraction and regression, thus actually reducing the access of MSEs to credit. In addition, the government as an investor will often get no financial return on such credit lines. Similarly, once having become used to risk free capital, banks (and non-banks) generally find it hard to wean themselves off subsidised capital, and microfinance or other targeted portfolios are often stopped when the credit line expires. Borrowers who cannot trust that access to finance with be permanent generally do not perform well on repayment. Credit lines work best if there is a liquidity problem, but for credit lines to work as intended, the recipient bank needs to retain sufficient risk to subject its financing applications to the normal appraisal and approval procedures – even if the pricing may be less because the risk is shared with a third party.

So far, **insufficient training and technical assistance** has accompanied the significant amounts of government credit lines having been made available to banks for microfinance. Capacity building is sorely needed to stem the bleeding from the current credit lines and to provide the basis for a more sound microfinance portfolio within the banking system. SMDF was designed to coordinate and provide the much needed training and TA, and hopefully the delays marring its start-up phase have now been overcome so that the Facility and the CBOS Microfinance Unit together can start filling the significant capacity gap at in the industry. Demand-driven and on-site technical assistance is probably the most effective and fastest way of building capacity at the retail level, i.e. funding should be made available for branches (or banks) to apply competitively for technical support against specific performance targets.

The benefits of **coordination, exchange of information and joint learning** have not yet been realized in the top-down, parallel system of financial service provision in Eastern Sudan. Firstly, documentation is extremely scarce and where available, of questionable quality. The aggregate data available on the microfinance industry size and performance is not shared and not fed-back as performance indicators to the reporting banks. Statistics, surveys, baselines, and research that provide estimates of the volume of the microfinance market and its characteristics by sector and area are very limited or unavailable. There is no one-stop-shop where all available information is compiled and

[116] UNIDO Sudan: Livelihood recovery in Eastern Sudan: Enterprise and Youth Entrepreneurship Development (YED) through Vocational Training for Employment and Income Generation, Draft Project Document.

developments tracked. A strengthened CBOS office for the Eastern region may help – or at least more CBOS presence in Kassala state. Alternatively, a more informal but inclusive **platform for all stakeholders** in each state could serve to start the industry development process. It is all together possible that better coordination, sharing of information, and joint discussion of challenges and ideas may leapfrog the Eastern industry forward, but such a process – as well as the possible designation of a champion for microfinance in the state – would need to be 'sanctioned' and nurtured by the national head offices of the various stakeholders.

7.4 Constraints in the Market of Eastern Sudan

Access to financial services for the poor is not a universal panacea for poverty reduction. Access to safe savings and business finance is only one of many services that poor households need to extract themselves from the grips of poverty. The building of human capital (education, skills, empowerment); enhanced health (water, sanitation, access to health care and nutrition education); and most importantly, the infrastructure to generate increased wealth from livelihood activities (local cash economies, access to markets and market information) are crucial factors impacting the ability of poor people to succeed in improving their livelihoods.

Basic **numeracy and literacy skills are low** in the rural areas of Eastern Sudan. This negatively affects people's access to and use of information and training, the ability to appropriately price produce, and the general inclusion of rural communities into the supply chain. The lack of a capable and skilled workforce acts as deterrent for growth due to the limited technical knowledge of production techniques and of management skills, and causes low productivity, quality, design and competitiveness. It also contributes to the difficulties for MSEs to present a bankable project proposal to a MFP and gain access to financing.

Microentrepreneurship is hard and does not always succeed. Despite the many unmet needs in rural and urban communities, carving out off-farm business opportunities and market niches requires innovation and skill. The immediate choice among off-farm livelihood activities in many rural areas of the East is often running a kiosk selling dry goods, trading in a limited number of basic goods or animals from the homestead or at weekly markets; making and selling food products etc. **Not all poor people have the skills and/or the time to make a success** of these activities. Competition is stiff, margins are low and returns are limited, especially when many clients invest their loans in similar activities ("copy catting") in limited local markets (villages, settlements and refugee camps). As is the case for any business effort, the challenges of running MSEs profitably is compounded by general economic slump, and by droughts and floods and other external shocks.

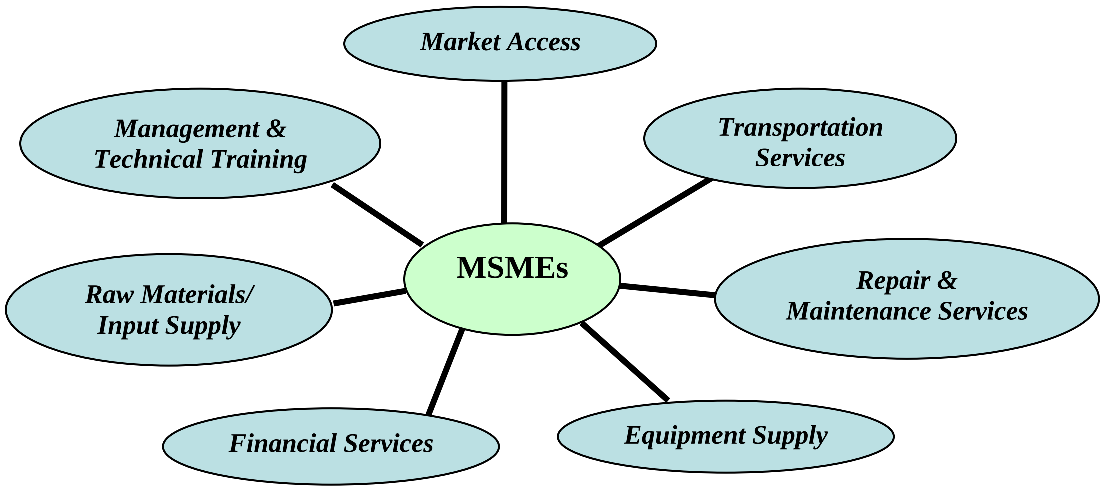
The mobilization, training and nurturing of small income generating projects and micro enterprises among poor people so that they can confidently access a banking institution when they need financial services remains an important task to accomplish in order for the financial system to be truly inclusive. This task of **building tomorrow's market** is not for the banks. Tried and tested microfinance methodologies of group formation and locally managed, savings-based services (SCAs, village banks and sanduqs) along with services using new IC technologies, like for example mobile phone banking remain valid aspects of the efforts to facilitate access by all Sudanese to professional, market-responsive and sustainable financial services. NGOs, SDFs and donor-funded projects are much better suited for this work than MFPs, especially when they work with commercially oriented companies that have business experience to impart on the future microfinance customers. Companies are generally more credible and effective as providers of business skills than governments or donors[117]. In Eastern Sudan, however, commercially based public and private **business service**

[117] UNDP: Private Sector Strategy, 2007, op.cit.

providers have been crowded out by donor- and government affiliated entities providing subsidized services.

Experience in Sudan and in other countries demonstrates that constraints of limited market development, fragmented and distorted investment and service provision, and human resource capacity gaps need to be addressed coherently and concurrently in order for MSEs to grow. Among the many constraints faced by MSEs, financing is usually given high priority, and useful, affordable and high-quality financial services are indeed an important service needed by MSMEs. But they are only one part of am array of services required (see Figure 20).

Figure 20. Range of Business Services needed for MSMEs



Like any financial service, microfinance cannot by itself reduce poverty. Microfinance needs **complementary strategies** to be effective, including strengthening community institutions, training and capacity development for clients and personnel, value chain integration and marketing support as well as a politically led effort to break up the price controlling cartels and a so far virtually non-existent cooperation among the different service providers.

8. Opportunities for the Future - Recommendations

In this report many pages have been spent in an attempt to contextualise microfinance in Eastern Sudan, and it is hoped that the reasons for this are clearer by now – there are many stakeholders and contextual aspects that need to be taken into account when considering additional interventions. Lessons need to be learned and approaches need to be adjusted. There are, nevertheless, several opportunities to rectify the current situation and get microfinance of to a more sustainable start.

In order to develop a sound, dynamic and growing microfinance industry in Sudan, the (few) interested microfinance providers need to get **access to training, exposure and solid technical support** to successfully manage the entirely new methodology that is microfinance. Financing and investment products need to be re-/designed so that they start small and increase with the ability of the customers to gainfully utilise more financing. Repayment instalments and frequencies should be tailored to the revenue flow of the business activities, and deposits should carry incentives. Care must be taken not to overload customers with unnecessary transaction costs (transport, unproductive time in queues and meetings, excessive paperwork, insurance, etc.). At the same time, a 'zero tolerance' for late repayments must be enforced, a reliable loan tracking database be introduced and an accurate MIS be put in place. These are only some of the basic operational principles of microfinance that have yet to be applied in Eastern Sudan and which would serve to inform the comprehensive training and TA agenda needed. To ascertain which MFPs may be interested in the transformation to Good Practice Microfinance, the access to capacity building resources needs to be **competitive and performance-based**, so that disinterested providers would in effect de-select themselves from assistance.

As mentioned by Pancho Otera already at the 2007 National Microfinance Forum, Good Practice microfinance needs a **champion** to promote and safeguard its principal operational principles during the transformation phase from provision of social transfers and services to commercially viable (sustainable) financial service provision. With the pantheon of patrons already working to promote causes and agendas in Eastern Sudan, Good Practice Microfinance will not be able to take root without one or more 'patrons' working to link up stakeholders horizontally in the local environment to complement the existing vertical linkages. In order to bring forth a champion, a **regional or state-based microfinance industry** needs to be formed by the providers of microfinance that wish to restructure to good practices. This is a process that needs to be given time, secretarial support and opportunities for MFPs to get together and exchange experience, lessons learned, and performance information. In the process, communication, information and data flow and exchange with the champions at central level in Sudan, notably the CBOS MFU and SMDF should increase and improve.

A mere quantitative increase in the availability of financing will not in itself provide the desired poverty reduction impact in Eastern Sudan nor foster a vibrant financial services sector, as the high arrears rates already have demonstrated. In that sense, more of the same will in effect provide *less* access to finance for the poor in the short term and risk ruining the financial services market in the longer run. If Good Practice microfinance cannot be applied, **alternatives to microfinance** should be explored – to work successfully, microfinance requires adherence to its basic principles and practices and should never be 'done anyways'. For Eastern Sudan, alternatives to microfinance include general and BDS market development; value chin integration for micro- and small enterprises; and mobilisation of future potential microfinance clients. Such efforts are important contributors to poverty reduction and may be less complicated for grants-based funders and socially mandated government agencies to support (see section 8.4).

8.1 Realigning the Strategy: Capacity building First

The provision of successful microfinance in a captured and 'depressed' economic setting like Eastern Sudan calls for high levels of market responsiveness, responsibility and prudence on the part of providers to carefully design products, adapt delivery mechanisms and assess the amount of finance available against the customers' business capacity and opportunities for investment to avoid over-indebtedness. Very few of those building stones for Good Practice microfinance are yet available in Eastern Sudan, and the attempts to drive forward expanded access to finance with carrots (subsidised credit) and sticks (regulatory directions) from central level have not produced the desired results.

The absence of a strong champion in Sudan has meant that Good Practice Microfinance as otherwise well elaborated in the CBOS Vision of 2006 have taken a backseat over the past year. Impatience, the delays in the establishment of the Sudan Microfinance Development Facility (SMDF) and political pressure for the Pilot Project of *musharakah* arrangements all contributed to putting the 'cart before the donkey' and providing capital for microfinancing to bank branches that are ill equipped, untrained, unfamiliar and disempowered to manage and grow a microfinance portfolio. The strong supply-push in the weak market has lead to serious default problems.

8.1.1. Stop, Plan and Publish a Change in Approach

A new approach is needed. The approach recommended here may sound drastic, but it is commensurate with the seriousness of the current problem of capital bleeding into the market through ill structured and defaulting small loans by ill equipped providers that have not been sufficiently trained to provide the service that the cheap capital provided is earmarked for. The proposed approach consists of four phases:

1. REST - Temporarily halt the Pilot Project capital disbursements to banks
2. RESTRUCTURE - Provide competitive access to performance-based capacity building
3. RECOVER - Drive a one-off coordinated debt collection effort
4. RECOMMENCE - Restart the process of microfinance provision in Eastern Sudan

First, it may be necessary to clearly indicate a change of approach by a **temporary cessation of credit** for weakly designed financing packages to the poor to avoid further leakage of capital from the Sudan Pilot Microfinance Project into defaults that have little hope of being recovered. This 'rest' should be announced as soon as possible to calm the local market.

The cessation should be announced together with the publication and dissemination of a Re-Alignment Plan to all relevant stakeholders in the industry, both at central (Khartoum) and local (branch, sub office, outlet) levels in Eastern Sudan. These stakeholders would also benefit from receiving a copy of the CBOS Microfinance Vision from 2006 in Arabic so as to be able to read or re-read the background for the entire endeavour.

The Re-Alignment Plan should describe in detail the process over the coming 6 months, which is proposed to include the following:

RESTRUCTURE
- a) A re-design of the State-level SDF MFIs proposed for Kassala and Gedaref
- b) A Microfinance Capacity Building Fund for Bank Branches in Eastern Sudan
- c) An international tender for a commercial, Islamic MFI as 'demonstration plot'

RECOVER
- a) Prepare and ensure adoption and implementation of a common debt-collection guideline, write-off policy[118] and incentive system for all local bank branches having participated in the Pilot Project – encourage other bank branches to join
- b) Monitor debt collection and reward best achiever. Non-performers automatically de-selects themselves from future capital partnerships

RECOMMENCE

Relaunch the Microfinance Pilot Project on competitive terms with clear targets and indicators for performance in time for financing of the planting season of 2010.

8.1.2 Restructure for Sustainability

The restructuring phase consists of three distinct efforts to improve the quality of microfinance provided in Eastern Sudan before further expansion takes place.

[118] Write-off is an accounting term meant to clear books of old debt. It does not imply that loans written off no longer have to be repaid, not that collection should not continue.

8.1.2.1 Immediate TA to the SDF MFIs

The SDF MFIs proposed have the potential to become the first real MFIs in Kassala and Gedaref but they set out with a legacy of constraints: They are government institutions, they are proposed capitalized by government funds, they are staffed by civil servants seconded to the institutions and as of yet untrained in business oriented financial management, loan tracking and financial performance monitoring.

To become successful these institutions need to adopt the three Ss, i.e. become Separate, Specialised, and Sustainable.

- The MFIs will need a separate structure (building, brand, management)
  - For the SDF MFI not to be directly associated with government charity, it must be separate from the rest of the SDF and from the non-financial services undertaking. This requires a separate brand, logo, preferably building, but at least entrance, staff, and organization.
- The MFIs will need specialized management and systems (admin, finance, MIS)
  - To be effective, transparent and able to record and report on performance, an SDF MFI must not only have specialized and well-trained management and staff, but also specific systems for admin (financing and policies, procedures, and contracts; HR (performance-based job descriptions with targets to be met, credit committee, incentive scheme); financial management (loan tracking, MIS, recording, reporting) and IT (MIS, data processing, etc.). The non-financial 'industry facilitation work' that the SDFs are eminently well placed to provide does not require administrative systems very different from a regular government office.
- The MFIs must convincingly demonstrate a business plan to attain viability by year 3-4
  - To aim for sustainability, the SDF MFIs must be able to grow their portfolio quickly and substantially; cost their services appropriately (and as low as possible); price their products correctly and cover their operational costs, the cost of capital replenishment and the cost of any losses. To keep losses down, debt collection performance must be of high quality, i.e. no more than 5% of the portfolio should be contaminated by arrears at any time.

The SDF MFIs have potential to become the first demand-driven and customer-centred microfinance institutions in Eastern Sudan. But this would require an immediate effort to ensure a good practice compliant design, including:

- Start-up management support (TA for final design). The work plans of the MFIs are not detailed enough, and do not relate sufficiently to their markets. They require a SWOT analysis and a market-based strategic business planning process involving all current staff to identify requirements of resources, training, TA and set appropriate targets for outreach and performance. Most of all, a 180 degree change of approach among staff is needed from "service provision to poor beneficiaries" to "commercial customer orientation".
- Supportive, trained and vision-holding Board that can ensure that the MFI is protected from political interference, especially as elections approaches. Microfinance in Sudan has historically been used for political ends[119] and it is a challenge to work with government funding, especially in a market saturated by 'relief mentality'. The Board must provide protection for management to take appropriate credit decisions in order to develop and maintain high-quality portfolio
- Management and staff need clear job descriptions with performance-based monitoring and incentive systems that promote a high-quality portfolio but penalises non-performance. Staff training, mentoring and HRD is clearly necessary, and support from e.g. ACORD's existing loan officers and program manager as well as from SMDF would be helpful;

[119] See e.g. Africa Microfinance Action Forum: Diagnostic for Action: Microfinance in Africa, Women's World Banking 2008, p. 85: "The Sudanese government uses microfinance as a social service offered to the poor and also as an electoral propaganda tool".

- Product design and development will be necessary. It will be important to make the broad range of Islamic finance products work for the market segment of the poor, which as discussed is chiefly a question of customer care and accurate costing and pricing. There are some initial lessons to be learned from the Aroma branch of ABS in Kassala, but more TA is needed to manage the change from "creating sustainable livelihoods for the beneficiary" to "offering a sustainable financial product to the customer"
- Improved customer care can be facilitated by feedback loops to turn the MFI from a top-down centralized system geared to funders and superiors to a market-led institution that listens to its customers. The planned Finscope study will be able to reflect customer needs and preferences in detail, and will need to be followed up with training for bank/MFI staff about how to reflect demand in products and services. Especially in banks, this requires management buy in.
- Data recording, reporting and monitoring needs to be a lot stronger than hitherto seen primarily for the benefit of management of the MFI. A tracking system for outstanding financing is required along with a strong MIS incorporating both accounting and financial business data. International standard formats for portfolio and financial reporting are available and should be adopted from the beginning, but staff training will be necessary to successfully implement these new systems.

With the SMDF now fully functional, the above proposed technical assistance effort would appear very much within their mandate as a specialised apex capacity provider. The SDF in Kassala has already requested 6 months of TA from SMDF and hopefully solid expertise can be speedily recruited. Should the Board of the SMDF for any reason be unable to support the entire proposed intervention, UNDP and UNHCR could be contacted for possible co-funding of the TA needed to ensure a good start for the new MFIs.

8.1.2.2 Capacity building Fund for MFPs in Eastern Sudan

In order for the capital already disbursed and earmarked for microfinance to be used well, and in order for the microfinance outreach (portfolio) in Eastern Sudan to grow in a healthy manner, capacity building is needed.

The urgent establishment of a Fund with transparent and objective eligibility criteria is proposed to enable bank branches and other existing, licensed MFPs in Eastern Sudan to access the much needed training, technical assistance, systems enhancements and other capacity building efforts for them to be able to provide Good Practice Microfinance by mid 2010.

In line with the CBOS Microfinance Vision, the Fund would aim to support business turnaround for Microfinance Providers (MFPs) to help build a stronger, more commercially oriented microfinance industry that can serve a growing number of poor people, ultimately contributing to increased prosperity for the population of Eastern Sudan.

As a Good Practice-based business partner to interested MFPs, the proposed Fund would subscribe to the following principles for its provision of support:

- *Demand-driven:* The Fund would solicit applications and proposals from MFPs which are based on their business (work-) plans and financial projections (funding gaps) and work with them to develop an appropriate package of technical assistance;
- *Competitive awards:* Transparent eligibility criteria should be widely disseminated to ensure equitable access, while all applications received will be appraised on selection criteria to ensure the best investments;
- *Market-orientation:* Fund support should be market-led and require a partial (match) contribution by the recipient MFP as determined e.g. by the current performance of the partner institutions.

MFPs applying for support should be encouraged to propose a preferred supplier of the services for which funding is sought, which would then be vetted by the Fund that would maintain a 'roster' of qualified suppliers. The subsidy should primarily be managed by the partners, enabling them to pay for services provided at market rates by business service providers.

- *Performance-based:* During the appraisal of applications, targets and indicators for achievement against the funding requested should be negotiated, and performance-based agreements should be signed with the partner MFP, defining amount, nature and timing of support as well as monitoring indicators, targets and reporting requirements. The Fund Secretariat should monitor performance over time. If a partner institution does not fulfil the agreed performance targets (without good reason), funds would be required reimbursed, and the partner automatically de-selects itself from further funding.

In order to be considered for technical assistance support, interested MFPs would be submitting proposals with relevant documents attached, including e.g.:

- A business (work) plan and financial projections, indicating how the support would strengthen the institution;
- A set of objectively verifiable targets and 3-6 monthly performance indicators for the proposed period of support;
- Description of the proposed source (preferred supplier) of capacity building service, if identified;
- Audited accounts, Balance Sheet and P&L from the previous year of operation, if available;
- Projected cash flow for the duration of the grant and proposed instalment dates and amounts as well as reporting schedule.

Upon receipt of an application, the Fund secretariat would carry out an appraisal including e.g. staff interviews, on-site visit, client interviews, records checking, audit, and cross checking information with CBOS and other donors. In appraisals, the following elements should be taken into consideration:

- Adequacy of the legal/institutional status (license) and current outreach
- Quality of the governance structure and organisational set up
- Vision and commitment, credibility and stability of the leadership and management
- Capacity for strategic planning and change (integrating the use of external technical support, if needed)
- Management information systems and internal controls in place
- Client orientation
- Motivation and capacity of staff
- Experience and capacity to overcome constraints
- Outreach (depth and scale)
- Financial performance and solidity (efficiency, repayments, operational and financial self-sufficiency, equity, assets and liabilities)

After the appraisal process, any recommended support package would be presented by the Secretariat to the Board for approval. If an investment is approved, the Fund and the MFP sign a Memorandum of Understanding including the mutually agreed upon performance indicators. As part of its work, the Fund would be promoting closer cooperation and exchange of experience among MFPs as a way to start building a microfinance industry in Eastern Sudan.

The Fund could be established as a sub-account under the SMDF or – perhaps preferably – could be locally embedded either with the existing CBOS office in Gedaref or a new CBOS sub office in Kassala, where oversight and support to date has been limited; or with the management unit for the East Sudan Reconstruction and Development Fund. Applications to the Fund would be appraised by a small secretariat reported to a Board of Representatives of contributing funders including CBOS.

8.1.2.3 International Tender – Seeing is Believing

Because microfinance as a viable financial industry really has not yet developed in Sudan, inviting a specialized, commercial provider of Islamic microfinance to establish an MFI in Eastern Sudan may prove a 'short-cut' to develop the industry. An international competitive bidding process should be used to attract the best bid in terms of value for money, but it would be important to develop a detailed TOR for the bidders to accurately reflect the challenges and opportunities in the market. In addition, negotiation of the financing terms for the intervention should be discussed with potential funders prior to the announcement. UNCDF would be a good resource in the validation of the financing model.

8.1.3 Debt Collection to re-set the stage

Because of the lack of or delay in technical assistance, training and management buy-in at the beginning of the 'supply-push', microfinance in Eastern Sudan has come off to a rocky start with slow disbursements and very high delinquency rates as a result. While staff and branch management are being training, gaining familiarity with the new market segment and confidence with the new methodology, it is necessary also to 'retrain' customers to understand the importance of repayment discipline.

Misunderstood compassion for the poor as 'beneficiaries' rather then self-employed entrepreneurs and consumers has created dependency and 'relief mentality' is widespread. The appeals process in the Default Commission as well as direct political intervention to negate legal actions (imprisonment) of defaulters has seriously damaged the inherent social obligation to repay debt and left the customer base expecting government bail out. In addition, the lack of a common understanding of the working principles of microfinance among state level stakeholders, and the absence of horizontal cooperation among MFPs and other stakeholders at the local level may have enabled wilful defaulters to cheat the system.

For Good Practice Microfinance to succeed, it is necessary to reinstate 'zero tolerance' for default. The TA and training of MFPs will provide guidelines, policies and tools for delinquency management, but a coordinated and consolidated debt collection drive will be helpful to ensure that the customer base 'gets the message' that loopholes are closed. Such a drive needs careful planning and importantly, requires all stakeholders to be fully informed and supportive of the effort, including in particular political stakeholders. For this reason, the debt collection drive should have a strong 'champion', e.g. the Wali of each State.

The CBOS branch may require support by technical assistance to prepare and ensure adoption and implemented of a common debt-collection guideline, write-off policy and incentive system for all the local bank branches currently managing microfinance funds under the Pilot Project. Other branches, especially branches with high default rates in general and with default rates in their allocated microfinance portfolio in particular, should be encouraged to join the effort. The draft guidelines should be reviewed by all participating banks at branch (and head office) level and adopted with an agreed time line, and debt collection targets.

The first step of the guideline would be a review and aging of the outstanding (microfinance) portfolio of each branch into current, overdue less than 365 days by known defaulter, and overdue more than 365 days/unknown (deceased, moved) defaulter. The write-off policy should be applied to the latter category. A second step may require rescheduling of outstanding debt that has been provided with excessive grace periods (of more than 12 months) with an incentive for customers repaying before due dates.

The incentives should focus on 'collectible' debt that is current or overdue less than 1 year and/or by known defaulters. A common and time-bound incentive scheme for all bank branches should be agreed, providing monetary and/or in-kind incentives to defaulting borrowers, intermediaries (e.g. unions, associations, cooperatives) and bank staff facilitating the collection of all outstanding overdue debt by the due date of the youngest outstanding loan (cut-off date). All debt collected should be deposited into the local branches' microfinance capital account, and incentives be paid out from this account at the cut-off date.

The branch that collects the highest percentage of overdue debt by the agreed end of the effort should be provided with an award. The media should be invited to follow the process provided they attend regular briefings by CBOS to ensure general understanding of the reasons for the debt collection drive and the benefits to be gained from repayment (the relaunch of Good Practice Microfinance).

8.1.4 Relaunch of the Microfinance Pilot Project

Once the debt collection drive is over, the TA and training process should have resulted in better portfolio monitoring skills and systems to avoid new debt accumulating in the branches. When debt is cleared; staff and management is trained, motivated and focused on their market; when policies, procedures and manuals have been updated and appropriate loan tracking and MIS systems have been installed/adjusted to microfinance – then the Microfinance Pilot Project could be re-launched with the banks on competitive terms and with clear targets and performance indicators for each branch in terms of outreach (number of new microfinancing contracts and deposit accounts opened), and performance (average contract size, debt collection, cost coverage and product innovations).

The capital should be available to the re-trained and interested branches not later than by May 2010 so that disbursements of Good Practice Microfinance can commence in time for the 2010 planting season.

8.2 Championing a Demand-oriented Local Industry

While many banks and NGOs face similar challenges with the microfinance market segment, there has been very little information sharing and coordination among providers of financial services in the East. Over the coming year, a platform for exchange of experience, lessons learned and joint learning should be established to facilitate the development of a market-oriented industry able to advocate effectively for Good Practice Microfinance – in effect becoming its own champion.

Such and Information Exchange platform could start informally with quarterly meetings and networking opportunities where learning from the intensive TA and training process could be discussed and reviewed. It may develop into a chapter of the Sudanese Association of Microfinance Institutions (SAMI) or an Association of Microfinance Providers in Eastern Sudan (AMIPES). But rather than institutionalization, the content and usefulness of the meetings to providers would determine success. Annex 4 provides a description of an industry building process including some of these useful tools and topics:

1. Outreach mapping
   Knowing who is working here is a helpful starting point when planning expansion. A provisional outreach map is included in Annex 3 for completion.

2. Code of Conduct
   Defining what microfinance actually means and how the business differs from other services would help all stakeholders, both providers, customers and funder relate more appropriately (see Annex 4).

3. Performance Reporting

Reporting formats are available on the CBOS website[120] but are not currently used at branch level. In addition, standard financial statements and performance reporting tools that incorporate Good international Microfinance Practices can be accessed, e.g. from Sanabel[121] and should be a minimum requirement from any MFP. A list of the 18 minimum reporting ratios for international microfinance is included in Annex 5. Training of accounting, MIS and management staff would be needed to ensure that performance reporting is utilized as a management tool and not just sent to head offices. Ideally, an Eastern branch of CBOS would compile microfinance-specific performance reporting data from all MFPs and provide *feedback* on performance to providers so that external monitoring becomes more meaningful. Reporting could be incentivised with a quarterly reward for best performance, e.g.

- Lowest Portfolio at Risk(30 days)
- Lowest Operational Expense ratio
- Highest growth in micro-portfolio
- Highest growth in financial self-sufficiency ratio

4. Credit reference service

It is not evident that multiple borrowing is a big problem in Eastern Sudan – yet. Therefore, research should be undertaken to determine the potential risk to MFPs of multiple borrowers indebting themselves beyond means. Until this potential risk is determined, it may suffice with a simple 'blacklist' of defaulters shared among all MFPs to prevent wilful defaulters circulating in the system. If research suggests that multiple borrowing is increasing, a simple credit reference service (CRS) among MFPs in the region may be feasible. It could be managed by the CBOS branch office or a contracted database manager. A decentralisation of the current customer coding system to CBOS branch level may also help meet CRS needs among banks.

5. Better business services are easier to attract when there are more customers. As a group of MFPs in an area, it would be much easier to engage existing and attract new public or private business providers to fill gaps in the supply of services, e.g. Microfinance-specific Audit, accounting, insurance, ICT, MIS and loan tracking software, CIT, telecommunication-based services (EPOS, ATM, debit cards, smart cards linked to insurance, etc.). Currently, private sector providers are 'crowded out' by in-house or centrally provided services, and local support for services are lacking. This can affect efficiency by rendering inoperable service systems until maintenance arrives from Khartoum.

6. Information exchange, joint training and learning

With access to a local Fund for capacity building (see 8.1.2), MFPs could also team up to receive training and TA in joint teams, which would facilitate exchange of experience, enhance coordination, and make training more cost-effective. The Information Exchange platform can be utilized to combine resources and join forces to attract and synergise around training opportunities, such as visiting consultants, research or study teams, etc. Similarly, each quarterly meeting could include 1-2 short presentations by member MFPs on recent experiences, challenges or new products followed with discussion. 'Guest presenters' could be invited to discuss particular problems or new developments, e.g. from State government, the Trade Chamber, IT providers, the CBOS Customer Coding Team, the MFI PASED from Port Sudan, etc.

[120] Report formats nos. 5, and 7-9 may be most relevant. See http://www.mfu-cbos.gov.sd/html/res/File/Forms%20for%20micro%20finance.pdf
[121] http://www.sanabelnetwork.org/en/node/328

Currently all MFPs, whether banks or NGOs, have similar challenges with their microfinance portfolios. All have received specific budget allocations and have limited levels of authority on how to utilize it. For all, the market segment in unfamiliar; the product range unadapted; and the clients new. There are similar levels of capacity gaps and similar training needs. Therefore, it would make sense to pool resources and in the process, get to know and discuss common challenges with like-minded institutions working in the same market segment. As the Information Exchange matures and the training and TA process accelerates with access to funding at branch level, a regional microfinance industry in Eastern Sudan will begin to take shape based on demand and interest – rather than driven by external requirements. As an industry, coordinated action for outreach, awareness raising, public education, and advocacy will also become easier.

8.3 Central Support to Expansion - Opportunities for CBOS

It would help for everyone to understand the background for the principles, costing and pricing in banking and microfinance in particular a little better. Rather than just the annual Banking Policies, CBOS MFU could perhaps develop a **quarterly 'Microfinance Bulletin'** for its branches and banks to present and discuss pertinent microfinance issues, like profit margins; debt collection (introducing the Portfolio at risk ratio), operational viability (introducing the operational self-sufficiency ratio), etc. Making the Bulletin a 'two-way' communication channel would increase it's usefulness, i.e. include an address and email to an 'editor' for questions, comments and news, and reserve space for "News from Around the Land" where branches can bring up challenges or ideas. Enough of these flyers should be printed for CBOS branches to be able to hand them out to stakeholders at State and locality levels.

Such a Bulletin may also mitigate the communication gap with non-financial stakeholders, e.g. stakeholders at local authority level. Some HAC offices may not yet be aware of the Policy from 2007 permitting NGOs and INGOs to operate commercial activities. A Bulletin featuring the background and official version of this revision of the Law would be helpful for NGOs, INGOs and CBOS branch offices to have and distribute to e.g. new staff at HAC offices.

In general terms, the MF regulations produced in 2007 follow good practice for bank-based microfinance. There is perhaps slightly more focus on Basel I CAR issues than would be strictly necessary for the bank microfinance portfolio (given that the Banking regulations already require the bank to be Basel compliant).

The **revenue ceiling** on *murabaha* contracts, currently of 9%[122] (Policies 2009) is not a good way to provide incentives for microfinance. In general, it is not understood as a recommendation, and is therefore possibly costing the banks money on the *murabaha* contracts. Some of these losses are made up on *salam* contracts, where banks set the unit price as low as possible to reap the largest profit – a lot more than 10%. While some banks (e.g. ABS) share the profit with customers (i.e. reduces the repayment by 1/3 of the unit cost difference), most banks optimize profit on *salam* to the consternation of customers and their representative unions and cooperatives.

Another aspect of the regulations which could be strengthened is the **aging and provisioning requirements for microfinancing**. While identical to the banking policies, they are not strict enough for microfinance which has a higher risk level due to its less attachable collateral – although generally repayment rates are better. International standards for aging and provisioning suggests the use of

[122] Central Bank of Sudan Policies for the Year 2009, The Monetary and Financing Policy for the Islamic Banking regime, Article (1) B) 2) the Cost of Finance.

Portfolio at Risk (1 day for banks and 30 days for MFIs) as a minimum reporting requirement to replace the 'arrears at 90 days' rate currently reported. PaR is calculated as:

$$\frac{\text{Value of total outstanding loan balance with any payments past due > 1 or 30 day (end of period)}}{\text{Value of all outstanding loans (end of period)}}$$

The aging and provisioning rules would also benefit from being slightly stricter, as per table 21.

Table 21: Aging of Portfolio at Risk

Aging of Portfolio at Risk	Current provisioning[123]	Recommended Provisioning
Value of loans outstanding with arrears by age of arrears (end of period)		
1 - 30 days	0%	2%
31 - 60 days	0%	5%
61 - 90 days	0%	10%
91 - 180 days ("substandard")	20%	50%
181 - 360 days ("Delinquent")	50%	75%
> 360 days ("Bad debt" - to be written off)	100%	100%

A number of other standard microfinance ratios should gradually be required for the portfolio, whether provided by a bank or an MFI (see Annex 5). Given the limited capacity for financial ratio calculation in many MFPs it would be preferable for MFPs to report raw data along with their ratios so that calculations can be verified.

While training in financial analysis and MF ratios in particular is needed across the board, it would probably be most cost-effective to train a small team of trainers in CBOS (MFU/SMDF) who could in turn tour the regions to provide **training to CBOS branch staff** and a first training of bank staff. CBOS branch staff should then be able to provide follow-up training, given appropriate and sufficient materials. A standard training course outline in financial analysis, ratios and performance monitoring for MFIs is included in Annex 6.

The **centralized customer coding system** of CBOS has required all banks to enter every new client – including micro-clients – into its centralized coding system. While AML and KYC requirements are recognized the centralised system is a very cumbersome, time consuming and costly procedure for the customer and investment officer at branch level – and it also delays the contract processing time with 7-30 days, as the data needs to go from the branch to head office to CBOS' coding department and back. In addition, some of the data required in the coding format (e.g. name of mother) is culturally inappropriate in Eastern Sudan. Given the small size of the microfinance portfolio in the banks, this portfolio in itself poses no systemic risk. To provide an incentive for banks to engage in microfinance and cut the processing time and cost for clients, it may therefore be appropriate to exempt micro-clients from the central coding system. To ensure that banks would meet their KYC requirements, a specialised Credit Reference Service (see section 8.2) for microfinance could be considered as a faster, simpler and more locally relevant measure to prevent wilful default and fraud.

8.4 The Alternatives: Opportunities for Non-financial Funders

8.4.1 Support Market-led Development

Factor markets like (micro)finance will not by themselves be able to revive a sluggish economy that excludes the poor, especially not if the core markets are captured by cartels. In view of the need for

[123] Central Bank of Sudan: Microfinance Regulatory Framework, July 2008.

Peace dividends, economic market recovery in Eastern Sudan is a high priority, which requires broader efforts. While a large percentage of the total Eastern economic wealth appears concentrated on a few hands, the vast majority of the people of Eastern Sudan earn their living from micro- and small scale businesses in agriculture, livestock and local trade, and spend their hard earned money as consumers in these same markets. Hence, there is a need to focus on the functioning of these markets and make them work better for the poor.

The commercially oriented public and private sector business development service (BDS) markets for the micro and small enterprises (as well as for financial services) are very underdeveloped. Similarly, the **value chains involving micro and small enterprises** are flat; pricing (and thus the ability to make a profit) is depressed; and there are many gaps which stalls further development. The core reason is an intense supply-drive that has resulted in government and donor agencies funding of (free) 'service delivery' to a market which is assumed not be able to pay. This crowding-out needs to be inversed and space needs to be created in the market for public and private sector operators to be able to generate revenue by charging for services that people demand and are thus willing to pay for. This is not to say that subsidies should cease completely, but in order to support economic development, subsidies have to be placed 'smartly' and outside of the commercial transaction.

A good amount of information is available on existing and potentially profitable micro- and small enterprises[124], but few analyses exist of the value chains and the gaps that could be closed to increase value chain integration and inclusion of more micro and small enterprises (MSEs). Value chain analysis is, however, an expected output to the ongoing UNDP Recovery of Livelihoods and Sustainable Natural Resource Management in Kassala State. In addition, WFP has expressed interest in supporting local value chains to help import substitution and local production. The INGO Practical Action has based earlier work on a sound value chain analysis approach and could be of assistance in updating such data.

From a micro-enterprise perspective, the value chain analysis process sometimes selects too narrowly. At the base of the value chains, there is less need to 'specialize' by selecting only 1-2 products (VCs), as the gaps and constraints to access and integration typically span the production/provision of a number of similar goods and/or services. Addressing gaps that span a larger number of MSEs could potentially integrate and link many more MSEs into several VCs in parallel. Often, therefore, VCI initiatives should try to broaden the base of inclusion and only specialize further up the value chain. See Annex 7 for an initial list of potential value chains which may be feasible to study further in Eastern Sudan.

[124] See e.g. German AgroAction: Baseline Survey 2009, op.cit.; Zanad market study, 2009, op.cit, and PACT: Reintegration Opportunities for Ex-Combatants in Eastern Sudan (Gadaref, Kassala and Red Sea State), IOM, September 2007.

Box 22: Example of self-financed Info dissemination

The "Bizz Van" could make weekly rounds of markets and towns in each State providing information, particularly on:

- Taxation info and formats and contacts
- Legal advice
- Business registration procedures, formats and contacts
- Pricing information – market prices can be compiled and also disseminated via SMS to mobile phones, as attempted by FAO
- Financing information – listing of which financing products are available from which banks at which prices and on which terms and conditions
- Opportunity info – listing of markets, fairs, large events, opportunities for purchase, display and sale of goods and services
- Training and BDS info – listings of trainings, trainers, and specialists in relevant fields (consultants, companies, advisors)
- Evaluation forms for participants in trainings and other events to be completed, compiled and published by the Bizz Van team to inform future customers/participants of the level of customer satisfaction, etc.

Advertisement-based information should be considered. Service providers who wish to have information travelling with the Bizz Van should be charged a fee. Compiled and processed information (e.g. market price lists, training calendars, service provider catalogues, etc.) should be sold to customers. This would also provide a direct feedback as to which type of information is in most demand.

Information is a huge gap in all value chains and in both general and BDS market development in Eastern Sudan. An oral business tradition combined with the remoteness and isolation (spatial and cultural) of many MSEs result in a tremendous lack of awareness and information that directly affects business ability. In some cases, religious and cultural mores serve to discourage people from accessing and independently compiling data and knowledge further increasing inertia and protracting dependency. **Education, information and awareness** are rights and access should be dramatically increased. Rather than the extreme supply-drive already institutionalized in the market, however, more **demand-driven and self-financing approaches** based on response to queries should be promoted. Examples include fairs and market events; "Bizz Vans" - mobile units of business information, including factual documentation and helpful hints about how to operate a business successfully, and "Business Bulletins" – advertisement-financed local-languaged papers listing and showcasing available products and services (including financial services), prices, sales, market events, etc. (see Box 22). The level of information in the market place is so low that there is almost no limit to which information could be disseminated to facilitate access.

To further value chain integration ideas in general, a new **national volunteer program** is being planned with UNDP support to expand the options for young, educated graduates to perform civilian national service in rural areas, helping to develop, research, pilot test and link new products and services into the market and new micro enterprises into sustainable value chains. These volunteers could complement the already significant and positive experiences and work of I/NGOs in Eastern Sudan, e.g. GOAL and P.A. and expand their outreach, and it is thus recommended that the volunteer scheme with time be extended to I/NGO projects. Other obvious linkages would include resources at the universities and technical colleges for the development and testing of prototypes; introduction of field-based research and a generally closer link between what is being taught in the classroom and its applications in the real economy.

The need to **crowd back in commercially oriented private and public sector providers** of services is particularly urgent in **training**. A history of well meant government and donor-driven supply of training programmes through various agencies and NGOs has resulted in trainings designed by suppliers being availed free-of-charge to selected participants who are being paid to attend (lunch/accommodation, transport, 'lost work opportunity'). Providers of these training insist "there is high demand". This is unsurprising for e.g. a 4-month all-expenses-paid residential course that will end with a certificate and a gift box. However, some NGOs admit that the gift box (tool kit to start a business) has been introduced as an incentive for attendance in e.g. adult literacy classes.

It would be preferable if the management of institutes of training in Eastern Sudan be transferred to **commercially oriented providers** that will be able to design a business plan and lead the institutes to commercial viability so that it may remain a service provider in the market even after donors have left[125]. If there are other reasons why donor-dependent NGOs should run such establishments, the minimum requirement would then be for such NGOs to present a business plan for a viable commercial operation within a maximum of 3 years.

As a necessary soft transition from the current state of 'free trainings' to a more market-led and demand-driven system of service provision, a **voucher program** for training and specialist support to micro enterprises (and other services) is being planned with support from UNDP. Vouchers are purchased by (private and public) sponsors for distribution (or sale at lower costs) to participants, e.g. as performance rewards. Until market principles of demand and supply are restored, vouchers can serve to enable access to training for motivated people who may be unable to afford the cost, while ensuring a cost-covering revenue for the training provider. It is also a way for funders working to support particular excluded communities, e.g. refugees and IDPs to ensure their access to available training. In the meantime, funders (donors and government agencies alike) are strongly encouraged to stop promoting "free training".

The markets have been supply-driven for so long that the process of re-introducing a private sector development approach and a market-led economic growth strategy will necessarily take time, and require actively advocating funders (champions) willing to engage for the long term. But the MSE communities around markets and at State level, e.g. the Trade Chamber and the consumer cooperatives may well be enthusiastic **partners** in developing more inclusive markets.

8.4.2 Build the future market

Funders in Eastern Sudan have financed **community-managed "revolving" loan funds** as a means of increasing access by poor or excluded communities to financial services. Both indigenous *sanduq*s and externally promoted VS&LAs, SCA and other types of group-based revolving funds have received external capital injections from donors and government through Women's Development Associations and INGOs (in particular for refugee camp residents and IDPs). In some projects, the groups also collect and lend out members' deposits, while others do not collect members' savings at all, so that the loans to group members are entirely financed by external funds. In either case, the loans are financed mainly by money that the members themselves have not provided, i.e. 'cold' money.

A global review of these community-managed local funds in 2006 concludes that "when loans are financed by an early injection of external funds from donors or governments, the funds fail so consistently that this model of microfinance support is never a prudent gamble. The track record of externally-funded group funds is so poor that funders should simply abandon them as a vehicle for poor people's finance"[126]. In addition, very few of these types of externally supported ASCAs or ROSCAs ever grow sustainable (independent) but require ongoing contributions as demonstrated over the past 3 years with ACORD. Such projects are thus not well aligned with UNHCRs Self-Reliance Strategy. UNHCR in particular, but also other donors having supported local NGOs, are therefore advised to **phase-out the external capital injections** to these revolving funds. Phasing-out revolving

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[125] The excellent training centre in Al Girba in Kassala which can accommodate 120 participants (hereof 40 women) for long term residential and catered courses is a case in point. It is not being used to its maximum, chiefly because it is considered reserved for training funded by the donor (UNHCR) for selected clients. It is not covering its costs and hence will be lost as a resource in the state when donor funds wane, unless management is handed over to a more commercially oriented operator than the relief NGO SRC.

[126] Richard Rosenberg and Jessica Murray: "Community-based Loan Funds: Which Ones Work?" CGAP Focus Note, April 2006.

credit funds is in itself a relatively easy operation. The key concern is to maintain repayment discipline, i.e. phasing-out without establishing a precedent for default, and ensuring access by recipients *who need and benefit from financing* to alternative, more sustainable sources.

Support to **group and community mobilisation** efforts at the grass root level (where groups do not already exist) is needed in Eastern Sudan, especially among the poorest and most excluded groups of e.g. nomadic women, widows, camp-based refugees and newly arrived IDPs. Building on what appears to be a rich network of social group relations in the communities, donor and government funded projects or NGOs would be able to support human and financial asset building processes and thus contribute to increased future access to finance. This can be done effectively by ensuring that such future microfinance clients gain the skills, group coherence and discipline needed to successfully access and manage financial services later. It's all about creating a path out of poverty rather than a dependent circle. Paths for particularly vulnerable groups include:

- Group formation (*self-selected* to build trust bonds rather than externally selected)
- Training in group operations and savings and credit management (*priced* in either cash or in kind contribution, but not free)
- Introduction of *savings* or contributions to a common pot, either fixed, voluntary or both
- Enterprise development, market access and/or vocational training (linkage to suppliers)
    - All training must be *priced* and preferably done by commercial BDS provider;
    - Visits by the Bizz Van and a volunteer post to develop local value chains;
    - Groups can also be trained to manage and report on public (donor and GoNU) grant funds for sorely needed community infrastructure and common-good projects (e.g. LDCs/VDC);
- Linkages to MFPs – *facilitation of access* or 'graduation' of those beneficiaries with micro- and small enterprise potential and demand for financing (based on appropriate assessment of credit readiness) to sustainable sources of external financing, e.g. banks or MFIs.

List of Annexes

1. Terminology and Definitions – Islamic and conventional finance
2. Indicative Market Quantification – the calculations
3. Provisional Mapping tool for Outreach by Financial Service Providers
4. Note from the Field: Microfinance Industry building in Timor-Leste
5. Microfinance Minimum Standard Reporting Requirements
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Annex 1

I. Islamic Financing Terms and Characteristics

For many Muslims, some conventional financial services – whether banking or microfinance) are incompatible with the financial principles of Islamic Law (Shariya). In compliance with federal law, all formal service providers in North Sudan offer only Shariya-compliant (Islamic) financial services. To assist readers, a listing of the key characteristics of these types of financial services is presented here.

Shariya-compliant financial services have been designed specifically to ensure that providers and customers can enter into financial transactions avoiding any practices that are deemed usury, unfair, exploitative and therefore prohibited. The biggest difference between secular and Islamic finance relates to the pre-determined setting of interest by creditors, which is banned in Islamic finance, resulting from the Shariya precepts that:

- Money has no intrinsic value and therefore cannot be traded as other commodities (secular finance *is* the trade of money) and cannot increase in value over time unless backed by assets (secular finance holds that institutions must ensure the increase of capital value to counter effects of e.g. inflation);
- Providers of finance should share the business risk as investors (secular fund providers or investors are typically creditors that expect a predetermined rate of return).

In addition, key Shariya concepts that enjoy widespread observance include

- Prohibition of speculation by requiring that all financial transactions are linked to a real economic activity;
- Prohibition of investment in activities considered harmful to society (e.g. gambling, consumption of alcohol and pork, weapons production). In North Sudan, banned activities also include the purchase of foreign currency, shares and financial papers; outstanding or non-performing portfolios, FOREX bureaus and financial services institutions (acquisitions) as well as provision of finance to government and State-Owned Enterprises with more than 20% state ownership without prior CBOS approval[127].
- Prohibition against exploitation, e.g. in contracts which must clearly state terms and conditions, and must be understood and agreed by all parties – a principle shared by secular business ethics[128].

These and other requirements of Shariya-compliance has led to the development of a range of Islamic finance services for the provision of additional resources for economic activity as well as for the investment of deposits. There are at least 21 types of Shariya compliant contracts used by Islamic banks in the world, of which 16 are commonly used. These are usually distinguished as profit-sharing or non-profit sharing and further grouped into 1) profit-sharing-and-loss-bearing, 2) profit-and-loss-sharing, 3) asset-backed, or 4) services-based as per Table 1.1. below[129]:

[127] CBOS: Central Bank of Sudan Policies for the Year 2009.
[128] See also CGAP: "Islamic Microfinance: An Emerging Market Niche", Focus Note 49, August 2008.
[129] Islamic Financial Services Board (IFSB): Compilation Guide On Prudential And Structural Islamic Finance Indicators - Guidance On Compilation And Dissemination Of Prudential And Structural Islamic Finance Indicators For Banking And Near-Banking Institutions Offering Islamic Financial Services (IIFS), March 2007. Table 1.1. is also based on this document.

Table 1.1: Listing of the most commonly used Shariya compliant products

Type of contract/agreement	Financial Product	Used for funding (IIFS resource mobilization)	Used for financing (IIFS investments)
Financial products			
Profit sharing instruments			
1) profit-sharing-and-loss-bearing	Mudārabah	Yes	Yes
2) profit-and-loss-sharing	Mushārakah	Yes	Yes
	Diminish.Mushārakah	Yes	Yes
Non-profit sharing instruments			
3) Asset-backed contracts	*Sales-based:*		
	Murābahah	No	Yes
	Salam	Yes	Yes
	Bay Muajjal	No	Yes
	Lease-based:		
	Ijārah	Yes	Yes
	Ijarah Muntahia Bittamlik	Yes	Yes
	Mugawala	No	Yes
	Production/manufacture:		
	Istisnā	Yes	Yes
	Mugawala	No	Yes
4) Services-based	Wadī'ah	Yes	No
	Wakālah (agency underwriting)	Yes	No
	Kafalah (suretyship)	Yes	Yes
5) Benevolent contracts	Qard	Yes	Yes
	Qard al-Hassan	Yes	Yes
	Hiba (gift)	Yes	Yes
6) Securities	Sukūk	Yes	No?
	Ijaraa Certificates	Yes	No?
	Musharakah Certificates	Yes	No?
Non-financial products			
7) Insurance/Mutuals	Takaful		
	Life (family)		
	Non-life (General)		
	Re-takaful		

The Islamic financing products most commonly found in North Sudan are described below to assist readers unfamiliar with Islamic banking, and to contribute to a common terminology for the microfinance sector.

1. Profit sharing and loss bearing instruments

Mudāraba (Profit and loss sharing investment agreements)

Mudāraba is an equity-based instrument denoting secular trustee financing where one party is the investor providing capital and the other (Mudarib) providing 'labour' i.e. is the fund manager providing technical and managerial skills (both parties can be an individual or a group of people). The ratio of profit sharing is predetermined in the agreement. Monetary losses are absorbed by the investor(s). Mudaraba agreements go both ways: banks can invest with managing customers in projects, and customers can invest in projects managed by the bank (deposit investments with fixed terms and profit share but also some fees).

Mudaraba savings products are relatively common, enabling customers to earn a profit on their investments in the bank. Both un-restricted and restricted

Mudarabah exists, the latter including limitations on where, how and for what purpose the IIFS can invest the funds. Unrestricted Mudarabah is prohibited by Central Bank of Sudan. Shares in Mudarabah funds can be traded at the stock markets.

While promoted in many countries, including Sudan, Mudaraba-type bank investment contracts for MSMEs are limited. The chief constraint is the substantial operating costs associated with the complex, formal accounting and reporting requirements needed to ensure that profits are distributed fairly.

2. Profit and loss sharing instruments

Mushārakah (joint venture/co-ownership contracts)
Often the least offered, but most encouraged Islamic finance product, musharakah partnerships are established between the bank and either individuals or groups as equity investors in a joint business (typically going concerns, projects, working capital and assets including real estate). The partnership contract specifies each partner's share of *actual profit earned* (not necessarily equal to the ratio of capital invested[130]) but losses will be shared as per capital contribution.

In *Diminishing Musharakah* joint ventures, the customer may co-fund as little as 20% of the joint venture but buys increasing shares of the banks' investment over time through pre-determined, monthly payments. The customer's investment can be provided via Mudaraba deposit investments with the bank (see above).

3. Asset-backed non-PS contracts

3.1 Sales based:

Murabaha (Purchase order/cost + mark-up sale contract)
The most commonly used Islamic finance contract Murabaha is an asset-based sales transaction used to finance tangible assets/ goods. The buyer should specify his/her requirements, and the financier will then procure the item from the market and resell it to the buyer at cost plus an agreed and fixed service fee with no buy-back option (to avoid speculation). Ownership changes when the buyer takes possession of the asset (whether it is paid for or not), but the amount is typically paid to the bank in equal monthly installments. Until then, the financier (bank) owns the asset and its inherent risks.

Current Sudanese banking laws limits the use of Murabaha contracts to maximum 30% of the portfolio of banks in North Sudan. The first installment (down payment) by buyers is regulated to 10% for buyers of goods for agriculture, manufacturing, medicines and export and 25% for buyers of any other goods.

Salam (trade/ pre-finance)
A sales contracts by which the customer "pre-sells" a specific amount of goods (typically crop/produce) to the bank at an agreed price and date and the buyer (bank) advances the payment (capital or goods, e.g. agricultural inputs) to the customer against a future receipt of the agreed goods.

[130] As per the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Sharia'h Standards.

3.2 Lease-based:

Bea Eijari or Ijaraa (Leasing agreement)
Typically used for the financing of machinery or equipment, Ijaraa refers to the selling of a use or service for a fixed price, and the agreement specifies the duration of the lease, the fixed service (lease/rental/usage) fee and payment schedule. As opposed to Murabaha sales contracts, the asset remains the property of the financier who is thus also responsible for its maintenance and insurance throughout the lease/rental period – as well as the risk of obsolescence e.g. for computer equipment. These costs and risks are factored into the service (lease) payments. Payments of rentals are treated as payments of operating expenses and are therefore fully tax-deductible. Leasing may therefore offer tax-advantages to profit making MFPs. For ownership to be transferred to the 'lessee', a (murabaha) sales contract has to be concluded at the end of the lease period.

Ijarah-W-al-Iqtina or Ijaraa muntahia bittamlik (Hire-purchase contract)
As opposed to Ijaraa, the W'al lktina contract is the Islamic equivalent of a secular lease and sale contract under which an Islamic bank/MFP leases or rents goods or assets to the customer ("the lessee") for an agreed price, and at the end of the lease period, the bank transfers the title of the goods or the asset to the customer as a purchase (Ijeraa thumma al-bay). The rentals as well as the purchase price are fixed in such manner that the bank gets back its principal sum along with profit over the period of lease.

Interestingly, the Central Bank of Sudan policies 2009 refers to the 'mugawala' product which is specific to Iranian Islamic banking. It is comparable to the Ijaraa Wal Iqtina (leasing purchase) product, which is not widely offered in Sudan, and can be used for Istisna'a (turn-key) products as well[131].

3.3 Manufacture/production (financing non-existent assets):

Istisna'a (installment based payment)
This contract is essentially between a manufacturer (or contractor) who agreed to produce/constructor and deliver, at a given price on a given future date a specific good – typically a building, factory or other turn-key project – and an investor (the bank) who agrees to pay. As opposed to Ijaraa, however, payment does not need to be up-front, but can include advances and progress-related installments. The contract determines the type of asset being purchased, the total price as well as the payment schedule. As owner and investor, the bank can then sign an agreement to sell on the factory to a third party (user), e.g. a project company on deferred payment terms – as owner, the bank in effect ensures the transfer of payments from the user to the contractor. The bank can continue to own the factory and charge the user a fee based on the profitability of the factory, or it can sell the factory to the project company. One advantage of this financing method over Murabahah, for example, is that start-up costs (e.g. earth removal) may be included in the fee to the user or the purchase price, as long as all costs are known to all parties from the outset.

[131] Central Bank of Sudan: Financing Policies 2009 and Islamic Financial Services Board (IFSB): Compilation Guide: Guidance On Compilation And Dissemination Of Prudential And Structural Islamic Finance Indicators For Banking And Near-Banking Institutions Offering Islamic Financial Services (IIFs), March 2007.

4. Service-based (investment) contracts

The service-based contracts function at par with deposit accounts in secular banking, ensuring the depositors' rights and returns on investments managed by banks.

Wadiah is an amount deposited on which the depositor is guaranteed his or her fund in full – similar to a zero-risk, zero-loss investment account.

Wakālah is an agency contract, where the investment account holder (principal) appoints the IIFS (agent) to carry out on behalf of the principal the investment for a fee or for no fee, as the case may be.

5. Benevolent contracts

Qard and Qard al-Hassan (benevolent loan)
Qard is the only cash loan product permissible by Shariya laws. It is interest-free and intended to allow the borrower to use the loaned funds for a period with the *understanding that the same amount of the loaned funds would be repaid* at the end of the period. Qard al-Hassan signifies that repayment is less expected – the financier expects reward only from God, and such loans are often forgiven in case of default.

Qard are associated with charity rather than banking, and cannot be provided sustainably. In addition, extensive availability of Qard al-Hassan in a locality risks affecting the repayment discipline of customers who need Qard or other financing instruments.

6. Securities

Shariya compliant capital markets have evolved over the past 25 years, and stocks, bonds and other security certificates are traded across the muslim world. The key difference from secular stock security markets is the direct link from the traded paper to an underlying, tangible asset.

Sukūk (certificates) represent the holder's proportionate ownership in an undivided part of an underlying asset where the holder assumes all rights and obligations to such asset.

7. Non-Bank services – Insurance

Mutual Insurance Funds
Members of a group contributing to a joint fund to support the group in times of need and someone managing the common funds as custodian (kafalah) is an old and established concept in Islamic finance (takaful) and in North Sudan (sanduq). Such mutual benefit funds abound as ASCAs or ROSCAs at the village level. Conceptualized as an enterprise rather than charity, takaful institutions were later formalized primarily to cover trade related losses. The first formal takaful company based on a cooperative model, the Islamic Insurance Company, was established in Sudan in 1979[132] and many have since followed.

[132] G. Nagaranjan and R. L. Meyer: "Rural Finance: Recent Advances And Emerging Lessons, Debates, And Opportunities, Ohio State Unive rsity (Columbus, Ohio, USA), July 2005.

As opposed to most secular mutual insurers, an Islamic Takaful operator is usually mandated by its shareholders to operate takaful holders' (participants') funds in their best interest but bears no underwriting risk. Therefore Takaful operator's funds need to be segregated from participants' funds. However, in Sudan a Takaful holder (participant) is usually also a shareholder in the Takaful operator (due to the cooperative background).

Sheikan Insurance and the National Health Insurance scheme of Sudan is also based on takaful principles. While Sheikan operates very similarly to a secular insurance company, it invests premium funds in Shariya-compliant ways only. The NHI has very little to invest and is barely able to meet expenses at State level with the significantly below-market fee structure imposed by Federal law.

Demand has been registered for micro-takaful, but provision to poor clients at an affordable cost without massive subsidization remains a challenge[133]. Due to the long history of kafala and takaful in Sudan, however, the level of public and supplier awareness imperative to the success of any micro insurance is comparatively very high and bodes well for risk sharing arrangements with the poor.

II Microfinance Terms and Characteristics

Microfinance Bank is a company registered under the Company's Law of 1925 and licensed by the Central Bank to provide microfinance services, including saving, financing, internal monetary transfers and other financial services required by the economically active poor people for the running and expansion of their medium, small and micro enterprises[134].

Deposit Microfinance Institution is an institution (public corporations, public or private companies limited by shares, NGOs, credit associations or cooperatives) licensed by the Bank to accept deposits from the general public for the purposes of providing microfinance services.

Non-Deposit Microfinance Institution is an institution (company, a cooperative, or under incorporated under special legislation) registered with the Bank as a microfinance provider but not authorized to accept deposits from the general public.

Microfinance [credit ceiling]. CBOS delineates microfinance from other finance by customer and contract size, the latter currently not to exceed a value of SP 10,000/contract for individuals.

Microfinance Client is defined in Sudan as a person in possession of a monthly income not exceeding double the average monthly income of a Sudanese citizen or minimum wage in the Sudan (currently SP 500/month), and whose total of productive assets, excluding land cost, do not exceed a value of SP 10,000, provided he is not a regular employee in any organization and not less than 18 or more than 60 years of age.

Small Project [Micro and Small Enterprise] CBOS' definition of businesses of the poor reflects the widely held social rather than commercial approach to financing of "projects whose running needs microfinance". Micro enterprises are defined as operated and managed by a single entrepreneur who "works alone or uses a small number of

[133] CGAP: Islamic Microfinance, op.cit.
[134] Bank of Sudan Act, 2002

close family members, at a wage that represents additional income to them, in a kind of work that does not require formal registration; management and accounting requirements are simple and flexible; and a manager who is not formally registered or licensed and has no official records for activities and revenues. Such kinds of activities involve primitive production, craftsmanship; value added treatment and commercial distribution" [135].

Microenterprises need not be formally registered

[135] CBOS: Microfinance regulatory Framework, July 2008.

Annex 2

Indicative Market Quantification – the calculations

Demand/Supply Estimations **Eastern Sudan**

Indicative Projections of market/demand based on current data									
		2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	
A. Total population									
(census 08 + 2.2% p.a.)									
Kassala (KSA)		1,789,806	1,829,182	1,869,424	1,910,551	1,952,583	1,995,540	2,039,442	44.7% female
Households (HH)s @ 6.2/HH		288,678	295,029	301,520	308,153	314,933	321,861	328,942	
Gedaref (GEF)		1,348,378	1,378,042	1,408,359	1,439,343	1,471,009	1,503,371	1,536,445	50.3% female
HHs @ 5/HH		269,676	275,608	281,672	287,869	294,202	300,674	307,289	
B. Econ active (54.7% as per ILO stats)		1,716,587	1,754,352	1,792,947	1,832,392	1,872,705	1,913,904	1,956,010	
KSA and GEF									
15% in government employment		257,488	263,153	268,942	274,859	280,906	287,086	293,402	
20% in formal non-govt employment		343,317	350,870	358,589	366,478	374,541	382,781	391,202	
C. Self-employed/BOP (65% of B)		1,115,781	1,228,046	1,255,063	1,282,674	1,310,893	1,339,733	1,369,207	
D. Poverty calculations									
KSA: 70% of A		1,252,864	1,280,427	1,308,597	1,337,386	1,366,808	1,396,878	1,427,609	
Poor HHs @ 6.2		202,075	206,521	211,064	215,707	220,453	225,303	230,260	
Poor in productive age grp (54.7%)		685,317	700,394	715,802	731,550	747,644	764,092	780,902	
GEF: 53% of A		714,640	730,362	746,430	762,852	779,635	796,787	814,316	
Poor HHs @ 5		142,928	146,072	149,286	152,570	155,927	159,357	162,863	
Poor in productive age grp (54.7%)		390,908	399,508	408,297	417,280	426,460	435,842	445,431	
E. Adjustments for need/ability									
Kassala:									
a) Outside cash econ:	HK/T	530,266	541,932	553,854	566,039	578,492	591,219	604,226	
	85% declining	450,726	460,642	415,391	283,020	289,246	147,805	151,056	

b) 15% of bal. Kassala	Adults	15-60 yrs	372,954	381,159	415,296	490,228	501,013	580,757	593,533
	Youth	15-19 yrs	164,000	167,608	171,295	175,064	178,915	182,851	186,874
	HHs	@ 6.2	109,971	112,390	122,456	144,550	147,730	171,244	175,011
Gedaref: 25%	Adults	15-60 yrs	293,181	299,631	306,223	312,960	319,845	326,882	334,073
	Youth	15-19 yrs	109,016	111,415	113,866	116,371	118,931	121,548	124,222
	HHs	@ 5	107,196	109,554	111,965	114,428	116,945	119,518	122,147
Min. market for 2 States	Adult		666,135	***680,790***	721,519	803,188	820,858	907,638	927,606
	HHs		217,167	***221,944***	234,420	258,978	264,675	290,762	297,159

Annex 3

Mapping of Financial Service Providers In Kassala and Gedaref

A mapping of financial services providers based on geographic outreach (location of branches across the two States) was attempted during the Consultancy. The provisional result is presented below in Map 1 and 2. As data by locality could not be obtained from NGOs, only banks are presented in the banks.

The Consultancy also started mapping the market penetration by locality in the two States. With the dearth of data and in the short time available, it was not possible to get and verify outreach data by locality from all providers, and the maps could thus not be completed.

The tools for market penetration mapping are presented here (Map 3) with the (limited and perhaps inaccurate) raw data received as at 30 August 2009 (Table 4). It is hoped that future State chapters of the Sudan Microfinance Association or a similar organisation will be able to complete the Mapping by adding outreach data from all banks, NGOs and CBOs by locality, so that a more complete picture of service coverage can be developed and updated regularly (see Section 8.3 of the Report). This would enable stakeholders to:

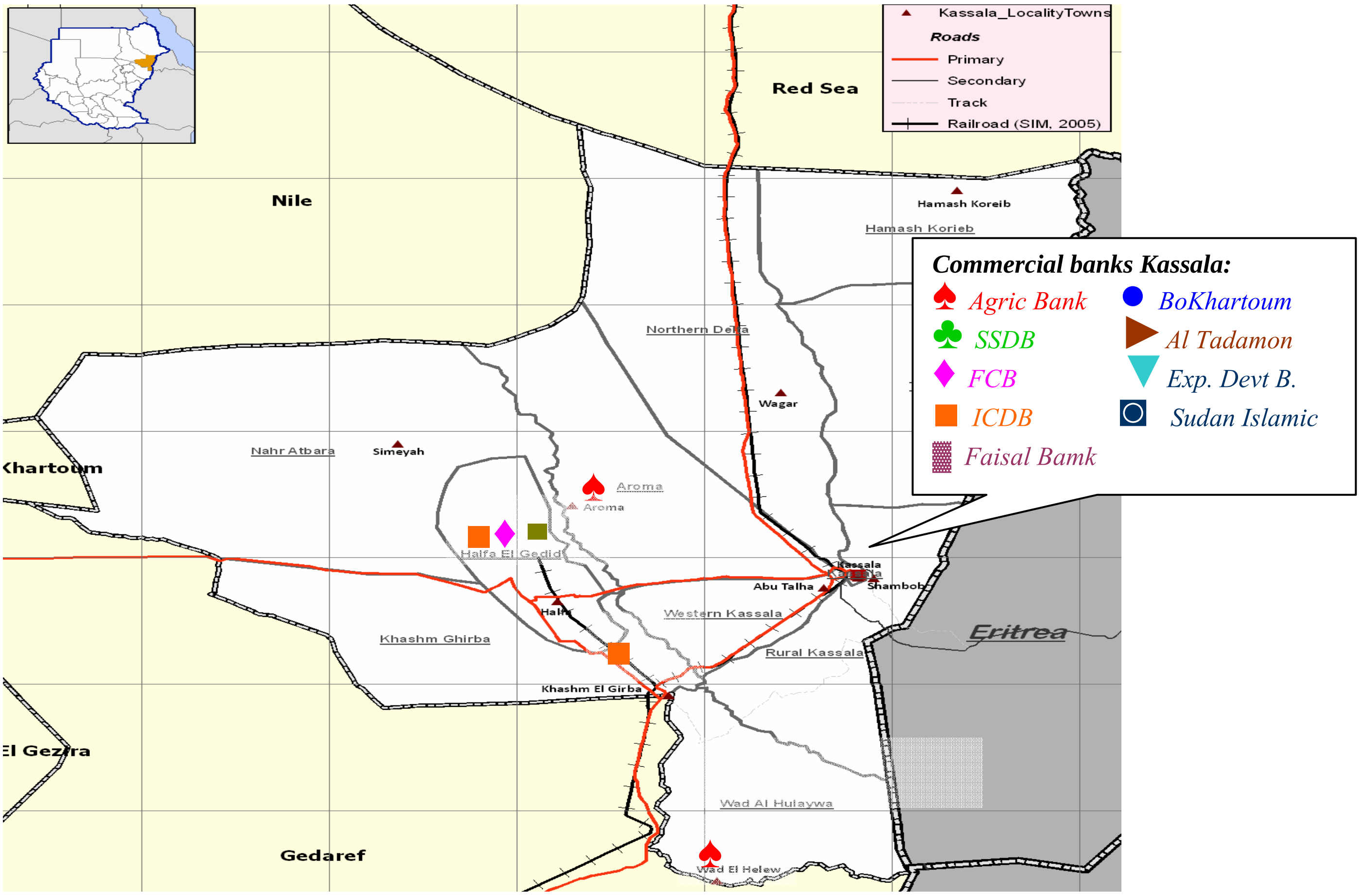
- Review progress on outreach
- Remain alert to possible risk of multiple borrowing among clients in localities served by more than one provider
- Coordinate planned expansion to new areas with a view to focus on currently under- or un-served localities

Please note that for purposes of demonstration, the total portfolio data provided by banks has been used for this mapping. Future mapping can of course focus on microfinance services only.

For a summary overview of outreach and performance data that adhere to international Good Practices, please also see Table 5. During the consultancy, it was not possible to complete this format as no microfinance provider had or was willing to share the data necessary to compute these basic performance ratios. The industry should, however, aim to be able to provide these basic data in future.

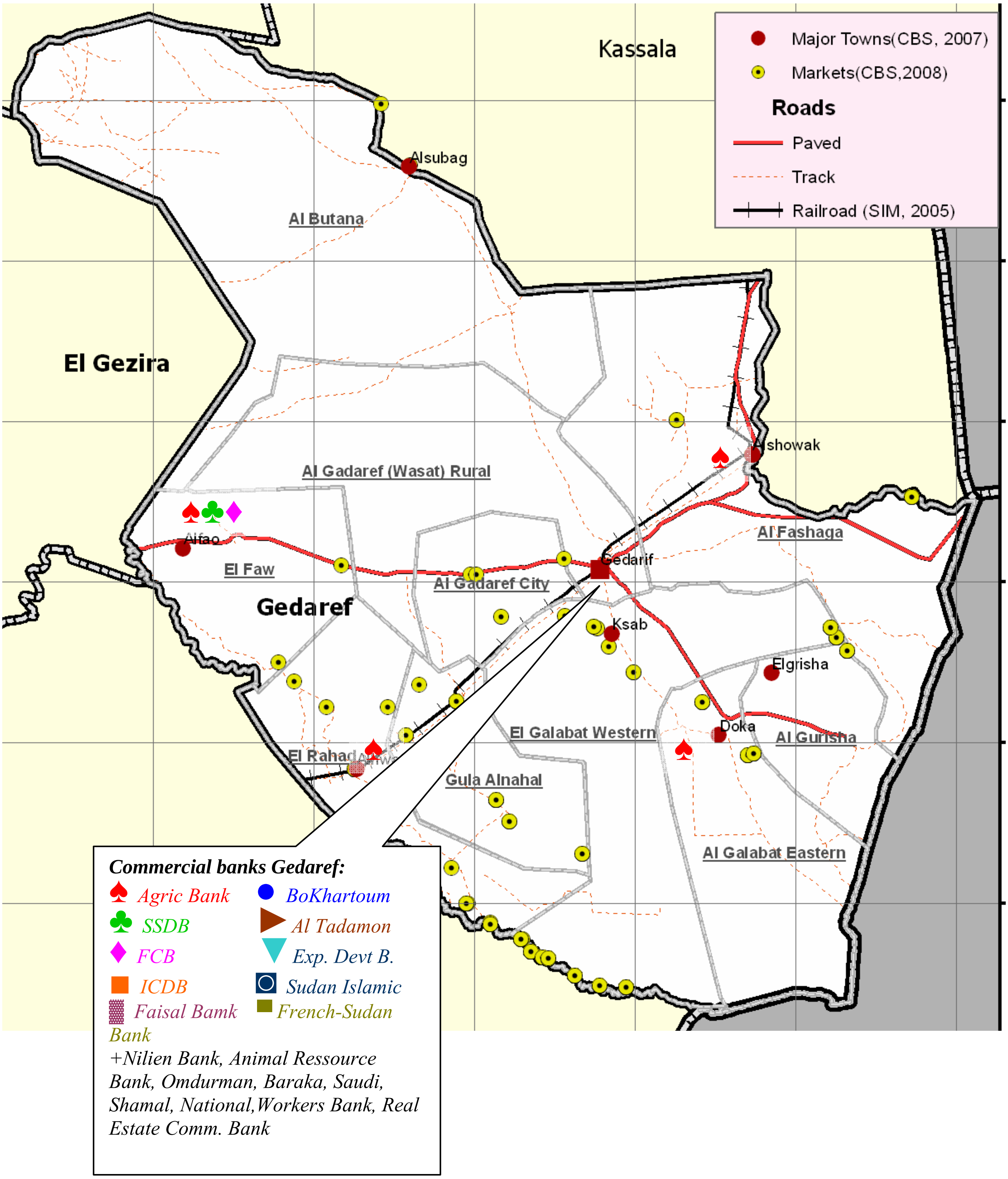
The underlying maps used for the mapping exercise were kindly provided by TRMA/UNDP that has produced them for the Sudan Information Management Working Group (IMWG). He names and boundaries do not imply official endorsement by the Government of Sudan or UN. For further information, contact TRMA.sd@undp.org

Map 1: Provisional Geographic Outreach of Commercial Banks, Kassala State



French-Sudan Bank

Map 2: Provisional Geographic Outreach of Commercial Banks, Gedaref State



Map 3: Provisional Market Penetration by State of Select Financial Service Providers as at Aug 2009 (incomplete)

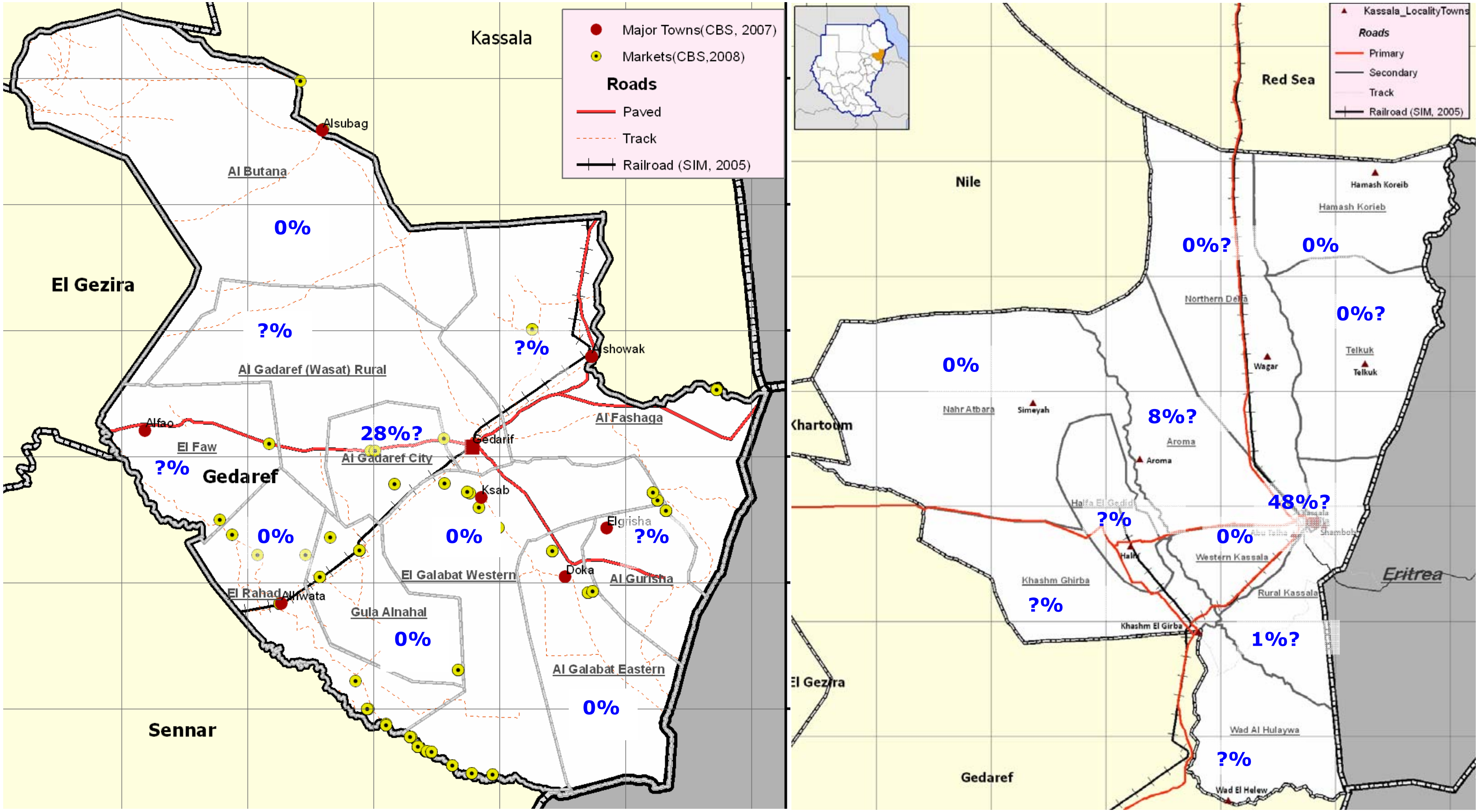


Table 4: Raw Data for Market Penetration Map (incomplete as few MFPs could report) as at August 2009 - Provisional

State	Locality	Total pop.	# women	# HHs	Fin. Service provider	# borrowers	# savers	% of HHs
Kassala		1,789,806	798,992	288,678				
	Kassala Town	298,529	147,377	48,150	ABS	2,010	3,000	48%
					SSDB	1,500 /200	13,500	
					FCB	1,000	450	
					ICDB	270/135	3350	
					Faisal	200	400	
					Islamic	n.a.		
					Tadamon	n.a.		
					Exp devt	n.a.		
					ACORD*	2,345	2,345	
					WDAs/PA	21	21	
	Kassala Rural	154,630	68,585	24,940	WDA/PA	5	5	0.02%
	Kassala West	79,376	37,373	12,803				-
	Halfa al Gedida	211,864	104,858	34,172	ICDB	n.a.		
					FCB	n.a.		
					French	n.a.		
					ABS	n.a.		
	Nahr Atbara rural	136,911	69,615	22,082				
	Girba rural	98,939	47,985	15,958	ICDB	n.a.		
					WDA/PA	86	86	
	Wad al Helaiw	84,681	41,956	13,658	ABS			
	Aroma Rural	102,759	44,423	16,574	ABS	1400	800	8%
	Shamal al delta	91,851	39,955	14,815				
	Hamesh koreib	255,288	90,949	41,175	-			
	Talkook	274,978	105,916	44,351	-			

State	Locality	Total pop.	# women	# HHs	Fin. Service provider	# borrowers	# savers	% of HHs
Gedaref		**1,348,378**	**678,561**	**269,676**				
	Al Botana	71,365	32,990	14,273				
	al Fashaga	120,835	60,830	24,167	ABS?			
	Central Gedarif	111,669	55,430	22,334	ABS?			
	Al Gedarif City	269,395	32,961	53,879	ARB	45/23		29%
					ICDB			
					SSDB/SDF	2,000	1551	
					Omdurman			
					Tadamon	70/15		
					Shamal			
					Workers	27/38	400	
					FCB	7,806		
					RCB	4,283	1637	
					ABS	750/262	1008	
	AlFao	176,662	89,812	35,332		FCB		
						SSDB		
						ABS		
	Al Rahad	196,438	99,767	39,288				
	Qalaa Al Nahal	66,122	34,749	13,224	ABS?			
	Galabat al Garbia	91,875	47,107	18,375				
	Elghoreisha	83,394	43,335	16,679	ABS?			
	El Galabat Sharquia	160,623	81,580	32,125				

* = # borrowers used, as no. members/savers not disaggregated by state/locality.

Table 5: Example of Outreach and Performance Overview of Microfinance Providers

Service Provider	# Borrowers	SP contracts outst.	# Savers	SP savings	Par(30)	Caseload	OSS %	FSS %	As at:
Banks									
e.g. ABS									e.g. Sept 09
SSDB									
ICDB									
Farmers Commercial									
Real Estate									
Annimal Ressources, etc.									
Subtotal, Banks									
MFIs									
e.g. SDF MFI									
Subtotal, MFIs									
Multi-purpose NGOs and donor projects									
e.g. ACORD (Kassala)									
ACORD – UNHCR									
WUSC Gedaref									
WDA Gedaref									
WDA Kassala									
KWDAN Kassala									
WFP									
Subtotal NGOs/projects									
TOTAL:									
AVERAGE:									

Annex 4

Example of Industry Building

USAID | EAST TIMOR

FROM THE AMERICAN PEOPLE

NOTE FROM THE FIELD

Supporting Small Businesses

East Timor works to improve the poor's access to credit

Courtesy of MFWG

[Microfinance Working Group Chairman, Lola Dos Reis, and Group Member, Jose Gusmao, sign Timor-Leste's first Code of Conduct.

"Timor-Leste's Microfinance Working Group has not yet celebrated its second anniversary, yet it has already developed a clear and detailed code of conduct, a joint reporting format for all members, and an industry-wide performance monitoring system, all of which are based on best practices collected from microfinance groups around the world."

Ms. Liz McMahon, Secretary of Timor-Leste's Microfinance Working Group; and Lisa Rogers, Information Officer at Development Alternatives, Inc. (DAI), which administers USAID/Timor-Leste's Small Grants Program, submitted this microfinance success story.

East Timor (Timor-Leste) is the world's newest nation and one of the poorest, with 41% of the population living below the national poverty line of $0.55 per person per day. McMahon and Rogers describe how funding under the Small Grants Program helped a group of international and Timorese microfinance organizations to form a powerful alliance to address one of the country's most urgent needs: access to credit for the poor. The group has focused on transparency and sustainability so its members can continue to provide vital microfinance services to their clients. With its shared approach and commitment to the highest standards, Timor-Leste's Microfinance Working Group is a model for improvements to the sector in other countries. Some highlights:

"Most of Timor-Leste's poverty stricken population survives on simple farming and operating microenterprises outside the formal economy. It is estimated that the current market demand for microfinance in the country is 240,000 individuals. Microfinance offers many a stepping stone away from subsistence towards greater participation in the cash economy.

"The majority of microfinance institutions operating in Timor-Leste are relatively new, most having started after 1999. They formed a joint Microfinance Working Group (MFWG) in August 2002 to find ways to work more efficiently together; share their experience and best practices; become more effective advocates for the microfinance sector; and inform the government, general public, donors, and stakeholders of the importance of microfinance both to poverty alleviation and as a sustainable development alternative.

U.S. Agency for International Development
www.usaid.gov

“In September 2003, the MFWG, with funding from USAID’s Timor-Leste Mission, sent a delegation of microfinance practitioners and a Timorese government representative to Kampala, Uganda. There, they learned that in order to reduce reporting burdens for MFIs with multiple donors, the Donor Group supporting Microfinance in Uganda and its collaborating partners developed a standard, computerized reporting format. This will allow member MFIs to report their performance to a central database, which will provide feedback to members on their performance against peer group averages in Uganda and pave the way for coherent benchmarking in the industry.

“Inspired by their experience in Uganda, the MFWG decided to develop a shared Code of Conduct and a Performance Monitoring System of its own. The objectives of the initiative were as follows:

- To improve the cohesion and credibility of the Microfinance Working Group through a Code of Conduct that defines joint goals and practices, thereby establishing an identity as a group of ‘good practice’ microfinance practitioners;
- To develop and agree to a standard set of indicators for reporting on outreach and performance, and to provide a baseline of such measures across all members of the Group; and
- To seek adoption of the Code of Conduct, a Joint Reporting Format, and a system of Performance Monitoring by all members of the MFWG and their donors, in order to provide comparable information on the growth of microfinance in Timor-Leste.

“For assistance with developing these tools, the MFWG used the USAID Mission’s Small Grants Program to contract the technical expertise of a dynamic consultancy team—one with extensive experience in Uganda, and one a Bahasa-speaking microfinance consultant. This team carried out a three-week initiative that included writing a curriculum and translating it into Bahasa, five days of training, and an individual microfinance assessment.

“To begin the process, The MFWG selected a taskforce to assist the team with the first draft of the Code of Conduct. The MFWG’s members agreed, among other things, that as long as institutions remain unregulated, they must adhere to certain principles: (a) savings are collected only from members who are also borrowers or who are about to become borrowers of the microfinance institution; (b) clear and comprehensive governance and management structures, policies and procedures are in place to minimize the moral hazard risk to the depositors; and (c) for credit-led institutions, a deposit reserve ratio (current as-sets/deposits) at or greater than 100% will be maintained at all times.

“MFWG members signed the Code on April 23, 2004. The Government of Timor-Leste’s Vice Minister of Development and Environment as well as the USAID Program Manager for Economic Growth attended the ceremony. The Vice Minister expressed hope that the systems and the Code developed could serve as a basis for increased and transparent information to government, donors and clients, and stressed the need for microfinance institutions to focus on attaining sustainability to ensure long-term services to clients.

“In signing the Code, the MFWG became one of the few Associations in the world to do so. The Code of Conduct sets clear standards by which microfinance clients, donors and the Government of Timor-Leste can hold practitioners accountable to good microfinance practices.

“Along with the Code, the MFWG, led by the USAID-funded consultancy team, established a Joint Reporting Format, which they used as a basis for selecting key indicators for a Performance Monitoring System.
“To design the Joint Reporting Format, the MFWG collected all formats already used by members and major donor agencies active in the country and submitted them to the team for analysis and consolidation. The formats were compared, and the indicators of outreach and performance were compared to the indicators listed by CGAP (Disclosure Guidelines for MFIs), the Technical Guides published by MicroRate and SEEP on standardization of terminology, definitions and ratio calculations, as well as the Performance Monitoring Tool developed for and in use by the microfinance industry in Uganda.

"The consultancy team opted for a broad training approach in the development of a proposed reporting format that included a review of the construction of financial statements and a portfolio management system. "This review ensured that all members not only had the information which they needed to construct financial and portfolio indicators, but would also use the standardized 'best practice' formula.

"The MFWG selected seven indicators as the basis of a Performance Monitoring Plan. To measure key aspects of outreach, the group chose:
(1) number of borrowers;
(2) total net value of loan portfolio in dollars;
(3) number of savers; and
(4) total net savings mobilized in dollars.
For performance, the group selected:
(1) asset quality;
(2) portfolio at risk (30 days) as a % of loans outstanding;
(3) efficiency: credit officer caseload; and
(4) viability: operational self-sufficiency and financial self-sufficiency.

"The Performance Monitoring System which the team constructed will enable practitioners to measure the performance of the sector over time and to benchmark their performance against others in their category, providing valuable information for public consumption. A baseline has been constructed, and MFWG members plan to submit their quarterly data on the eight indicators included in the Performance Monitoring System to the MFWG Secretariat for consolidation into an "Industry at a Glance Sheet."

The MFWG Secretariat will save data from each quarter so that progress can be monitored and trends in the industry can be analyzed."

McMahon and Rogers conclude that, "The Code of Conduct, Joint Reporting Format, and Performance Monitoring System enhance transparency and promote accountability for the nascent micro-finance industry in Timor-Leste. They enable practitioners to work together to build a strong microfinance industry to alleviate poverty and promote sustainable economic growth in the world's newest nation."

Annex 5

Microfinance Minimum Standards Reporting Requirements

Up until recently, the SEEP Network's list of minimum standard reporting for Microfinance Institutions included 18 basic ratios (now the list is being expanded to 24 ratios to comply with Basel II and AML requirements, as more and more MFIs are licensed by central banks). For Eastern Sudan, the original 18 ratios would be a great start to the process of more accurate recording of performance for management review, and more transparent reporting for CBOS and other stakeholders. The 18 ratios are included below.

These ratios and many more that enable a bank branch or MFI manager to properly analyse and monitor his or her portfolio are compiled in the "MFI Disclosure Guidelines" published by the Consultative Group for Assistance to the Poorest, CGAP – a group of 27 donor agencies that oversees and supports microfinance worldwide. These guidelines are available at http://cgap.org/gm/document-1.9.2785/Guideline_disclosure.pdf

From a regulator's perspective, global consensus guidelines have been developed to capture the many principles of good practice in regulation and supervision of microfinance. The guidelines summarize these principles for government regulators and others engaged in moving microfinance into the formal financial sector. They are available in Arabic at http://cgap.org/gm/document-1.9.2773/Guideline_deposits_ar.pdf

Finally, CGAP has recently published a list of minimum indicators that donors and investors in microfinance institutions should track to be able to assess growth and development accurately. These guidelines can be accessed at http://www.cgap.org/gm/document-1.9.36551/Indicators_TechGuide.pdf and summarise the key areas of monitoring as follows:

Summary

At a minimum, measure in five areas:

1. Outreach (breadth)
   —Number of active clients *or* accounts
2. Outreach (depth)
   —Average outstanding balance per client *or* account
3. Loan repayment
   —Portfolio at risk (PAR) *or*
   —Loans at risk (LAR) *or*
   —Current recovery rate (CRR) together with Annual loan loss rate (ALR)
4. Financial sustainability (profitability)
   For nonsubsidized institutions:
   —Return on assets (ROA) *or*
   For subsidized institutions:
   —Return on equity (ROE)
   —Financial self-sufficiency (FSS) *or*
   —Adjusted return on assets (AROA) *or*
   —Subsidy dependence index (SDI)
5. Efficiency
   —Operating expense ratio (OER) *or*
   —Cost per client

Summary of SEEP Microfinance Ratios

The following financial ratios are currently used as the international standard for microfinance ratio analysis. They were published after long-term broad discussion in the microfinance community Consensus was reached amongst practitioners, donors (including CGAP), raters, and international technical bodies in the development of the terms, definitions and the ratios to be used.

These ratios have been published by SEEP in "Measuring Performance of Microfinance Institutions: A framework for Reporting, Analysis and Monitoring" (2005). The reference numbers assigned for the ratios have also been used in the *MicroSave* toolkit. It is recommended that the Framework be referenced for detailed descriptions of the ratios and their application.

Ref.	Term	Formula	Explanation
		Sustainability and Profitability	
R1	Operational Self-Sufficiency	<u>Financial Revenue</u> (Financial Expense + Impairment Losses on Loans + Operating Expense)	Measures how well an MFI can cover its costs through operating revenues.
	Financial Self-Sufficiency	<u>Financial Revenue[1]</u> (Adjusted Financial Expense + Adjusted Impairment Losses on Loans + Adjusted Operating Expense)	Measures how well an MFI can cover its costs taking into account adjustments to operating revenues and expenses.
R2	Return on Assets (ROA) Adjusted Return on Assets (AROA)	<u>Net Operating Income – Taxes</u> Average Assets Adjusted Net Operating Income – <u>Taxes</u> Average Adjusted Assets	Measures how well the MFI uses its assets to generate returns. This ratio is net of taxes and excludes non-operating items and donations.
R3	Return on Equity (ROE) Adjusted Return on Equity (AROE)	<u>Net Operating Income – Taxes</u> Average Equity Adjusted Net Operating Income — <u>Taxes</u> Average Adjusted Equity	Calculates the rate of return on the Average Equity for the period. Because the numerator does not include non-operating items or donations and is net of taxes, the ratio is frequently used as a proxy for commercial viability.
		Asset/Liability Management	
R4	Yield on Gross Portfolio	Cash Received from Interest, Fees, <u>and Commissions on Loan Portfolio</u> Average Gross Loan Portfolio	Indicates the MFI's ability to generate cash from interest, fees, and commissions on the Gross Loan Portfolio. No revenues that have been accrued but not paid in cash are included.
R5	Portfolio to Assets	<u>Gross Loan Portfolio</u> Assets	Measures the MFI's allocation of assets to its lending activity. Indicates

[1] If the MFI chooses to apply the Accrued Interest Adjustment, then the numerator would be Financial Revenue – Accrued Interest Adjustment.

Ref.	Term	Formula	Explanation
			management's ability to allocate resources to the MFI's primary and most profitable activity—making microloans.
R6	Cost of Funds Ratio Adjusted Cost of Funds Ratio	Financial Expenses on Funding Liabilities (Average Deposits + Average Borrowings) Adjusted Financial Expenses on Funding Liabilities (Average Deposits + Average Borrowings)	Calculates a blended interest rate for all the MFI's funding liabilities. The adjusted ratio will usually be higher due to affect of the Subsidized Cost of Funds adjustment.
R7	Debt to Equity Adjusted Debt to Equity	Liabilities Equity Liabilities Adjusted Equity	Measures the overall leverage of an institution and how much cushion it has to absorb losses after all liabilities are paid. The adjusted ratio considers reductions to equity due to adjustments.
R8	Liquid Ratio	Cash + Trade Investments (Demand Deposits + Short-term Time Deposits + Short-term Borrowings + Interest Payable on Funding Liabilities + Accounts Payable and Other Short-term Liabilities)	Indicates level of cash and cash equivalents the MFI maintains to cover short-term liabilities. Short-term means assets or liabilities or any portion thereof that have a due date, maturity date, or may be readily converted to cash within 12 months.
		Portfolio Quality	
R9	Portfolio at Risk (PAR) Ratio Adjusted PAR Ratio	PAR > 30 Days + Value of Renegotiated Loans Gross Loan Portfolio Adjusted PAR > 30 Days + Value of Renegotiated Loans Adjusted Gross Loan Portfolio	The most accepted measure of portfolio quality. The most common international measurements of PAR are > 30 days and > 90 days. The adjusted PAR reduces the Gross Loan Portfolio by the Write-off Adjustment.
R10	Write-off Ratio Adjusted Write-off Ratio	Value of Loans Written Off Average Gross Loan Portfolio Value of Loans Written Off + Write-off Adjustment Average Adjusted Gross Loan Portfolio	Represents the percentage of the MFI's loans that has been removed from the balance of the gross loan portfolio because they are unlikely to be repaid. MFIs' write-off policies vary; managers are recommended to calculate this ratio on an adjusted basis.
R11	Risk Coverage Ratio Adjusted Risk Coverage Ratio	Allowance for Loan Losses Portfolio at Risk > 30 Days Adjusted Allowance for Loan Losses Adjusted Portfolio at Risk > 30 Days – Write-off Adjustment	Shows how much of the portfolio at risk is covered by the MFI's Impairment Loss Allowance. The adjusted ratio incorporates the Impairment Loss Allowance Adjustment and the Write-off Adjustment.
		Efficiency and Productivity	
R12	Operating Expense Ratio	Operating Expense Average Gross Loan Portfolio	Highlights personnel and administrative expenses relative to the loan portfolio the most commonly used efficiency

Ref.	Term	Formula	Explanation
	Adjusted Operating Expense Ratio	Adjusted Operating Expense Average Adjusted Gross Loan Portfolio	indicator. The adjusted ratio usually increases this ratio when the affect of subsidies are included.
R13	Cost per Active Client Adjusted Cost per Client	Operating Expense Average Number of Active Clients Adjusted Operating Expense Average Number of Active Clients	Provides a meaningful measure of efficiency for an MFI, allowing it to determine the average cost of maintaining an active client. The adjusted ratio usually increase this ratio when the affect of subsides are included.
R14	Borrowers per Loan Officer	Number of Active Borrowers Number of Loan Officers	Measures the average caseload of (average number of borrowers managed by) each loan officer.
R15	Active Clients per Staff Member	Number of Active Clients Total Number of Personnel	The overall productivity of the MFI's personnel in terms of managing clients, including borrowers, voluntary savers, and other clients.
R16	Client Turnover	Number of Active Clients, End of Period + Number of New Clients During Period – Number of Active Clients, Beginning of Period Average Number of Active Clients	Measures the net number of clients continuing to access services during the period; used as one measurement of client satisfaction.
R17	Average Outstanding Loan Size Adjusted Average Outstanding Loan Size	Gross Loan Portfolio Number of Loans Outstanding Adjusted Gross Loan Portfolio Adjusted Number of Loans Outstanding	Measures the average outstanding loan balance per borrower. This ratio is a profitability driver and a measure of how much of each loan is available to clients. The adjusted ratio incorporates the Write-off Adjustment.
R18	Average Loan Disbursed	Value of Loans Disbursed Number of Loans Disbursed	Measures the average value of each loan disbursed. This ratio is frequently used to project disbursements. This ratio or R17 can be compared to (N12) GNI per capita.[2]

Annex 6
Sample Training Course in Financial Performance Monitoring and Management

	Sunday	Monday	Tuesday	Wednesday	Thursday	Saturday
AM	**Session 1:** Introduction Schedule **Session 2:** Introduction of the PMT, CDs **Session 3:** Logistics of PMT I: - Reporting periods, currency - Poverty lending proxies **Session 4:** PMT Group work: Install PMT, create, save & open input file	**Session 7:** The Balance Sheet - Uses - Current - Desired Presentation Group work **Session 8:** PMT Group work: Input Balance sheet Presentation of PMT Group work	**Session 10:** The Income Statement - Uses - Current - Desired Presentation Group work **Session 11:** PMT Group work: Input Income statement	**Session 14:** Indicators of: - Portfolio/asset Quality - Outreach - Poverty focus - Productivity **Session 15:** PMT Group work: Input portfolio data and generate Quarterly report	**Session 18:** PMT Group work: PMT case study Analyse output. Q&A on ratios. **Session 19:** The logistics of a Joint reporting Format II: - Donor approval - Common Rates - Narrative report - Introduction	**OPTIONAL** **Session 22:** Benchmarking current performance information Performance Monitoring System - The Role of an association
Lunch						
PM	**Session 5:** Portfolio data - Uses - Current - Desired Presentation & Group work **Session 6:** Introduction to Balance Sheet and Income Statement - Indicator Quiz	**Session 9:** Indicators derived from B/Sheet: - Capital ratios - Liquidity ratios - Asset Quality - Productivity	**Session 12:** Indicators derived from I/Statement: - Efficiency - Asset Quality **Session 13:** Interest rate setting for sustainability	**Session 16:** Financial statement calculations: - Averaging - Annualising - Adjustments - Multi-service NGOs **Session 17:** Indicators of Viability - Presentation - Calculation	**Session 20:** Q&A on PMT **Session 21:** Evaluation Closure	Mapping of Outreach and Performance in location (with participants)

Annex 7

Indicative ideas catalogue for Value Chains In Eastern Sudan

In response to the TOR, the Consultancy focused of the factor market for financial services. However, the financial services industry can work only if the real economy is functioning, and microfinance can only contribute to poverty reduction if real markets work for the poor. Requested specifically to provide some tentative ideas about which value chains may be further explored for potentials to better integrate more micro- and small enterprises, below is a brief list of initial proposals. Further scoping of value chains that could be developed in Eastern Sudan could benefit from reviewing the baseline survey data of German AgroAction as well as the Review of Opportunities for Income Generation for Ex-Combatants from 2007 (cited in the main report).

1. Dairy products

a. Production of milk by small livestock breeders (microfinance, MF)
b. Delivery in steel jugs (MF) to micro-chilling stations to improve quality and reduce loss (group MF)
c. Collection and cold-chain transport to dairy processing plant (transport coop)
d. Dairy factory for pasteurized milk and other dairy products (cheese, yoghurt)
e. Packaging and labeling for local market
f. Cold chain transport to markets

C – f could be SME/group financed and would also assist in import substitution.

2. Meat products

a. Production of cattle/sheet/goat/poulty by small livestock breeders (MF)
b. Delivery to holding pens with vet check (MF), feeding (MF and water supply (MF)
c. Collection and transport to halal abattoir (transport coop)
d. Abattoir for hygienic production of diversified meat products (SME finance)
e. Packaging and labeling for local (and export) market (SME finance)
f. Cold chain transport from abattoir to markets (transport coop)

c – f could be SME/group financed and would also assist in import substitution.

3. Small holder crop productivity

a. Input supply (MF, SME finance) and water management (Group MF) for crop production (sorghum, millet, wheat) (MF/SME finance)
b. Tractor rental for harvest (group MF)
c. Compilation and dissemination by SMS of price info (MF/M-banking)
d. Collection and transport (transport coop - group MF) to mill
e. Milling (group MF/SME finance)
f. Packaging and labeling for local market
g. Transport from mill to markets.

4. Mesquite management teams

The exotic mesquite tree (shrub) has many good uses (good charcoal, briquettes, foliage is good source of animal fodder, honey made by bees feeding on mesquite shrub is supposedly particularly flavourful, etc.) and it may be unrealistic to assume it can be 'eradicated', but the tree does seem to spread only where it is not managed[136]. Rather than waiting for the 'charcoal season' when crop harvesting is over and farmers typically engage in alternative livelihoods, it would seem feasible that mobile (call-out) mesquite management teams could be a viable group microenterprise – teams could be paid cash or in produce.

a. Team formation, training and appropriate tools to manage mesquite for various purposes (fodder, fencing materials, charcoal, briquettes or management) – expertise from Practical Action and UNIDO.
b. Linkage to producers of tools and kilns (Practical Action)
c. Advertisement of services in area of residence (Bizz Bulletin)
d. Mobility – rental or hire-purchase of vehicle – more teams can share one

5. Sustainable environmental initiatives

With the fragile environment in Eastern Sudan, one must applaud the decree of the Gedaref Walit to ban polythene bags from markets, and wonder why this has not been extended to Kassala. Given the high level of environmental concern in Gedaref, it would be a good place to expand on environmentally friendly and commercially viable initiatives, e.g.

a. Electric 'rickshaws' to replace the 2-stroke engine rickshaws currently operating, especially in Gedaref (see box 7.1) – SME finance
b. Introduction of 'pedal power' – bicycle rickshaws (MF)

6. Widening of consumer goods availability

There is a dearth of variety of goods available for consumers in the local markets, and while purchasing power is not strong and price sensitivity is high, it would still appear to be feasible to expand the range of goods being traded. Focus should be on useful innovations so as to counter the significant 'copycat' market development ongoing in East, and should seek to exploit all resources and communities. For example:

a. Initial import, then adaptation and local production of lightweight, durable, 'camping' gear, equipment and furniture for pastoral/nomadic communities (foldable/hangable storage containers, air mattresses, foldable beds, gas fridges, etc.);
b. Solar panels for cell phone charging, light, cooling and water pumping.

[136] See S. Pantuliono and M. Babiker: Addressing chronic livelihoods vulnerability in Red Sea State, Sudan, Oxfam GB, February 2006 and UNIDO Sudan: Livelihood recovery in Eastern Sudan: Enterprise and Youth Entrepreneurship Development (YED) through Vocational Training for Employment and Income Generation, Draft Project Document for more details on the uses and feasible support to mesquite VCI.

Box 7.1 – The Safa Tempo of Nepal

In 1993, the Global Resources Institute developed Electric Vehicles (EV) as a profitable business in Kathmandu, Nepal by converting 7 polluting diesel operated three-wheelers (rickshaws) into EVs ("Safa Tempos"). After a 6-months trial as public taxi vehicles, Nepali professionals and entrepreneurs bought the 7 EVs and started Nepal Electrical Vehicle Industry (NEVI) in Kathmandu. Today, the EV industry in Nepal consists of 5 manufactures, 37 charging stations and several hundred vehicle-owners. Over 600 Safa Tempos ply the streets of the valley.

The driving component of the EVs is a motor with variable speed and power. In a Safa Tempo, a 72-volt pack consisting of 12 deep cycle batteries provides traction power. A new and fully charged battery set can drive a Safa Tempo an average distance of 60 kms. Commercial operation of EVs requires at least two sets of batteries and battery charging and exchange stations at convenient points along the routes. Safa Tempos are manufactured in Kathmandu by assembling imported components from India and US. The gross vehicle weight is 1000 kg and it can bear the weight of 12 passengers. It is noiseless and pollution free! It costs a little more to operate than a regular rickshaw…and therefore it may need a 'smart' government subsidy to get introduced in Eastern Sudan. But it's an idea.

7. Better and wider availability of services

a. Service, maintenance and repair of new equipment as mentioned above (e.g. mobile units delivering gas and repairing gas-operated fridges within a radius of a smaller town as advertised in the 'Bizz Bulletin'
b. Is there a prospect in accessing the trading skills and experience of the Rashaida?
    - Export promotion of new 'adapted mobile furniture' and other Eastern products?
    - Import of new raw materials?
c. Services for mobile communities, including mobile teachers providing child and adult education in local languages; mobile health workers – perhaps weekly visits to designated locations as part of expanded and adapted National Health Insurance?
d. Vet clinics and watering stations in town for working animals (MF)
e. Quality services (plumbing, electricians, fittings, sanitation, etc.) would no doubt be in high demand if the vocational collages could produce them
f. Information – the Bizz Bulletin proposed is in itself a possible enterprise
g. Kassala is known as the Honeymoon capital of Sudan, and yet there are very few hotels, none of which are of tourist standard.

8. Business Development Services – for Enterprises and MFPs

Business Development Services (BDS) are broadly defined as non-financial enterprise development services, which includes training and technical assistance (TA), technological development and dissemination, marketing assistance and policy and advocacy work, which will lead to the growth and enhancement of MSEs through a process of transfer, adaptation, mobilisation and utilisation of skills, knowledge, technologies and engineering to enhance human, economic, technical, analytical, managerial and institutional capabilities.[137] There are generally seven BDS categories and as per the examples provided below, there may be opportunities to expand the base and integrate more micro businesses in all of the categories in Eastern Sudan.

[137] In Line with World Bank definitions for technical assistance.

Table 7.2: Examples of Business Development Services

Category	Examples
Market Access	➢ marketing business ➢ market linkages ➢ trade fairs and product exhibitions ➢ development of samples for buyers ➢ market information ➢ subcontracting and outsourcing ➢ marketing trips and meetings ➢ market research ➢ market space development ➢ showrooms ➢ packaging ➢ advertising
Infrastructure	➢ storage and warehousing ➢ transport and delivery ➢ business incubators ➢ telecommunications ➢ courier ➢ money transfer ➢ information through print, radio, TV ➢ internet access ➢ computer services ➢ secretarial services
Policy/Advocacy	➢ training in policy advocacy ➢ analysis and communication of policy constraints and opportunities ➢ direct advocacy on behalf of MSEs ➢ sponsorship of conferences ➢ policy studies
Input Supply	➢ linking MSEs to input suppliers ➢ improving suppliers' capacity to provide regular supply of quality inputs ➢ facilitating the establishment of bulk buying groups ➢ information on input supply sources
Training and Technical Assistance	➢ mentoring ➢ feasibility studies and business plans ➢ exchange visits and business tours ➢ franchising ➢ management training ➢ technical training ➢ counseling/advisory services ➢ legal services ➢ financial and taxation advice ➢ accountancy and bookkeeping
Technology and Product Development	➢ technology transfer/commercialization ➢ linking MSEs and technology suppliers ➢ facilitating technology procurement ➢ quality assurance programs ➢ equipment leasing and rental ➢ design services
Alternative Financing Mechanisms	➢ factoring companies that provide working capital for confirmed orders ➢ equity financing ➢ facilitating supplier credit

In some markets, there is a need for external financing to develop BDS. When donors and governments engage in value chain or BDS development, however, it is important to be smart about where any subsidies are places so as to promote rather than displace a revenue stream for an entrepreneur or a company.

Like microfinance providers, BDS providers also need to become sustainable in order to ensure the long-term provision of their services to their clients. The sustainability of BDS centers on two questions: (i) who can deliver BDS sustainably (cost-recovery) and (ii) how can the services be paid for. In Eastern Sudan, it is not uncommon for 'beneficiaries' to be paid a sitting allowance to attend pre-determined and/or centrally developed trainings. To move from such a situation, in which BDS sustainability will be very difficult, to a demand-driven approach, customers will have to contribute to cover the costs of the services they demand. To facilitate this shift to a "payment-for-service" approach, a cost-sharing strategy will need to be put in place. On the supply side, BDS providers needs to be better able to adapt their services to fit the needs and budgets of MSEs. There are several potential cost-sharing models:

- ***Using <u>temporary</u> subsidies to lower the cost of a service***. Under this strategy, donors can subsidize the cost of market research, product development, and promotion on the supply side (but outside of the commercial transaction) so that providers could charge a more affordable price to customers. On the demand side, sponsoring e.g. by voucher programmes, can facilitate the shift to a 'payment for service' culture.
- ***Repackage services***. Donors and sponsors can encourage a provider to break down the service into smaller pieces, for example, providing several one-day seminars instead of a two-week training. Training of trainers models are also often less costly.
- ***Introduce alternative payment schemes***. Sponsors and donors can offer to pay for introductory services that have immediate pay-back for clients, e.,g. by voucher-sponsoring Model 1 of a training. Once clients benefit from these services, they may be more willing to pay for additional services, or their cash-flow may improve because of the BDS and is more able to pay the next time. Secondly, gradual payments or payments in installments could be introduced. Thirdly, projects and associations can help their members/customers purchase a service as a group and negotiate a group discount, or a "subscription" fee for repeat services such as market information or printing/photocopying, where clients would pay a one-time fee to receive the service over a specified period.

Annex 8

Terms of Reference for Consultancy

International Microfinance Consultant for Eastern Sudan

Background

Access to microfinance is extremely limited in Sudan. In 2006, a Central Bank of Sudan (CBOS) sponsored report noted that microfinance is still in its infancy in Sudan with supply of formal microfinance covering only about 1-3% of the potential demand. Although Sudan has a diversified experience of microfinance projects scattered throughout the country, which provide lessons for future activities, very few interventions have truly addressed the needs of the poorest, promoted sustainability or attempted to mobilize sufficient resources to grow the sector.

The sector in Sudan is largely credit-oriented (e.g. not focused on savings). A number of specialized and commercial banks have provided small scale microfinance services for more than 15 years. These include the Agricultural Bank of Sudan (with experience in rural areas and with community-based (CBOs) and civil society organizations (CSOs), and the Savings and Social Development Bank (SSDB) that serves as an intermediary for international NGOs (INGOs) and UN agencies. Unfortunately, their outreach remains minimal. Furthermore, none targets the poorest of the poor, and they have limited links with grass roots organizations.

NGOs, on the other hand, have been much closer to grass roots organisations and the borrowers. However, their efforts are often hampered by a social ‘beneficiary’ rather than a client approach. A successful experience of urban microfinance is PASED - Port Sudan Association for Small Enterprise Development in Red Sea State in the East. Operating since 1984 first as the NGO, ACORD, it is currently the largest provider of microfinance services in Sudan with 4,010 clients (December 2006) and an average repayment rate of 85%. Other experiences include a Grameen-type credit programme for internally displaced women (IDP) women in IDP settlements by Elkifaya Bank, ACORD, Practical Action and Plan Sudan in Kassala State, and the Khartoum-based Sudanese Development Association (SDA) which assists poor women to set up CBOs for savings and credits and was instrumental in setting up the ‘tea women’ of Khartoum. Unfortunately, none of the above experiences have produced a sustainable, i.e. profitable, microfinance model for the rural areas, which constitute more than 90% of the geographical area of Sudan. Lack of road and transportation infrastructure, lack of market access, lack of business skills and recurring conflicts have all contributed to a weak microfinance sector in Sudan as well as changes in donor interest that cut short projects that implicitly need a longer-term horizon for sustainability.

To better understand the sector and promote access, UNDP co-sponsored a National Consultative Forum on Microfinance with the Central Bank of Sudan, World Bank and IFAD in 2007. The forum was able to:

- Examine and take stock of past and ongoing experiences in the sector within Sudan as well as globally by reviewing key case studies;
- Foster a partnership between potential microfinance providers in Sudan and identify synergies to allow practitioners to benefit from the ongoing activities, share information, data and enhance capacities;
- Enhance networking in the field of microfinance by establishing common platforms for collaboration;

- Define successful strategies for promoting the role of women entrepreneurs given their social and economic weight in the country; and
- Review the possibility of establishing an information center for investors and end users of microfinance.

In 2007, the CBOS issued a new policy that 12% of bank loans must go to microfinance and allocated $40m to 8 commercial banks in northern Sudan. According to the Bank, 45% of the money has been loaned (with the bulk of the business being in Gedaref state in eastern Sudan). Participating banks across the north include the Animal Resources, Farmers, Savings and Loan and Agricultural banks.

The CBOS is committed to the new policy and to ensuring that it meets the needs of the poor – both through the commercial and NGO sector. It recognizes that there are impediments to access to the commercial banking sector for a variety of reasons:

- Historically, commercial bank lending has an extremely limited outreach to poor clients, and where it took place, in many cases it actually impoverished the borrower. Commercial banks so far have no capacity, trained staff or the institutional set-up to provide microfinance services to the poor.
- General lack of interest by the commercial sector in microfinance because it perceives it as expensive to administer and micro borrowers as bad credit potential and not a good source of income for the bank; and
- The requirement for collateral for borrowers is often prohibitive for the sector of the population that microfinance intends to target.

In an effort to bring good practice to Sudan, the CBOS has hired the Frankfurt School of Management to establish the Sudan Microfinance Development Facility (SMDF) as a new apex institution. In terms of regulatory progress, the CBOS has issued a recommendation that has been adopted by the Humanitarian Aid Commission (HAC) allowing NGOs to provide microfinance services. The respective regulatory framework on microfinance has been finalized and published by Micro Finance Unit of the CBOS enabling non-banking institutions to join the sector as non-deposit-takers not regulated by the CBOS. The CBOS will continue to provide technical assistance to the commercial sector with SMDF providing funding to existing or new MFIs and technical assistance to MFIs generally, including community-based organizations, NGOs and State microfinance institutions (MFI).

Recognizing that it will take time for commercial banks and MFI's to meet the needs of borrowers and that these providers may never be accessible to certain segments of the population, UNDP, UNHCR and the CBOS are proposing to strengthen the provision of microfinance by NGOs in eastern Sudan where large numbers of refugees, IDPs, conflict victims and rural and urban poor are in need of credit and savings.

As a first phase, under UNDP's Livelihood and Sustainable Natural Resource Management Programme for Kassala and as part of UNHCR's Strategy for Self-reliance for Refugees, UNDP and UNHCR are jointly funding the cost of an external international microfinance expert to undertake the following activities:

- Document and review current microfinance programs being implemented in eastern Sudan by the NGO sector (identify type, scope, target population, selection criteria, etc.) with a specific focus on ACORD and its provision of loans to refugees in camp settings;
- Assess access to microfinance via the commercial banking sector in eastern Sudan;
- Assess demand for microfinance in Eastern Sudan;
- Provide recommendations on how to expand access to microfinance in eastern Sudan.

As a result of the above-mentioned activities the consultant is expected to deliver the following results:

- In cooperation with the CBOS, UNDP and UNHCR and with normative support from the SMDF, develop a long-term technical assistance plan to the sector with a specific plan to support ACORD.
- Develop a Project Document (Proposal) for a Microfinance Program in Eastern Sudan

UNDP, UNHCR, SMDF and the CBOS will jointly form the selection committee of the consultant who will work for 50 days.

Duration and place of work

The consultancy will take place in Khartoum (10 days) and Eastern Sudan (40 days), including the preparation of reports. The consultant will work in close collaboration with a national microfinance expert who will support him/her during the entire period of the assignment. The consultant will closely collaborate with CBOS, UNDP, UNHCR and SMDF who will provide briefings and organisational support.

Due to the parallel hiring process, the consultancy is expected to start on the date of arrival of the international microfinance expert, estimated for the 12th **of July 2009**. The consultancy starting date can be postponed by UNDP in the case that the international consultant does not manage to enter the country on time due to visa processing or similar issues.

The consultancy will incorporate all the remarks and recommendations by CBOS, UNDP and UNHCR, presenting the final document to CBOS, UNDP and UNHCR at the latest 15 days after receiving the comments to the preliminary document. The maximum period defined for the presentation of the final document to CBOS, UNDP and UNHCR is 90 days after signing the consultancy contract.

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Annex 9

Work Schedule and List of Persons Met

I. Work Programme/schedule

Date	Time	Organisation/venue	Activity
29/08/09	20:30		Arrival to Sudan of International consultant
30/08/09	10:00	UNDP G.City	Brief in meeting with Econ advisor Maja Bott and Dr. A. Suliman
	13:00	UNDP G.City	Work planning with Dr. A. Suliman
			Literature search and review
	20:00	`	Meeting with Betsy Lippmann, UNDP
31/08/09	09:30	UNDP G.City	Brief-in contd.
	11:00	UNDP TRMP unit	Collecting maps, documents, SSP briefing
	14:00	UNDP Gamaa Str	Introduction, Deputy Res Rep. & Head of PR
	16:00	PACT Consultants	Meeting on M-banking, North Kordofan
01/09/09	09:00	IFAD	Meeting on IFAD livelihood programmes
		UNDP G.City	Literature review, research tool design
02/09	09:00	UNDP G.City	Meeting to verify activities in East.
	13:15	SMDF	Briefing on background and status of SMDF
	14:00	CBOS MFU	Briefing and logistics w/ Mr. Khalid Abdelgadir
03/09	09:30	UNDP G.City	Briefing by Mr. Khalaf Alla, UNDP RoL prg.
	11:00	UNHCR	Meeting with Asst. Rep (0) Abdul Rahman Issa
	14:00	MoSW	Meeting hosted by Undersect/Head Women's Dept Mrs. Khadeiga Abulghassim, attended by Dirs and GEF.
05/09			Preparation of research tools, literature search and review
06/09	10:00	Practical Action	Meeting with Prg Manager
	11:00	CBOS MFU	Meeting Dep. Manager
	13:30	SMDF	Meeting on industry building
07/09	10:00	UNDP G.City	Meeting RRP to verify activities in East Sudan
	10:30		Literature review and research tool planning
			Input to data structure for FSP database, TRMP
08/09	11:00	Family Bank	Meeting GM Mr. Mohamed Derar
	12:15	CBOS MFU	Meeting assigned assistant to consultancy Mr. Mohamed Badawi
	13:00	PLAN	Meeting on livelihood programmes and INGO Network
	16:00	UNHCR	Meeting with Mr. Mohamed Nisar Khan
09/09	08:45	CBOS MFU	Logistics (DSA) and meeting Mohamed Badawi
	10:00	SDF Khartoum	Meeting GM Mr. Mohamed El Beely & staff
	13:00	ACORD	Meeting on microfinance program and plans
	15:00	UNDP Gamaa Str	Meeting Head, PR, Mrs. Fatima ElSheikh
	17:30	FAR/INGO network	Meeting with ICWA policy officer Manisha Thomas & FAR accountant Chuck
10/09	09:00	UNDP G.City	Work planning, review of research tools
12/09			Literature review, finalize research tools, planning & logistics
13/09	08:00	Travel to Kassala by UNHCR shuttle	
		Kassala State 13 September – 03 October	
14/09	09:00	UNDP office	Brief-in meeting Office Manager, RCO rep. & Livelihood Prg Manager
	10:00	UNHCR suboffice	Brief-in Meeting Head of Suboffice and staff
	11:00	MoSW, Kassala	Meeting Mrs. Maria El Khidir on SDF, MoSW
	13:00	Practical Action	Meeting on microfinance and livelihood activities

Date	**Time**	**Organisation/venue**	**Activity**
15/09	09:00	MoFNE, Kassala	Meeting on Kassala SSP process & economy
	11:00	ACORD office	Meeting on background, status and plans for microfinance activities
	15:00	WFP Office	Meeting with Head of Sub office
16/09	09:00	Agricultural Bank	Meeting with Branch manager
	10:30	Farmer's Commercial Bank	Meeting with Branch manager and staff
	12:00	SSDB	Meeting with Branch manager
	13:30	ICDB	Meeting with Branch manager
	15:00	Sheikan office	Meeting with dep. Branch manager and staff
17/09	08:30	Zakat Foundation	Meeting with dep. Manager and staff
	10:00	PLAN Sudan	Meeting on livelihood activities
	11:00	Nat. Health Insurance	Meeting on coverage and depth of service
	13:15	UNDP	Meeting w/ livelihood prj manager
	16:00	UNHCR	Meeting with staff to plan field visits
18-22/09	Eid – Consultancy assistant departs, drafting of report		
21/09	13:00	FAO	Meeting on livelihood activities
	15:00	German AgroAction	Meeting on baseline study & activities
23/09	08:30	UNHCR	Depart for field visit: - COR office, Girba - Refugee camp, Girba - SRC training center, Girba - Meeting WDA coordinator, Girba - ASCAs at Refugee camp Kilo 26
24/09	07:45	UNHCR	Depart for field visit: - Hangola IDP settlement with GOAL - IFAD Gash Agric project coordinator - WDA groups, Aroma - Agricultural Bank, Aroma Branch
26/09			Compile research results, draft report Organize translation of Kassala demand study
27/09	09:30	Wau Nur block	Meeting w/ Sawasawa housing association and inspection of new houses in IDP settlement
	12:00	ACORD	Discussion on data and plans
	14:00	KSA WDA Network	Discussion of revolving fund projects w/ executive committee
28/09	08:30	HAC	Meeting on NGO registration/cooperation
	09:30	Farmer's Union	Meeting with executive committee on union membership & financial services - Visit to wholesale agricultural market
	12:30	MoFNE	Meeting with Department of Cooperatives
	14:00	Pastoralist's Union	Meeting with chairperson on union outreach and financial services
	15:00	Trade Chamber, KSA	Meeting with executive committee members on membership and financial service facilitation
29/09	08:30	UNDP Guesthouse	Meeting with chairperson of Union of Farmers on Rainfed Land on outreach and access to finance
	11:30	Islamic Insurance Company	Meeting on coverage of insurance and interest in micro-insurance
	12:30	Bank of Khartoum	Visit to branch
	13:15	Faisal Bank	Meeting with Branch Manager on microfinance portfolio & interest in micro-insurance
	14:00	WB/CDF	Meeting with CDF manager on livelihood activities and coordination
	15:30	WDA Umbrella	Discussion of revolving fund projects w/ coordinator and chair M. El Khidir visit to WDA ASCA in Totil block visit to Beja WDA in Kassala Debriefing meeting w/ Maria ElKhidir

Date	Time	Organisation/venue	Activity
30/9	09:00	Cooperative Union	Meeting with President on outreach and financial services
	11:00	UNDP guest house	Prepare debriefing presentation
01/10	09:00	IFAD Kassala	Briefing on Gash Project and livelihood programming coordination
	14:00	UNDP office	Joint Debriefing with UNDP, UNHCR, WFP and IFAD – discussion of options
03/10	Private transport from Kassala to Gedaref (CBOS/UN vehicle unavailable)		
	Gedaref State 03 – 08 October 2009		
04/10/09	09:00	CBOS office	Brief-in and overview with Branch manager and staff
	12:00	MoSW	Briefing with Minister and staff of SDF and Women's portfolio Revolving Fund
	14:00	MoFNE	Meeting with economic department (overseeing department of cooperatives) and DEPD
05/10	09:00	SSDB	Meeting with branch manager and staff
	10:30	Farmer's Comm Bank	Meeting with branch manager
	12:00	Real Estate Nat. Bank	Meeting with branch manager and staff
	13:00	Agricultural Bank	Meeting with investment officer on MF portfolio
	14:30	Animal Ressources Bank	Meeting with branch manager and staff
	16:00	CBOS office	Compilation and review of State bank data (CBOS unavailable for further discussions)
06/10	09:00	Worker's Nat. Bank	Meeting with branch manager and staff
	10:30	Al Tadamon Bank	Meeting with dep. Branch manager and staff
	12:00	SDF Gedaref	Meeting with SDF Manager & all staff
	14:00	Ma'an Network office	Meeting with Network manager & women's umbrella association
	15:30	Watania Cooperative Insurance Company	Meeting with branch accountant on insurance products and coverage
07/10	08:30	Cooperative Union	Meeting with President and auditor - Visit to consumer coop supermarket - Visit to wholesale market
	10:00	Labour Union office	Meeting with Executive committee members on financial services and members' access to finance
	11:00	Ma'an/Women's Umbrella	Field visit with Women's Umbrella and members of Mufarkhat SCA to women's SCA at Um Khanger for exchange of experience
	14:00	UNHCR antenna office	Meeting with reg. advisor and staff of antenna office on ACORD program in camps
	15:30	Ma'an/Women's Dev't Association	Meeting with coordinator on outreach, membership and revolving fund model of WDAs
08/10/09	Public transport from Gedaref to Khartoum (CBOS/UN vehicle unavailable)		
09-16/10/09			Draft report
17/10/09	14:00		Debriefing with Maja Bott
18/10/09	12:00		Debriefing UNDP Khartoum
20/10/09	11:00		Debriefing CBOS MFU internal
22/10/09	12:00		Debriefing CBOS MFU, UNHCR, UNDP
24/10/9	03:30		Departure from Sudan

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Investment officer Mr. Omer Ahmed 0912969311

Worker's National Bank

Branch Manager Mt. Mohamed Ahmed Fath Elrahman 0912237092
Deputy Branch Manager Osman Ahmed Alawad 0122355832
Investment officer Mr. Atif Abdalaziz 0912801147

Tadamon Islamic Bank

Deputy Branch Manager Mr. Khalid Mohamed Hassan 0912900250
Investment officer Mr. Fath Alrahman Awad Alsied 0912950169
Investment manager Mr. Haider Ahmed Abdalla 0122752620
Auditor Mr. Abdalla Abdellatif 0912264662

Watania Cooperative Insurance Company

Accountant, Gedaref Branch Mr. Talaha Abdel Halim Abdallah 0913555661

Labour Union

President Mr. Hassan Fadl Almoula

Cooperative Union

General Secretary Mr. Hamid Abdalfadil 0915243977
Accountant Mr. Mohamed Ahmed Alsir 0917846068

Ma'an Network, Gedaref

Executive Manager Mr. Omer Saeed Osman 0919115762 gdfsdnsaeed2006@yahoo.com

Women's Umbrella Association

Coordinator Mrs. Amal Adam Ismaiel 0122030291

Um Khanger Women's Savings and Credit Association (SCA)

President Ms. Howida Abdalla 0923880413

Almoufargaat Women's Development Association

President Ms. Amona Mahmoud.

Women's Development Association, Gedaref State

Treasurer Ms. Raia Mohamed Abdelhaie 0121827013

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