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The Strategy for Development of the Microfinance Sector in Sudan

A Central Bank Initiative



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The Status of the Microfinance Sector in Sudan

- A growing focus on poverty alleviation in response to the high and rising poverty levels in both urban and rural parts of Sudan.
- Poverty levels have been associated with high inequality alongside low productivity due to increasing informalization since the 1990s, especially in urban areas.
- Supply of micro finance is extremely small compared to demand for these services. Rough estimates have put the demand covered at only about 1-3%.
- Microfinance, as it is known and practiced worldwide, is at an infancy stage in Sudan

The Vision/Strategy Objective

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

The New Paradigm

Assumptions Underlying the Strategy

i) The Poor

- Need easy access to financial services with efficient delivery mechanisms.
- Realize that timely and adequate credit on commercial basis is preferable and more sustainable than access to subsidized credit.
- Perceive formal savings (in banks and postal network) as a safer and more rewarding service as opposed to savings at home or in jewelry, especially if the formal saving service is in a reasonably nearby geographical area.

The New Paradigm



Assumptions Underlying the Strategy

ii) NGOs/CBOs/SHG

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

The New Paradigm

Assumptions Underlying the Strategy

iii) Banking System

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

The New Paradigm

Assumptions Underlying the Strategy

iv) Government

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

Cross Cutting Areas of Intervention

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graph TD; A["Cross Cutting Areas of Intervention"] --- B["A policy environment that promotes inclusive financial systems and supports the growth and development of the financial sector at the bottom of the market"]; A --- C["An institutional and regulatory framework that is supportive of market oriented approaches in the delivery of broad based financial services"]; A --- D["An infrastructure that provides financial institutions with the required human, financial, capital and information resources to provide effective and sustainable services."];
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A policy environment that promotes inclusive financial systems and supports the growth and development of the financial sector at the bottom of the market

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

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

Challenges Facing the Expansion of the Microfinance Sector In Sudan

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Strategy Recommendations To Address These Challenges



The Challenge:-

**Outreach to the poor
is still limited among
many microfinance institutions
and especially banks.**

- The *formal banking system*, as it is structured at present, is not designed to serve the financing needs of the poorer segments of the Sudanese society.
- The absence of satisfactory methods of *identification of the economically active poor* (microfinance clients) has inhibited credit flows to these excluded segments of the population.

The Strategy Recommendation

Review Central Bank of Sudan policies to encourage banks to engage in Provision of MF

A balanced
Regulatory Policy

Flexible Pricing Policies

Regulations to accommodate special characteristics of the Microfinance Sector

New MF
Banks Licensing

Capital Requirements

Capital Adequacy

Limits on Unsecured Lending
and Provisioning of Loans

**Encourage More
Effective MF
Service Delivery**

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graph LR; A[Encourage More Effective MF Service Delivery] --- B[Expansion of Branch Network for existing institutions]; A --- C[The establishment of new specialized formal MFIs]; A --- D[The downscaling and restructuring of existing banks to serve as rural specialized MF banks]; A --- E[Banks Wholesaling to Non-Bank MFIs & SHGs/CBOs]
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Expansion of Branch Network for existing institutions

The establishment of new specialized formal MFIs

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

Banks Wholesaling to Non-Bank MFIs & SHGs/CBOs

The Challenge:-

Diversification of the range of MF services and products

- Little emphasis on the development of MF products that are appropriate to the needs of the poor.
- The dominance of short-term and sales-based modes of finance - murabaha (purchase and resale plus profit margin) and salam (forward crop-financing)
- Meager use of MSEs-friendly equity financing modes constitute barriers to effectively extend financing to MSEs.

The outcomes are:

- Relatively higher cost of finance,
- Short-term nature of financing limited to the production cycle,
- Borrowers (micro-entrepreneur) are deprived from realizing potential gains at market maturity (as peak prices of their produce are normally witnessed after the harvest season).

The Strategy Recommendation

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

- Review and develop Islamic financing regulations to allow wider application of modalities in line with clients' needs. Modalities to be considered in this regard:
 - Musharaka (profit sharing) linking the production cycle to that of the market.
 - Link Musharaka with that of Murabha (purchase and resale plus profit margin) and Salam (forward crop-financing).
- Improve bank capacities to implement innovative financing modalities while observing the essence of Islamic financing regulations.

The Challenge:-

Savings Practices

- The currently practiced Islamic mode for deposit taking (on a non interest bearing basis) does not encourage saving.
- Problems associated with Islamic modes of Savings:
 - The small amount associated with individual micro-savers does not qualify for investment, even at a micro level, and
 - Savers from the "economically active poor" with adequate amounts to be invested—in most cases- lack the know how and professional ability to decide on who to invest with.

The Strategy Recommendation

- Study with a view to reviewing the Islamic interpretation and design conducive modes for increasing savings.
- Treat micro savings as a pool for investment funds to be operated on the basis of "Mudaraba" (speculation form) thereby yielding profits to savers.
- Link policies for increasing savings with wholesale credit policies from banks to non-bank microfinance institutions.

The Challenge:-

The Lack of Collateral

- The limited access to financial services by small farms and non-farm micro-enterprises is mainly attributed, among other factors, to the absence of a legal, policy and regulatory framework for collaterals and guarantees appropriate for microfinance.

The Strategy Recommendation

Alternative Non-Conventional Collateral Mechanisms

- **Allow for greater flexibility in determining the type of non-conventional collateral that is more appropriate for micro credit.**
- **Allow MFIs to accept partial registration of payment guarantees.**
- **Adoption of such collaterals and guarantees requires that MFIs, in general, and banks, in particular, change their procedures and branch structures to accommodate such changes.**
- **It also requires more reliance on reputational collateral that can be generated by credit bureaus through the provision of clients' repayment history that could aid in assessment of risks.**
- **The strategy recommends a pilot project whereby the provision of unconventional/ social collateral is first studied, developed and tested for adoption as an acceptable and practical form of guarantee.**

The Challenge:-

Absence of institutional Credit guarantee systems operating now in Sudan

- The individual borrower guarantee that is prevalent lifts the burden of loss of the business due to natural hazards, death or disability of the borrower. Nevertheless, the “portfolio” guarantee approach, whereby the guarantor covers whole or part of the default of the MFI according to a specific agreement, is non-existent.

The Strategy Recommendation

Establishment of credit guarantee schemes with the purpose of sharing credit risk with banks

- Three mechanisms are recommended for further exploration and implementation:
 - Community Repayment Guarantee Fund
 - MFI maintained Credit Guarantee Fund
 - Joint Guarantee Schemes
- Involve the Zakat Fund with a view to supporting new insurance funds - in the form of solidarity fund - within clients' unions and networks.
- Formulate the right incentives to encourage formal private insurance companies to financially and operationally support such micro insurance mechanisms.

Other Challenges

1. Lack of strong institutions able to attract savings, recycle them into loans and provide other financial services needed by the economically active poor in a sustainable manner.
2. Coordination between institutions offering microfinance services and those with different mandates (banks, NGOs, social funds, and rural development projects) is extremely limited.
3. Performance as microfinance providers is limited by the widespread perception that the loan is a gift and by the associated resistance to the shift from grants to a market oriented approach.

4. Lack of exposure to worldwide microfinance good practices coupled with lack of training in microfinance facilitation and management constrain service providers' ability to manage and operate programs that effectively and efficiently provide microfinance services to the poor.
5. The training and experience of the personnel in commercial banks is unsuitable for servicing poor clients.
6. Lack of information on the credit history of the client is a major challenge facing MFIs.

The Strategy Recommendation

Development of Financially Sustainable MFIs as a major pillar of the Microfinance Strategy

- Promote efficiency and self-sufficiency and sustainability goals for MFIs by building both financial and managerial capacities.
 - Financial capacity building focusing on improving MFIs' absorptive capacity and ability to attract greater funds, increase the number of loans disbursed and encourage savings, expand their clientele base etc.
 - Managerial capacity building focusing on the institutional and human resources of the MFI. Promote efficient management that emphasizes the use of diagnostic and management tools for performance monitoring and transparent reporting while instilling a culture of accountability.

Establishing a Supportive Infrastructure

- Supporting the Creation of a Supportive Information Base:
 - Create a database on microfinance activities as a necessary requirement to inform policy makers, regulators and the donor community.
 - Establish an Information Credit Bureau (ICB).
- Supporting the Establishment of an Umbrella Organization/Apex Institution
- Establishment of a Specialized MF Department in the Central Bank of Sudan

Conclusion

Comprehensive strategy encompassing all aspects necessary to achieve the objective of increasing the depth and breadth of outreach of financial intermediaries as well as to diversify their products to be more responsive to the needs of micro-entrepreneurs and economically active poor.

Success of the MF strategy is dependent on:

- Integrating it within the overall strategy for the reduction and eventual elimination of poverty in the country.
- The recommended actions are undertaken, not only by the CBS as the leader and regulator of formal financial intermediaries, but also by other relevant government entities as well as non-government stakeholders.
- Macro policies that focus on creating an enabling environment and a favorable business climate that fosters investment opportunities for small and micro-entrepreneurs and farmers.
- The donor community supports the strategy in terms of availing technical and financial assistance.

Commitment at all levels is a corner-stone for the success of this strategy.