Journal of Economic Cooperation **26**, 4 (2005) 27-50

THE PRACTICE OF ISLAMIC BANKING SYSTEM IN SUDAN

Magda Ismail Abdel Mohsin*

This paper sheds light on the practice of Islamic banking system in Sudan. Its main objective is to show how successful the Islamic banking system in Sudan is and how this system succeeded in converting all existing banks into interest-free banks. Moreover, it emphasises the establishment of new Islamic banks in all the regions of Sudan and shows how those banks succeeded in minimising dealing with interest, attracting more depositors and financing the different sectors. To achieve this, the paper reviews the emergence of the Islamic banking system in Sudan within the last three decades, presents the structure and operations of the Sudanese Islamic banks, and highlights their contribution to the different sectors.

1. INTRODUCTION

The last three decades witnessed the revival of some of the Islamic financial institutions in Muslim countries such as the institution of Zakah, and later the institutions of *Waqf, Hisbah* and *Takaful.* The motivation for the revival of these institutions comes from the desire of various Muslim communities to formulate and reorganise their social, economic, and especially financial activities on "an interest-free basis". This gave rise to the emergence of Islamic banks in Muslim countries and later in western countries as well. Sudan was not an exception. In the 1980s, it started to implement Islamic law (Hamdi, 1998, p. 115). This implementation provided the opportunity to introduce Islamization to the Sudanese economy and, hence, most of the old Islamic institutions had the chance to be revived. Examples to this are the institutions of *Zakah*, the introduction of the newly Islamic Banking System and, recently, the revival of the institution of *Waqf*. Since discussing the revival of all these Islamic institutions is beyond the scope of this paper,

* Deputy Head, Economic and Quantitative Analysis, International Islamic College, Kuala-Lumpur, Malaysia.

it will focus only on the introduction of the new Islamic Banking System in Sudan, and the practice of Sudanese Islamic Banks and their contribution to the different sectors.

The paper consists of five sections including the introduction. Section 2 presents the emergence of the Islamic Banking System in Sudan. Section 3 describes the structure and operation of the Sudanese Islamic banking system. Section 4 highlights the contribution of Sudanese Islamic banks to the financing of the different sectors. The final Section concludes the paper.

2. EMERGENCE OF THE ISLAMIC BANKING SYSTEM IN SUDAN

The banking system in Sudan has experienced a dramatic development since independence in 1956. Prior to independence, the Sudanese banking system was characterised as colonial banking. The commercial banks were part of the foreign institutions and there was neither a central bank nor a local currency. Within this environment, there existed a banking and credit system consisting mainly of expatriate banks. The main objectives of those banks were to serve the needs of both export and import trade and act as deposit takers for the expatriate and indigenous firms operating in the country (Al-Harran, p. 181). After independence, the Sudan Currency Board was established in 1957 to issue the new Sudanese Currency. In 1959, the Bank of Sudan act was passed and in the following year, the Central Bank became one of the first operational central banking institutions in Africa. The Bank of Sudan assumed responsibility for the administration of foreign exchange and related currency matters including the regulation of the issuance of notes and coins and the development of a sound credit and banking system, and served as a banking and financial adviser to the government (Al-Harran, p. 182). In May 1970, a fundamental change took place in the banking arrangements in Sudan. The government decided to nationalise the entire commercial banking sector and severely restricted the direct influence of foreign capital over Sudan's banking and insurance sectors and export-import business. Moreover, through nationalising the entire commercial banking sector, the government tried to develop and improve the banking facilities available to various sectors, especially the traditional sector and the rural areas which desperately needed banking facilities (Al-Harran, p. 182). By the mid-seventies, private foreign banks were allowed to operate in Sudan again, side-by-side with the nationalised banks. These foreign banks included the Bank of Oman, the Arab Emirates Bank, Abu Dhabi National Bank, International Bank of Credit and Commerce, City Bank, the Pakistani-owned Habib Bank, the Bank of America and the Islamic Bank for Finance and Development. However, these banks were prohibited from dealing with Sudanese citizens, but were allowed to open accounts for import-export agents and Sudanese nationals working abroad (Bashir and Malik, 1987, p. 7, 9; Shaaeldin and Brown, 1988, pp. 128-130).

During that time, the idea of the Islamisation of the modern banking system emerged in Egypt. It consisted in introducing interest-free banking on the basis of profit sharing, as interest is prohibited by Islam (Tail, 1988, pp. 49-51. Abdul Gafoor, 1996, pp. 36-37). The first Muslim economist to introduce the concept of ‘interest-free banking’ was Professor Ahmad El-Najjar, known as ‘The Founder of Islamic Banks’ (El-Najjar, 1993). His idea was put into practice in a savings bank at Mit-Ghamr in Egypt in 1963. However, this bank was closed due to various political reasons (Tail, p. 51; Çizakça, 1996, p. 195). In the early seventies, many conferences were held regarding these issues in different Muslim countries. After 1973, and owing to the oil boom and massive accumulation of petro-dollar surpluses in the Middle East, the emergence of many Islamic Banks became a fact in some Muslim countries. The first Islamic Bank was the Dubai Islamic Bank (1975) (Ariff, p. 47) followed by the Islamic Commercial Bank of Abu Dhabi (1977) and Faisal Islamic Bank of Sudan (1977). This was soon followed by the establishment of a whole group of Faisal Islamic Banks in many Muslim countries (Tail, p. 53).

The establishment of the Faisal Islamic Bank in Sudan marked the first step to Islamise all Sudanese banks later. During that time, this Islamic bank found a great support not only from the government but also from the people, since the majority of the Sudanese were afraid to deal with the previous commercial banks which operated on an interest basis[1] (Hamdi, 1982, p. 121). This was clearly proven by the fact that the

[1] Although it was not guaranteed that this new Islamic bank had abolished totally dealing with interest, the words ISLAMIC BANK had a strong emotional effect on Muslims, who preferred it to the existing commercial banks.

real paid-up capital of this bank had increased from 0.6 to 2 million Sudanese Dinars in less than 4 years.[2] This increase represented 17% and 30% of the total paid-up capital of 18 commercial banks, both private and national. During that time, the shares were divided between Saudis, Sudanese and other Muslims in the ratio of 4:4:2 respectively (Shaaeldin and Brown, p. 121). The success of the Faisal Islamic Bank in this short period encouraged the government to open 5 more Islamic Banks. Al-Tadamun Islamic Bank, which was opened in 1980, was followed by the Sudanese Islamic Bank and the Islamic Cooperative Development Bank which were opened in 1982. Moreover, Al-Baraka Bank was opened in 1983, followed by the Islamic Bank of Western Sudan (Bashir and Malik, p. 9,10). All these banks succeeded in attracting more depositors, and hence, more branches were opened all over the Sudanese states.

The success of this Islamic banking system encouraged the government in the 1990s to convert the entire financial system into an interest-free system, following the same policy as in Iran and Pakistan (Haron, 1997, p. 6). This, in turn, forced all banks, commercial and foreign, to operate with Islamic financial modes. This conversion increased the number of banks operating on the basis of interest-free banks from 6 in the 1980s to 29 in the year 1997. All these banks have succeeded in attracting more depositors as will be seen in the following sections.

3. STRUCTURE AND OPERATION OF THE SUDANESE ISLAMIC BANKING (SIB)

The structure and operation of the SIB are basically different from those of commercial banking. The Islamic financial system derives its rules from the Qur'an and the *Sunnah*, while the rules of the commercial banks originate in the market. In other words, the main aim of the Islamic banks is to invest the funds entrusted to them through Profit and Loss Sharing (PLS) partnerships, whereas the conventional banks resort to the rate of interest (Çizakça, 1996, p. 202). Nevertheless, they provide nearly identical services to borrowers and depositors. The prime objective of Islamic banks, in general, is the elimination of interest in all

[2] All figures in this paper have been deflated according to the prevailing rate of inflation.

forms of transactions and the undertaking of business and trade activities on the basis of fair and *halal* (lawful/permissible) profits. Besides, giving zakah, the prohibition of monopoly, cooperation for the benefit of society and the development of all legitimate aspects of business according to Islamic principles (Haron, p. 1) are also objectives of Islamic banks.

In Sudan, the Bank of Sudan or the Central Bank is the leader of all Islamic banks. It emerged as the most prominent institution adhering to those Islamic banks' transactions and operations. Although the Bank of Sudan agreed on the methods of operation and the modes of financing in all Islamic banks in Sudan, individual banks differ in their applications. These differences can be attributed to the objectives and goals of each bank. In this section, the discussion of the Sudanese Islamic Banking will include their fund-raising activities, their structure, their operation methods and an analysis of their investment activities.

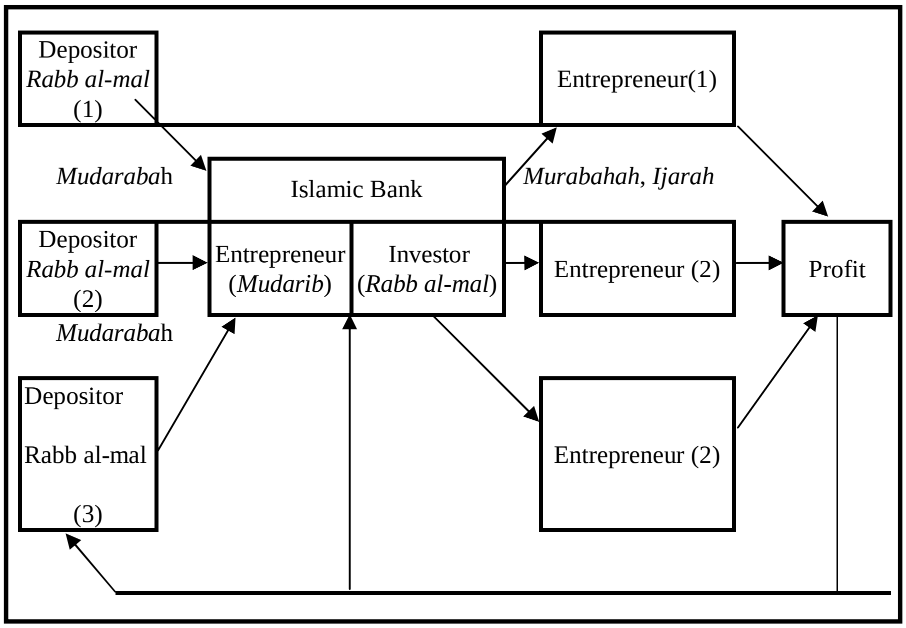
3.1. Structure of the Sudanese Islamic Banking System

The structure of the SIB is similar to the one that was presented in 1963 by the Egyptian economist Ahmad El-Najjar. The main idea of this new Sudanese Islamic Banking structure is to incorporate the classical *mudarabah* into a modern complex system in order to create an interest-free banking system (Çizakça, 1996, pp. 195-198). The function of these Islamic banks can be explained through the following structure.

As we can see from the below structure, Islamic banks function in reality with hundreds or thousands of investors and entrepreneurs. This is a two-tier partnership with three main groups: the depositors/investors *Rabb al-mal*, the Islamic banking, and the entrepreneurs (with whom the Islamic bank signs a partnership contract and to whom it provides finance).

The functions of those banks are as follows: First, on the liability side, the Islamic banks collect all the funds from their investors. They then have to utilise those funds by financing the entrepreneurs. Here, it is worth mentioning that the Islamic banks have a double personality. In the first phase, they function as a *mudarib* (speculator/agent) to whom the investors entrust their savings, and in the second, they themselves assume the role of a major investor financing a multitude of

The Main Structure of the Islamic Banks



Source: Çizakça, *A Comparative Evolution of Business Partnerships*, 1996, pp. 195-198.

entrepreneurs. Hence, the characteristic of the Islamic banking changes at this point from *mudarib* to *rabb al-mal*, once it has signed partnership contracts with those entrepreneurs. Whatever form of partnership is used, the profit of each entrepreneur is shared according to the stipulations of the contract signed with the bank. The bank's share of profits from all the ventures is then pooled in a reserve. This profit pool is shared between the bank and the holders of the so-called investment accounts. The only difference between the structure of the Islamic banks in Sudan and the one which had been presented by El-Najjar is that according to El-Najjar, only *mudarabah* or *musharakah* should be applied to medium and long-term finance in the second phase (Çizakça, 1996, pp. 195-198, 203). In contrast, in Sudan, as in other Muslim countries, they include *murabahah* too. We believe that if the Islamic banks continued to resort to *mudarabah* or *musharakah* partnerships as suggested by El-Najjar, their function would be similar to Venture Capital Companies which are very successful in developed countries.

3.2. Operation of the Sudanese Islamic Banking

All Islamic banks in Sudan, like other conventional banks, operate by providing three types of accounts: current accounts, savings accounts (with the exception of some banks, e.g. Al-Barakah Bank which does not take savings deposits, refer to Al-Haaj and Shatah, 1987, p. 7), and investment accounts. In this sub-section, the analysis of their operations will cover two periods: the 1980-1989 period, when the Islamic banks were operating side by side with the commercial banks; and the 1990s, when all commercial banks were Islamised, i.e. when they converted their entire financial system into an interest-free one.

Regarding the current accounts, both Islamic and commercial banks offer checkbook facilities and take a service charge. Depositors receive no profit on their balances, but their principal is guaranteed. However, the bank obtains the explicit permission of the account holder to use his funds for other business activities (Shaaeldin and Brown, p. 18; Abdul Gafoor, p. 42,43; Tail, p. 111; Rabooy, 1988, p. 202). By comparing the total amount of current accounts deposited in both the Islamic banks and the commercial banks, we realised that more depositors were attracted to Islamic banks than commercial banks. For example, in 1987, the total amount of current accounts of six Islamic banks reached 86,4 million Sudanese Dinars, while it reached 248,4 million Sudanese Dinars in 18 commercial banks (Al-Haaj and Shatah, p. 6). This means that the share of total current deposits of each of the 6 Islamic banks to that of each of the 18 commercial banks is in the ratio of 24:23. This shows that Islamic banks succeeded in attracting more depositors than commercial banks.

The second account is the savings account which is different from current deposits in that no service charge is imposed. There are no restrictions and the account can be drawn on without notice. Most of the banks adopt several methods of attracting clients (Abdul Gafoor, p. 42). The principal is guaranteed, but no profit is given (Hamid, 1996, pp. 136-138). This savings account has also succeeded in attracting more depositors to Islamic banks than commercial banks. The total amount of savings deposits of 6 Islamic banks reached 6.03 million Sudanese Dinars, while it reached 15.55 million Sudanese Dinars in 18 commercial banks in 1987 (Al-Haaj and Shatah, p. 7). This means that the share of the total savings deposits of each of the 6 Islamic banks to that of each of the 18 commercial banks is in the ratio of 10:8.

Table 1: Banks and their Branches Operating on the Basis of Interest-Free Banking

No.	Year of establishment	Name of the bank	No. of Branches
1	1960	Sudan Bank	10
2	1957	Agricultural Bank	115
3	1966	Al-Iqari al-Sudan Bank	11
4	1973	Saving Bank	30
5	1976	Abu-Dhabi Bank	1
6	1978	Citibank	1
7	1979	East Bank	1
8	1982	Habib Bank	1
9	1933	Khartoum Bank	109
10	1964	Bank al-Nilain li al-Tanmiyah al-Sinna‘iyah	37
11	1960	Sudanese Commercial Bank	37
12	1978	Faisal Islamic Bank	71
13	1978	Al-Bank al-Sudani al-Faransi	19
14	1981	Al-Bank al-Ahali al-Sudani	17
15	1982	Al-Bank al-Watani li al-Tanmiyah al-Sha‘abiyah	7
16	1982	Al-Nil al-Azraq Bank	5
17	1983	Al-Tadamun al-Islami Bank	31
18	1983	Al-Islami al-Sudani Bank	42
19	1983	Al-Tanmiyah al-Ta‘awniyah al-Islamiyyah Bank	33
20	1984	Western Bank	30
21	1984	Al-Barakah Bank	27
22	1986	Al-Saudi Bank	13
23	1988	Al-‘Omal Bank	9
24	1989	Northern Bank	14
25	1992	Al-Muzari‘ Bank	3
26	1993	Al-Tharwah al-Hayawaniyah Bank	12
27	1993	Omdurman al-Watani Bank	4
28	1994	Aifori Bank	2
29	1997	Investment Bank	2
Total			695

Source: Al-Jihaz al-Masrafi al-Sudani, 1994. Khilal ‘Ashara A‘wam, 1999, p. 378.

The third account is the investment account. In this case, the investment deposits are accepted for a fixed or unlimited period of time and the investors agree in advance to share the profit or loss in a given proportion with the bank. In this account, capital is not guaranteed (Tail, pp. 111-112). However, the credit ceiling policy[3], which was imposed on the banking sector during that period, led to a relative decline in investment deposits in Islamic banks compared to those in commercial banks. The percentage of total investment deposits in Islamic banks to those of commercial banks decreased from 30% in 1985 to 10% in 1986 and further to 6% in 1987 (Al-Haaj and Shatah, p. 8).

Moreover, the total amount of the paid-up capital of the six Islamic banks reached 17.8 million Sudanese Dinars while that of the 18 commercial banks reached 23.86 million Sudanese Dinars at the end of 1987 (Al-Haaj and Shatah, pp. 8-9). This means that the share of the total paid-up capital of each of the six Islamic banks to that of each of the commercial banks is in the ratio of 29:13. Hence, this shows that the shareholders have greater confidence in Islamic banks than commercial banks.

All these are examples indicating that both the depositors and shareholders have great confidence in those Islamic banks, since patronising Islamic banks makes them feel more pious than patronising commercial banks. The success of those Islamic banks within this short period encouraged the government to Islamise the entire banking system in Sudan in the 1990s. Hence, the number of Islamic banks and their branches operating on the basis of interest-free banking increased as shown in Table 1.

From the above table, we observe that the number of banks operating on the basis of interest-free banking increased from 6 in the 1980s to 29 in 1997. This is due to the conversion into interest-free banks of all conventional banks dealing with interest, together with the establishment of new Islamic banks in the 1990s. Moreover, the number of branches of these interest-free banks increased from 45 in 1989 to 695 in 1997 in all

[3] In 1984, the Central Bank imposed a credit ceiling policy for all banks according to which it ordered that 80% of this investment account be directed to finance the agricultural sector and the remaining 20% to the other sectors.

the regions of Sudan. The following table presents the amounts of total deposit and total finance for these banks from 1989 to 1997.

Table 2: Total Deposit and Total Finance in the SIB
(Millions of Sudanese Dinars)

Year	Total Deposit	Total Finance
1989	1,046	494
1990	3,385	1,766
1991	2,877	1,403
1992	5,627	3,311
1993	8,034	5,273
1994	11,704	10,073
1995	16,160	14,515
1996	67,793	33,948
1997	96,754	41,556

Source: Khilal ‘Ashara A‘wam, 1999, p. 379.

According to the above table, we observe that, as a whole, Sudanese Islamic banks succeeded in attracting people to deposit in them, since the total deposits increased from 1 million Sudanese Dinars in 1989 to more than 96 million Sudanese Dinars in 1997. Moreover, these Islamic banks succeeded in financing many areas, as their total finance increased from 494 thousand Sudanese Dinars in 1989 to more than 41 million Sudanese Dinars in 1997. All these can be attributed to the increase in the demand for the new Islamic Banks and their branches in all the regions of Sudan.

3.3. Analysis of the Investment Portfolio of the Sudanese Islamic Banking System

In addition to the *murabahah*, *mudarbah*, *musharakah* and *ijarah* mentioned above by Çizakça, the Islamic banks in Sudan also apply *muzar‘ah*, *bai‘ al-salam*, *al-qard al-hasan*, *muqawalah* and *al-istisna‘* on the asset side. Each of these modes of finance will be explained below.

Murabahah (Mark-up) is a form of trade credit or postponed payment. In this form of finance, the bank actually purchases and becomes legal owner of whatever the client has ordered, and then resells this commodity to the client at a previously agreed (higher) price. Since some jurists and scholars argue that charging this higher price as an extra amount over the original constitutes *riba* which is prohibited by Islam, the policy of the Islamic banks in Sudan does not oblige the client to buy what the bank has purchased on his behalf (Shaaeldin and Brown, p. 22). Indeed, this policy encourages bargaining between the Islamic bank and the client regarding the increase or decrease in the price of the commodity provided by the bank. Besides, the bank takes the risk of losing the value of the commodity if the client rejects it. Although the Islamic banks in Sudan have tried to avoid dealing with *riba* when using this mode, they fell into another trap. For example, some banks deal with *al-murabahah al-Suriyyah,* forgery mark-up (Ibrahim, 2001, p. 1). In this case, the bank, i.e. some of the staff, sells to the client a commodity which the bank has not yet purchased. At the same time, the bank delivers to the client an agreement on the terms of payment. Hence, the bank gives the client a loan, i.e. the amount of money supposed to purchase whatever the client ordered, and the client is supposed to return this loan with extra money.

In Sudan, the *murabahah* mode is commonly used to finance the trade sector which is of a short-term nature. This mode is the most practised in almost all Islamic banks. However, due to the misuse of this mode, the Central Bank issued a decree in the year 2000 ordering all Islamic banks to decrease their dealings based on *murabahah* to 30% and to increase their transactions based on other modes (Decree No. 29 A, 2000, 4). The following table shows the credit by modes of finance in the Sudanese Islamic Banks from 1996 to 2000.

Table 3: Credit by Modes of Finance
(Million Sudanese Dinars)

Year	**1996**		**1997**		**1998**		**1999**		**2000**	
Mode of Finance	**SD**	**%**	**1995**	**SD**	**SD**	**%**	**SD**	**%**	**SD**	**%**
Murabahah	18,130	53%	21,740	52%	25,500	54.3%	36,2	49%	26,2	30%
Musharakah	10,940	32%	9,470	22.6 %	9,9	21.1%	22,7	30.8%	36,6	42%
Mudarabah	0,680	2%	2,260	5.4%	2,8	6.1%	3	4.1%	5,2	6%
Bai' al-Salam	1,370	4%	3,500	8.4%	3.1	6.5%	3.7	5.1%	13,8	15.8%
Others	3,080	9%	4,850	11.6 %	5,6	12%	8,1	10.9%	5,4	6.2%
Total	34,2000	100 %	41,500	100%	46,9	100%	73,7	100%	87,2	100%

Source: Bank of Sudan's Annual Report, March 1984-1999. See also Al-Jihaz al-Markazi li al-'Ihssa', (Sudan: Bank of Sudan, 1999).

As can be seen from the above table, *murabahah* is more commonly used than any other mode. Despite its increase, it is noted that the practice of this mode declined from 53% in 1996 to 50% in 1999 and further to 30% in 2000 according to the policy issued by the Central Bank to decrease the use of this mode. Moreover, by issuing this policy, it is expected to abolish the use of this mode by all Sudanese Islamic banks in the coming few years (Ibrahim, p. 1). In addition, the decrease of the *murabahah* in the year 2000 led to an increase in the other modes. For example: *musharakah* increased from 30.8% in 1999 to 42% in 2000, *mudarabah* from 4.1% in 1999 to 6% in 2000 and *bai' al-salam* from 5.1% in 1999 to 15.8% in 2000.

The mechanisms used to decrease the use of the *murabahah* mode by all Islamic banks in Sudan and the consequences of this policy are quoted below as provided by the Bank of Sudan (Ibrahim, p. 2).

Decreasing the share of *murabahah* in Sudan is carried out through various mechanisms: First, by decreasing the *murabahah* margin in the annual financing (credit) policy of the Bank of Sudan; second, by imposing certain procedure conditions on the *murabahah* application so as to make it difficult for the bank and unappealing to the client; and third, by the periodical review of the local bank's statistical reports and the share of the *murabahah,* and thus imposing sanctions on the bank.

The consequences of this policy are as follows: First, it deepens the Islamisation of the banking system in Sudan; second, it increases the share of *musharakah* and other modes; third, it increases the return on investment for the banks; fourth, it leads to a greater supervision on the finance (lending) operations by the bank, which is rare under the *murabahah;* and fifth, although clients like *murabahah* because it gives them more autonomy over their business, they began to accept and even like *musharakah*.

So, by decreasing the share of *murabahah*, the Sudanese Islamic banking succeeded in increasing the share of other Islamic financial modes as seen in the above table. Besides, people started to accept and like the *musharakah* mode. If Sudan succeeds in abolishing the *murabahah* mode from all Sudanese Islamic banks and resorting to *mudarabah* or *musharakah* partnerships as suggested by El-Najjar, the

Sudanese Islamic banks will become rather similar to the American Venture Capital Companies.

The second mode of finance in the Islamic banks is *al-musharakah* (partnership). This mode is like a joint venture between the bank and an investor. In this case, each partner provides a part of the capital and shares the profits or losses in a ratio agreed upon in advance. As can be seen from the table above, *al-musharakah* is the second mode used widely in almost all Islamic banks after *al-murabahah.* Although the practice of this mode started to decline from 32% in 1996 to 21.1% in 1998, it again increased to 30.8% in 1999 and, due to the new policy of decreasing the *al-murabahah* mode, the *musharakah* mode increased again to 42% in 2000, thus becoming the most important instrument.

In Sudan, *al-musharakah* is widely used in financing the agricultural and industrial sectors. In the case of financing the agricultural sector, the banks provide small farmers with fixed assets such as tractors, ploughs, harrows, water pumps and inputs, e.g. seeds, fertilizers, pesticides and fuel. The farmer, on the other hand, contributes with his land, labour, part of the running expenses and management. The farmer gets a proportion of the net profit for his management and the remaining profit is divided between the bank and the farmer according to their equity share (Al-Harran, 1993, p. 274). During the 1986-1987 period, 868 *musharakah* contracts were signed with small farmers for the cultivation of about 3900 *feddans*. This experience proved a success since farmers realised unprecedented profits. Besides, the bank gained a very good profit compared to similar institutions (Mahmod, p. 191).

Al-musharakah is also known as *al-muzara'ah* (sharecropping). But in this case, the bank provides the land and machinery to the farmer, the farmer cultivates the land, and they share the output in pre-arranged proportions (Robertson, 1987, p. 1, pp. 82-125; Research Center, 1993, p .48). However, all local Sudanese Islamic banks are reluctant to use this mode because of its high risk, since Sudanese agriculture is exposed to high threats such as drought or flood, pests and other threats. Another problem with *al-muzar'ah* is that the prices of agricultural crops fall drastically at the time of harvest. All these, in turn, lead to poor production, decrease the return on the capital employed or even result in loss. Moreover, *al-muzar'ah* requires close supervision and follow-up, a matter which increases the transaction costs of the bank (Ibrahim, p. 3; Haque, 1984, pp. 1-41).

In the case of financing the industrial sector, the Islamic banks provide capital to the owners of the industries, and the owners, on the other hand, contribute with their industry, labour, part of the running expenses and management (Ahmed, 1990, p. 93). The industrialist also gets a proportion of the net profit for his management, and the remaining profit is divided between the bank and the industrialist according to their equity share. Through *musharakah* contracts, the Islamic banks succeeded in providing capital to the industrial sector for the purchase of raw materials, machinery and equipment. Moreover, the Islamic banks diversified their industrial investments as they entered, as a provider of capital, in different long-term projects. These included food factories, plastic factories, printing presses, drugs factories, spare parts for petroleum refinery, sugar factories, and railway corporations (Ahmed, p. 93). In addition, they enhanced the small-scale industries in Sudan which are believed to play an important role at the present, more labour-intensive stage of development. The Islamic banks opened specialised branches in one of the biggest industrial areas in Khartoum to develop the handicraft sector (Ahmed, p. 96).

The third mode of finance in Islamic banks in Sudan is *Mudarabah* (Çizakça, 1996, pp. 10-12). In this case, the bank acts as the principal *rabb al-mal* and the client as a *mudarib*. The bank provides the entire capital and the client the expertise, management and labour. Profits are shared by the bank and the client in a pre-arranged proportion, but when a loss occurs, the total loss is borne by the bank (Shaaeldin and Brown, p. 22; Al-Harran, pp. 59-60).

This mode of finance is the most recommended form in Islam since the Prophet himself used it. Its practice in the Islamic banks in Sudan gained importance since 1997 when it increased from 2% in 1996 to 5.4% in 1997 and further to 6.1% in 1998. However, it declined to 4.1% in 1999 and started to increase again to 6% in the year 2000 after the new policy of decreasing *al-murabahah* mode to 30% on all Sudanese Islamic Banks was imposed. As can be observed from Table 3, its practice fluctuated, i.e. increased, decreased and again increased. This makes us ask the following question: Why in the first place is not *mudarabah* rather than *murabahah* widely used in Sudanese Islamic banks? The answer to this question lies in the lack of a good supervisory body to follow up the client, which in turn creates the following problems. Using this mode without a good supervisory body imposes a double risk on the bank: First, the moral hazard that arises from the client declaring a loss or profit is lower than the actual one because of lack of honesty; second, the business risk, which arises from the behaviour of market forces, is different from that expected (Al-Harran, p. 144). Besides, the lack of a good supervisory body to follow up the client resulted in the abuse of the loan meant for development projects. For example, the farmer who receives a loan for the purchase of seeds to cultivate his land may choose the easy way of buying the seeds and selling them at a higher profit on the black market. In so doing, he gets his agreed profit without cultivating his land and without bothering himself with the running expenses on cultivation.

The fourth mode is the *bai' al-salam* (postponed delivery). In this case, the client pays the bank the full negotiated price of a specific product which the bank promises to deliver at a specified date. This mode is limited to products whose quality and quantity can be fully specified at the time the contract is signed (Tail, pp. 100-101). Although this mode increased from 4% in 1996 to 8.4% in 1997, it decreased again to 3.7% in 1999. But due to the decrease of the *murabahah* in 2000, it again increased to 15%.

Al-qard al-hasan is an interest-free loan. In this case, the bank provides this loan to the client but earns no profit at all. Repayments are made over a period agreed by both parties (Shaaeldin and Brown, p. 22; Al-Harran, pp. 98-99; Tail, pp. 106-107). This is the only loan permitted by Islamic principles. This mode of finance is usually granted to finance a number of agricultural projects (Ahmed, p. 95). The *Al-ijarah* mode is a lease contract under which the bank leases equipment or a building to one of its clients against a fixed charge (Research Center, pp. 35-36). Regarding the *al-muqawalah* mode, the bank plays an important role in encouraging small entrepreneurs to be active members in the society. For example, if a farmer has an agricultural land that has been left uncultivated for a long period of time, the bank will provide all the operational expenses necessary to cultivate this idle land. In return, the farmer has to pay the bank the negotiated amount of money in agreed monthly installments. In the case of the *al-istisna'* mode, the entrepreneur pays the full negotiated amount of money to the bank and the bank has to provide him the return in fixed assets such as building, industry or the industrial equipment needed. *Al-qard al-hasan*, *al-ijarah*, *al-muqawalah* and *al-istisna'* are used in the Islamic banks in Sudan. Due to the lack of data on each mode, they were grouped together. Table 3 shows that their use started increasing from 9% in 1996 to 11.6% in 1997 and further to 12% in 1998. However, they declined to 10.9% in 1999 and further to 6.2% in the year 2000. This can be attributed to the big increase in *Musharakah*.

3.4. Similar Practice of Venture Capital in Sudan

Venture Capital (VC) is a financial institution and a method of investment. One of its most remarkable characteristics is the fact that it prefers financing young entrepreneurs or start-ups that are usually rejected by the conventional institutions of finance (Murat Çizakça, 2000, p. 105). In other words, these are entrepreneurs who may have excellent ideas but no business experience and they may not be able to submit to the banks sufficient collateral or guarantee (Çizakça, 1996, p. 50). This is one of the remarkable characteristics of VC for which, unlike traditional banks, collateral is not the most important criterion. What matters to the VC is the management team, the product itself, its potential marketability and the expected profits (Çizakça, 1996, p. 51).

The function of the VC Company is basically similar to that of the Islamic bank. The function of the Islamic banks is similar to the companies to the extent that they use *mudarabah* and/or *musharakah* partnerships and they differ from them to the extent that they use the *murabahah* (Çizakça, 1996, p. 203). Venture Capital is basically a two-tier partnership. In the first stage, it functions as an agent for those who provide it with capital, for example small business administrations, pension funds, private sector and banks, and philanthropic foundations. In the second, it becomes a principal for entrepreneurs to whom it provides capital. At this stage, the venture capitalist enjoys enormous power in determining which idea and which entrepreneur will be supported by the company. This implies that any entrepreneur who wishes to be financed by the venture capitalist has to work very hard to persuade him. Only then can the venture capitalist choose the entrepreneur and finance is provided to him through equity finance, i.e.

the entrepreneur is asked to form a joint-stock company and a certain portion of the shares of this company is purchased by the venture capitalist. The profit generated is then distributed between the venture capital sector and those who provided the capital in the first place in a ratio of 20:80 (Çizakça, 2000, pp. 105-111).

The success of this type of venture capital in the United States in the last three decades has encouraged Europe, Germany, East Asia and Turkey to introduce it to their financial institutions. In a similar way, Sudanese Islamic banks can practice venture capital in the agricultural sector if they resort to *mudarabah* and/or *musharakah* partnerships rather than *murabahah*. For example, in 1988, the Sudanese Islamic banks financed young entrepreneurs (farmers) who presented good projects to improve their situation. To help them, the SIB imported battery cages from Holland and one-day-old chicks. These banks kept the chicks in special farms and looked after them till they were 4 months old and started to lay eggs. After that, the SIB distributed 300 chickens to 30 families who were in a difficult financial situation, and this number increased to 100 families at the end of the year. Due to the sophisticated and risky poultry system for these destitute families who did not have any prior training and guarantees, the bank signed a contract with the Ministry of Social Welfare for their training and supervision. Inputs were provided on the basis of *al-murabahah* and the families were required to repay in fourteen monthly installments (Al Harran, p. 280). By so doing, the bank intended to expand this project to more needy families. After a while, this project was successful and the SIB managed to expand it to 195 families in 1990, and further to 255 in 1992 (Mahmod, 1990, pp. 194-195; Umar, 1996, p. 35). This, in turn, generated cash income and increased the living standards of some of the poor families. Besides, it changed the situation of the destitute families from dependent to independent and they became productive members in the society. One of the examples which shows that the SIB really bore the risk of loss in this project was the flood that occurred in 1988 and killed almost all the chickens which were in the hands of 100 poor families. Due to these losses, the bank again gave each family 50 chickens, and appointed some people to help them (Umar, p. 36).

Taking this as a successful experience, as it improves the situation of some of the destitute families the Bank of Sudan imposed, in the 1990s, a new credit ceiling policy for all SIBs such that 15% of this credit had to be allocated to the financing of small farmers and small businesses (Annual Report, 1998, pp. 46-50). In the last decade, this policy encouraged all SIBs to expand this type of finance to include more needy families through the following steps. First, the client (needy person) has to conduct several meetings with the bank and provide the bank with a successful project that must include a detailed description of the type of work the client would like to do and the amount of money he/she would like to borrow from the bank. Only then would the bank agree to finance the client on the following basis. If the amount of money needed is less than one million Sudanese Dinars, then the guarantee can be a check from a third party. In case the amount of money needed is more than one million Sudanese Dinars, the guarantee must be in the form of real-estate, machinery or stored commodity mortgage. After that, the bank provides the inputs (such as chicken, transport vehicles or others) on the basis of the *murabahah* mode. In the case of financing the purchase of chicken, the client has to repay the bank in twelve monthly installments with a profit of 1.25%. If the client fails to repay the bank, the bank will then take the check of the third party guarantor which includes the amount of borrowed money plus the profit. In the case of transport vehicles' financing, the client has to repay the bank in eighteen monthly installments with the same profit of 1.25%. And in case the client fails to repay the bank, the bank will then confiscate the mortgaged vehicle.

Although financing small farmers and small businesses is needed to improve their situation, yet we believe that if this type of financing is changed from the *murabahah* to *musharakah* or *mudarabah* modes, it will be similar to venture capital which proved its success in western countries. Moreover, the new policy of the Central Bank of Sudan that declares the decrement of the practice of the *murabahah* mode from all Islamic banks to 30%, as mentioned above, will help in this regard.

4. THE CONTRIBUTION OF SUDANESE ISLAMIC BANKS TO SOCIO-ECONOMIC DEVELOPMENT

The Sudanese Islamic banks serve as a means of gathering savings in a pool, investing it and directing it to finance the different sectors. As mentioned earlier, their success in attracting many people who did not like to deal with conventional banks that operate on the basis of *riba* increased the amount deposited with them. Hence, these Islamic banks act as a financial institution that helps to develop small projects in the agricultural, industrial, crafts, and social sectors. Table 4 shows the contribution of the Sudanese Islamic Banks to the financing of different sectors from 1992 to 1999.

Table 4: The Contribution of Sudanese Islamic Banks to the Financing of Sectors
(Millions of Sudanese Dinars)

Type of Sector	1992	1993	1994	1995	1996	1997	1998	1999
Agricultural Sector	4.4	7.2	14.0	11.6	35.6	50.0	62.6	52.0
Industrial Sector	2.0	3.2	7.2	10.4	25.2	28.6	35.6	38.6
Services & Social Sector	2.6	4.0	9.2	10.6	36.0	42.6	48.6	49.2

Source: Calculated form, Bank of Sudan, Al-Masrafi, No. 19, Khartoum, 1999.

One of the main objectives of the Sudanese Islamic Banks is to finance the needy sector, especially the agricultural sector, which employs 70% of the labour force. As can be seen from the above table, the contribution of Islamic banks to financing the agricultural sector has increased from 4.4 million Sudanese Dinars in 1992 to 52 million Sudanese Dinars in 1999.

To enhance this sector, some of the Islamic banks, such as the Faisal Islamic Bank, the Islamic Co-operative Development Bank, and the Agricultural Bank, provided financial help in different ways. They financed small farmers in various regions to help them prepare for cultivation of their idle lands that had been left uncultivated for a long period (Al-Harran, p. 275). Moreover, they provided them with machinery, irrigation pumps and agricultural equipment. This, in turn, encouraged farmers to work hard and at the same time created new job opportunities for many unemployed workers.

The Sudanese Islamic Banks also contributed to the industrial sector. As can be seen from the above table, their contribution to financing the industrial sector increased from 2 million Sudanese Dinars in 1992 to 38.6 million Sudanese Dinars in 1999. In this case, the Sudanese Islamic banks provided financial support for the purchase of raw materials, machinery and industrial equipment. They also financed the small-scale industries and, hence, increased the need for more labour force.

The Islamic banks also contributed to the services as well as the social sectors. This is clear from the above table, since their contribution to financing these two sectors increased from 2.6 million Sudanese Dinars in 1992 to 49.2 million Sudanese Dinars in 1999. Their contribution to the services sector was remarkable since they helped to import 1,300 freight transport trucks and a number of coaches, altogether worth more than $18 million. Moreover, the Islamic banks contributed to the establishment of one of the successful passenger transport companies which links the capital with different regional towns and rural areas (Al-Harran, p. 95). Regarding the social sector, the Islamic banks contributed to it in many ways. First, they gave *zakah* to individuals and institutions in order to narrow the gap between the rich and the poor. They succeeded in collecting from the deposit accounts *zakah* that was due and transferring it to *Diwan al-Zakah* for distribution according to Islamic law. For example, in 1995, the amount of *zakah* collected from all Islamic Banks reached 13 million Sudanese Dinars. This amount was then forwarded to *Diwan al-Zakah* for distribution. It was distributed to 19,360 families in 7 regions as follows (Diwan al-Zakah, 1995, p. 78). It financed 13,729 families with cash money, provided 1132 carriages, 351 small shops, 41 fishing boats, 97 noodle machines, 243 chicken cages, 1688 agricultural projects, 152 coal yards, 420 vegetable tables, 57 traditional plows, 45 water suppliers, 1160 ateliers, and 245 sewing machines (Diwan al-Zakah, 1995, pp. 78-90). According to *Diwan al-Zakah*, these families, having been endowed with these productive tools, became productive and instead of being *zakah* receivers, became *zakah* givers in 1996/1997 (Diwan al-Zakah, 1997, p. 49). Second, banks financed on a *musharakah* basis about 174 families who fled their homes because of the war. With the help of those banks, those people managed to cultivate about 3000 *feddan* (Mahmod, pp. 191-192) and, hence, became active factors of production instead of being unemployed and a heavy burden on the society. Third, the Sudanese Islamic banks also contributed to the education sector by providing new subjects in Islamic banking to be taught at both college and university levels. They also contributed to the Islamic culture by publishing and issuing periodical magazines and books concerning Islam in general and Islamic banking in particular (Al-Haaj and Shatah, p. 11). Fourth, relatively speaking, they also contributed to solving the problem of unemployment since they employed more than 6200 people within twenty years. Moreover, they enhanced the development of human resources by sending their employees to acquire greater skills and experience in Islamic banking in various Islamic countries (Al-Haaj and Shatah, p. 12). They also contributed to the government treasury. According to the Sudanese Economic Report, the total amount of taxes paid by all Islamic Banks increased from 32 million Sudanese Dinars in 1997 to 78 million Sudanese Dinars in 1998, and further to 102 million in 1999 (Sudanese Economic Report 1999, pp. 74-134).

5. CONCLUSION

The last three decades witnessed the establishment of the Islamic Banking System in Sudan. Its main objective is to invest the funds entrusted to them through profit and loss sharing partnerships and to avoid dealing with interest (*riba*) which is forbidden in Islam. To some extent, the system succeeded in minimising dealing with *riba* through resorting to *murabahah, mudarabah, musharaka, ijarah*, etc. Undertaking business and trade activities on the basis of lawful and permissible profits encouraged more savers to deposit their money in such banks. This, in turn, encouraged the Sudanese government to convert all existing conventional banks into interest-free banks at the beginning of the 1990s. Moreover, more Islamic Banks and branches were opened in all the regions of Sudan. This increased the amount deposited by savers and, hence, the financing and promotion of the agricultural, industrial and social sectors. We hope that by resorting to *mudarbah* and *musharaka* and decreasing dealing with *murabaha*, the Sudanese Islamic banks can manage to lift dealing with interest totally and become successful venture capital banks in financing bigger developing projects.

REFERENCES

Ahmed, Osman. “Sudan: The Role of the Faisal Islamic Bank”, in *Islamic Financial Markets*, ed. Rodney Wilson (London and New York: Routledge 1990).

Arrif, Mohamed, “Islamic Banking”, Asian-Pacific Economic Literature, Vol. 2, No. 2 (September 1988).

Bank of Sudan, *The Thirty Seventh Annual Report*, (Khartoum: Bank of Sudan, 1997).

--------, *The Thirty Eighth Annual Report*, (Khartoum: Bank of Sudan, 1998).

--------, *The Thirty Ninth Annual Report*, (Khartoum: Bank of Sudan, 1999).

The Bank of Khartoum, *Summary of the Islamic Financing Forms*, (Khartoum: Bank of Khartoum, n.d.).

Bashir, Bakri, ‘Abdul Rahim and Malik, Muhammad Ahmad Faraj. *Majalat Istithmar al-Jihaz al-Masrafi wa-Furas Tamil al-Tanmiyah bi al-Siyagh al-Islamiyyah* (Khartoum: Faisal Islamic Bank No. 10, 1987).

Diwan al-Zakah, *Dalil al-Zakah*, (Khartoum: Diwan al-Zakah, 1995-1997).

Abdul Gafoor, *Interest-Free Commercial Banking* (Petaling Jaya: A.S. Noordeen, 1996).

Al-Haaj, Isam Salih and Shatah, Jamilah Ahmad. *Sudanese Islamic Bank; Facts and Figures*, (Khartoum: Bank of Sudan, 1987).

Hamid, Abdul Jawad. *Al-Nizam al-Qanuni li al-Bunuk al-Islamiyyah* (Virginia: al-Ma‘ had al-‘Alami li al-Fikr al-Islami, 1996).

Hamdi, Abdul Rahim. “Tajrubat al-Bunuk al-Islamiyyah,” *in al-Islam fi al-Sudan*, ed. by Jama‘t al-Fikr wa al-Thaqafah al-Islamiyyah, (Omdurman: Dar al-Asallah, 1982).

Hamdi, Mohamed El-Hashmi. The *Making of an Islamic Political Leader* : *Conversations with Hassan al-Turabi*, (Boulder: Westview Press, 1998).

Haque, Ziaul. *Landlord and Peasant in Early Islam: A Study of the legal Doctrine of Muzara'ah or Sharecropping* (Islamabad: Islamic Research Institute Press, 1984).

Haron, Sudin. *Islamic Banking: Rules and Regulations* (Kuala Lumpur: Peladuk, 1997).

Al-Harran, Saad Abdul Sattar. *Islamic Finance: Partnership Financing* (Petaling Jaya, Pelanduk Publication 1993).

Ibrahim, Faisal Ahmad. "Notes on Sudanese Islamic Banking Experience," (Bank of Sudan, May 2001).

Bank of Sudan, Al-Jihaz al-Masrafi al-Sudani, 1994.

Mahmod, Rashid Ali."The Role of Islamic Banks in Economic and Social Development with Particular Reference to the Sudanese Experience." Ph.D. diss., Glasgow College, 1990.

Ministry of Finance, *Sudanese Economic Report 1996-1999*.

Murat Çizakça, "Achievements of Venture Capital and its Potential in Emerging Markets with Specific Reference to Turkey", in *Özel Finans Kurumları*, 17 (Istanbul: Mecidiyeköy, 2000).

Murat Çizakça, *A Comparative Evolution of Business Partnerships; The Islamic World and Europe, with Specific Reference to the Ottoman Archives* (New York: EJ. Brill, 1996).

El-Najjar, Ahmed. *Harakat al-Bunuk al-Islamiyyah: Haqayiq al-Asl wa-Awham al-Suar* (Cairo: Sibrint, 1993).

Rabooy, Mohammad Ebrahim. "Islamic Banking in Theory and Practice", (Ph.D. diss., Exeter University, 1988).

Research Center, *Bank al-Tadamn Al-Islami* (Khartoum: Fatwa and Research, 1993).

Robertson, A.F. *The Dynamics of Productive Relationships: African Share Contracts in Comparative Perspective* (London: Cambridge University Press, 1987).

Shaaeldin Elfatih and Brown, Richard. “Towards an Understanding of Islamic Banking in Sudan: The Case of the Faisal Islamic Bank” in *Sudan: State Capital and Transformation*, (London: Biddles Ltd, 1988).

Sudan, *Taqwim Ada’ wa Kasb Thawrat al-Inqadh al-Watani Khilal ‘Asharah ‘Awam, 1989-1999*.

Tail, Mustafa Kamal al-Sayed. *Al-Bunuk al-Islamiyyah: al-Manhaj wa al-Tatbiq*, vol. 1 (Cairo: Dar al-Wafa’, 1988).

Umar, Al-Hadi Matar. “Mashari al-Usar al-Muntijah: Tajrubat al-Dawajin” (Khartoum: Sudan University, 1996).