



**BANKING FOR PROGRESS – FINANCIAL INCLUSION OF
THE ROMA**

May 24. 2012, Crowne Plaza Bratislava

Kiútprogram – Way out of poverty

**Lessons of an Employment-Generating, Social Microcredit
Programme**

1. The Vision of the Programme

The **objective** of Kiútprogram is to *enable people living in deep poverty – primarily Roma – to become self-employed* by providing them with social support, financial services and information; and as a result, *help them improve their social status and make a living for themselves and their families*. The most important *tool* of our financial services is issuing group-based, unsecured *micro loans*.

The primary mission of Kiútprogram is to facilitate social mobility and integration of the Roma. The most important specific goal of our operation is to see our clients establish sustainable businesses that connect into the regular flow of local economy. At first, it may seem strange that repayment of the loans is not the most crucial aspect of a micro-credit institution. Of course, a possible highest repayment rate is a vital factor, however, having a full repayment rate while the launched businesses fade away would be a definite failure.

For this reason, *our programme should be benchmarked against job creation or employment expansion programmes* instead of being compared to the activities, profitability or return rates of micro-credit organisations. To really serve the social advancement of the target group, several additional services should be provided in addition to lending, and a continuous presence is necessary in the field. This is a costly operation that could never be profitable or break-even in a business sense. Business profit is not the goal of Kiútprogram, however, *social profit* is its long-term goal, i.e., the taxes and contributions paid by the clients, welfare aid not paid and other costs not incurred by the social disintegration of the target group would altogether outweigh the costs of the programme. Therefore, in order to differentiate us from businesslike microlending, we describe our model as *social microlending*.

An important issue to clarify is why we chose social microlending as the tool of our mission, i.e. facilitating the social mobility of the poor and helping with the economical/social integration of the Roma. We need to add some background notes about the situation of the Roma in the former socialist countries of Eastern- and Central Europe without going into too many details since the reader of this study is already well aware of this problem. In addition, characteristics can greatly differ in various countries. This is why we only highlight the most important patterns in connection with our concept.

2. Why We Chose Microlending

Before the regime change, due to the formal system of universal employment, the employment rate was relatively high among the Roma, especially the Roma males. Most of them were employed in the industry, worked as unskilled workers in the construction industry; in some places they found employment in the agriculture, although not as members of the co-operatives. At the same time, large-scale industrial work and commuting destroyed Roma traditions and social connections in many communities. Integration into industrial work often led to subordinate relations.

The decline of economy, particularly of the industry, the shutting down of factories and the emergence of mass unemployment that followed the regime change hit the Roma population the worst. Their employment rate is far below the rate of non-Roma groups; a major cause of this is the low education level of the Roma. Since the service sector was disproportionately weak in the socialist countries compared to their development levels, service industry could not replace the jobs vanishing from the industrial and (in some regions) agricultural sectors.

These events also intensified regional segregation. People of higher social status with better financial background started to move to places with better employment opportunities, while poor people (with an increasing proportion of them belonging to the Roma) concentrated in certain disadvantaged former industrial – especially heavy industrial – areas where development potential was lacking; peripheral rural areas; or urban ghetto-like segregated settlements.

In some areas, there have been no significant improvements for decades; both local and foreign investors have avoided these areas and the economy stagnates. The theory that many assumed at the time of the economic downturn following the regime change has proved to be an illusion, namely that the economic growth will reach the wealthier classes first; then, it will reach the middle class; and as the growth speeds up and becomes steady, its benefits would also spread to the poor.

This has not been the case: economic growth did not result in the ascension of the poor. There seems to be no real hope for larger-scale regional development programmes or investments targeting job creation in disadvantaged areas. The current economic crisis worsened the situation even more.

Regional segregation and the spreading of poverty also resulted in an increased level of ethnic discrimination that further deteriorated the situation of the Roma. In many places, the

assumption emerged that the Roma do not actually want to work – at the same time, they are also often the targets of workplace discrimination.

Considering the current situation, our hypothesis is that the development of micro- and small businesses could be a viable step forward. Becoming an entrepreneur is an option that has no real alternative in certain areas of the affected countries at the present – except for state-sponsored employment programmes. Another rationale for this idea is that the ratio of small businesses in the former socialist countries is relatively low compared to Western Europe where these entrepreneurial units have a fundamental role in employment. This is especially valid for a large part of the Roma population whose traditions make it easier to become an entrepreneur or primary producer than becoming an employee.

3. The Subject of the Pilot and What Can We Learn

One of the biggest – though not exclusive – obstacles of starting a micro business is the lack of capital. (We will get back to other factors later.) Thus it was obvious to test if the microlending model¹ initiated by Mohamed Yunus was viable under our circumstances. This model has been adapted with success at many locations, albeit mostly in developing countries. Could this be applied for the benefit of the poor in Central and Eastern Europe, in particular the Roma living in severe deprivation?

Mohamed Yunus launched his experiments in 1976, providing *unsecured* loans of relatively small amounts to people living in deep poverty in order to enable income generation. He established the Grameen Bank in 1983 after processing and assessing the results of early initiatives and considering the fact that traditional commercial or investment banks are not willing to serve the poor. During the years before establishing the Grameen Bank, he introduced another innovation of fundamental importance, *group-based lending*.

Since then, the original method – or its modified version – had been tried and successfully applied by thousands of organizations in almost one hundred countries, but the number of failed attempts is not low either, and this makes the careful analysis of lessons learnt particularly important. What's more, the majority of successful adaptations took place in undeveloped countries where conditions significantly differ from ours.

In the following chapter, we briefly review the details of the Grameen model, however, first we go over the most important external circumstances that require the adaptation (appropriate modification) of the model. In this step, we primarily describe the conditions in Hungary -

because there are no significant differences compared to other former socialist countries in these aspects.

1. The most important characteristic differentiating the former socialist countries from both developing nations and developed market economies is the existence of a “prematurely born welfare state” (concept by János Kornai). A welfare state sustains a benefit system that provides a safety net of some sort. The level of this “safety”, however, is very basic compared to developed market economies; it does not enable the reproduction of manpower at the level necessary to re-enter the workforce of a modern economy. Thus we have a double effect here: on one hand, welfare benefits have a counterproductive influence on getting employed, on the other hand, living on these benefits long-term gradually makes the beneficiary more and more unfit for work. The amount of benefits does not allow for training, self-education, the maintenance of social relations, or the effective conservation of good health. Long-term unemployment not only damages one’s health, but also has a negative effect on the individual’s personality.

According to our experiences, some politicians and a part of the general public tend to significantly exaggerate the counter-employment effects of welfare benefits. This effect could be more significant in developed countries where unemployment benefits provide an acceptable standard of living. However, during our work we found that there is a very strong wish and willingness to work among the majority of the Roma (and non-Roma) people living in deep poverty. In some regions, there are simply no long-term employment opportunities. Furthermore, the negative effects of long-term unemployment hinder employment even if an opportunity comes up.

2. The low development level of developing countries demands unqualified work at a large scale. The highly developed service sector of developed countries also offers many relatively unqualified jobs. Former socialist countries stand somewhere in the middle, since there is a relatively low demand for unqualified work in the legal job market. (There are significant differences among countries in this aspect.) The Roma are in an even more complicated position since discrimination in employment is a common phenomenon, especially in the service sector.
3. Due to the relatively developed status of the former socialist countries, launching a new business requires more capital than in developing countries. If we aim at job creation via self-employment then a bigger loan should be issued than the typical amount in a developing country.
4. Entrepreneurs must face with a level of bureaucracy that is incomparably higher than in developing countries. Bureaucratic hurdles are almost impossible to overcome for people

with low-level education without assistance. When running official errands, the Roma often face discrimination.

5. In a significant segment of developing countries, taxation is inefficient in low-income brackets. In former socialist countries, this is less characteristic, however, the presence of the informal – or “hidden” – economy is also prevalent here. Income generating microlending very often creates businesses operating in the informal sector. We are convinced that this method is not a real solution to break out of deep poverty.¹ It might be suitable for somewhat improving living standards, but unsuitable for breaking out of poverty. Often, working in the informal sector actually increases vulnerability and carries many risks. If social contributions are not paid, health risks become especially huge, furthermore, people working in the informal sector will not receive pension either. However, operation in the formal economy carries an obligation to pay very high taxes and contributions. This necessitates different lending methods and bigger loans than in the original model.
6. Significantly fewer clients are involved in former socialist countries than in developing nations; this has a definite influence on the efficiency of operations. The number of clients and density of the poor are notably lower. In addition, the Roma are often less integrated into the fabric of society. Integration of the Roma might require a different approach than microlending to majority population.
7. Lessons in microlending as defined by Yunus gave way to the idea that it is also possible to base profitable service on lending to the poor. Just like in developing countries, microlending institutions emerged in former socialist countries, providing loans in small amounts mostly for consumer purposes at a high interest – albeit somewhat lower than local usurers. The operations of these financial institutions caused a high level of distrust towards any new lending institutions.

The primary question of the pilot is to explore if –despite all the above listed difficulties and peculiarities – microlending is applicable to people living in deep poverty, especially the Roma in former socialist countries; and define the circumstances and conditions under which the model can be viable. The following issues needed to be clarified:

¹ Our finding is supported by international experiences, for example, see Milford Bateman (2010): Why Doesn't Micofinance Work?, Zed Books, London, New York. Bateman challenges the notion that microlending decreases poverty in other aspects, too; he is also critical of the current practices. The majority of his criticism does not apply to our model.

- Identify the *optimal target group* of the model;
- Identify the *best methods*; find out if group-based lending applicable, and how;
- Identify the *optimal organisational structure*;
- Identify the *environmental, regulatory conditions* necessary for successful operations;
- Find out if the *method is efficient*; what results can be expected at what costs?

In the following, we look for the answers to these questions based on our experiences with Kiútprogram. As an initial note, we need to clarify that we do not have final answers to all questions, mainly because our programme has not ended yet. Due to the shortness of the pilot, many questions will remain unanswered. An important lesson is that before regular operations, the pilot needs to run for at least 3 years instead of the 2-year pilot we had.

There is no detailed impact study yet, and several aspects of the programme have not been processed yet. This work is still ongoing, and we plan to complete a book within a couple of months with a lot more details than this study has.

Nonetheless, we already have plenty of experience and knowledge regarding the necessary conditions under which it is worth considering the application of the model in other countries. We chose Slovakia as the first location to present the programme because the social/economical conditions and the situation of the Roma in Slovakia are - despite many important differences² - similar to the situation in Hungary³.

In the following, first we briefly summarise the original model of the Grameen Bank, then describe our expectations before starting our own programme. While defining expectations, we reviewed – at least – a part of the existing huge amount of literature and the results of other programmes, too (we do not include the latter in this short summary).⁴

This section is followed by the review of operations from multiple aspects, the external and internal circumstances and the description of necessary modifications made while implementation was underway. Finally we summarise lessons learnt so far. In the summary, we focus on aspects significant for further adaptation and implementation in other countries.

² Almost exactly a year ago we already held an introductory presentation at the *High Level Event on Structural Funds contribution to Roma integration in Slovakia* event, however, this is the first time when we can report thoroughly justified results.

⁴ Regarding specific feedback on Europe, our most important synthesizing source was the closing study of an EU research program conducted by the organization called *Microfinance Centre for Central and Eastern Europe and the New Independent States*.

4. A schematic review of the original Grameen model

1. The essence of the Grameen model is to provide financial services, fundamentally loans and information to those living in deep poverty in order to enable them to *utilise their own resources* to rise from their permanently disadvantaged living conditions. The primary prerequisite of success is mutual *trust* in addition to the loan given in the form of financial *capital*. Trust in the loan recipients, meaning that they will be able to reach their goal and building trust towards the loan provider that it will not draw advantage from its partner's difficult situation.
2. The process starts when the field worker of Grameen Bank arrives at the settlement and searches for people of the applicable social group who are interested in the project. The core of the credit providing activity is a *voluntary, self-nominated* group of five loan recipients where the traditional safeguards required by banks are replaced by mutual ethical commitment. The inner group leader has a prominent role. He/she is usually the first of those actively interested. After he/she committed to the programme, the field worker often finds the other four group members by using his/her assistance.
3. In case of the first loan, credit can be used *solely* to finance income-generating activities, i.e. launching a business. The business idea comes from the credit recipients in all cases. The entrepreneurial activities of the group are independent from each other, however, each member should approve of the business plan of everyone else.
4. Loans are granted following a one-week course with the purpose of getting applicants informed about the entire process. There is a verbal exam to ensure that the applicant understands the process, conditions, and takes responsibility in order to meet the conditions. Another objective of this is to filter out applicants who are not willing to make a real effort. The course is not a formal lecture but an interactive discussion of the whole process in a group setting. The exam is not formal either, rather a checkpoint to see if applicants really understand how the system works.
5. There is pre-set upper income/property limit of being accepted in the programme. The objective is to avoid accepting relatively less disadvantaged applicants who could take the places of those in deep poverty. Regardless of ethnicity or religion, anyone can be accepted if he/she is under the poverty line.
6. At the startup, two members of the group receive the loan. Repayment starts in the first week, the field worker meets the groups every week. If the first two loan recipients make

the payments on time, loans will be granted to another two group members after 6 weeks, then the group leader gets the loan after another 6 weeks. If a member does not make a payment as approved in the first 6 weeks, he/she is dropped from the group and the others must find someone else as a replacement. Loans will not be issued until the dropout member is replaced.

7. To ensure the simplicity and transparency of the system, the maturity of the loans is uniformly 50 weeks. If someone takes a loan of 1000 units, then he/she repays 22 units per week, i.e. repays 1100 units within 50 weeks, which is a little less than 20% annual interest rate. The amount of the loan is flexible within a pre-set upper limit. It is also possible to finance repayments in the first weeks if someone starts a business that is not profitable immediately.
8. Loan recipients must make a deposit 5% of the received loan to the joint group fund. This serves as an emergency reserve in case of unexpected situations, which can be used at the group's discretionary decision. In addition, the bank offers – specifically encourages – saving opportunities.
9. The field worker, a key player of the system, is a mix of a social worker and a credit advisor. In addition to searching for and identifying credit recipients, he/she also assists with the creation of the groups, the analysis of business ideas and helps evaluate if necessary conditions are met. He/she checks if transactions are on the right track, helps groups eliminate problems, and takes responsibility for the regular and timely repayment of the loan. Holds a meeting for the groups locally every week. Granting of the loan and repayments are conducted in front of the publicity of the meeting as well as the discussion of issues emerged and the acknowledgement of results achieved.
10. An important goal of the meetings is to discuss certain commonly accepted living guidelines, increasing self-confidence and acknowledging success.
11. If the first loan is repaid as agreed, the loan recipient may be granted a loan, which is larger in amount or is for a different purpose. Loans are still not granted for consumption, different purposes include the improvement of housing conditions and schooling of children, exclusively.
12. One of the most problematic points of the system is the situation when almost every group member received the loan and one of the members does not repay. If there is an emergency situation, then the group fund can be used or another loan can be granted as a

last resort. These solutions are for emergency only. The group fund can also be used in case of a temporary halt in the operation of one of the businesses, provided that all other group members are convinced that this step will be helpful. This aid must be later repaid to the fund. Another purpose of the weekly meetings is the resolution of temporary hardships.

13. If a group member is not able to overcome difficulties in spite of getting assistance, or does not want to make payments, and uses the loan for other purposes, then the other members of the group are given a restricted penalty: even if they meet their goals, they will not be able to enjoy the benefits granted for the next loan listed above under item 11. Besides, the ethical damage experienced at the group meetings will prompt group members to use social pressure to avoid such situations.
14. An important characteristic of the model is that a definitive majority of participants is women (95% in Bangladesh). The original objective was to recruit women as at least half of the participants but women turned out to be much more suitable partners in the programme. The main reasons are the following: a) higher level of commitment towards the family and the well-being of children; b) partly due to this, less inclined to spend money for other purposes; c) less mobile, less likely to escape from repayments; d) less opportunity to earn money in alternative ways; e) finally, being suppressed by multiple forces, women display a higher desire to break out from their situation.

5. The creation and launch of Kiútprogram

The idea of adapting the Grameen model was brought up by the Polgár Foundation for Equal Opportunities in 2008. The two central aims of the Foundation are to decrease the level of prejudice and discrimination against the Roma, and to improve their life circumstances in the most remote areas. The completion of the feasibility study took a year while 25 experts worked on it as volunteers. The preparation works included getting to know an earlier Hungarian pilot conducted by the Autonómia Foundation and a thorough field research financed by the Polgár Foundation.

We already identified several *difficulties* while working on the feasibility study that necessitated the modification of the original model.

1. The original model suggested that providing interest-free loans is not a good idea for psychological reasons - international and Hungarian experiences also confirmed this

notion. Hungarian regulations, however, set very complex rules for loans that are not interest-free. (We skip describing the details because regulations differ country from country.) In Hungary, *businesslike* financial services can only be provided by financial institutions licensed by the banking supervisory authority (unless otherwise specified by another regulation). *In general, separate regulations are needed for microlending, especially social microlending institutions if not during the pilot, at least in medium term.*

Finally the following solution was found: loans were formally issued by a commercial bank (Raiffeisen Bank in our case), and the non-profit organisation administered lending is its agent. The decision of granting a loan is made by the non-profit organisation; the commercial bank does the formal background tasks, within the framework of an appropriate contract. The bank provided the loans and undertook 20% of the lending losses within its CSR programme (later modified to a fixed amount of approximately 66,000 euros), and they also took over back office functions. As the legal format for the actual micro-credit institution, we chose to establish a non-profit corporation that can utilise private capital, thus the Kiútprogram Public Non-profit Ltd. (Kiútprogram Nonprofit Zrt) was founded with Polgár Foundation as its majority owner. The company had altogether 20 stockholders, including several well-known intellectuals and business professionals, both Roma and non-Roma.

According to our findings, this set-up works well as long as the bank remains engaged and maintains the necessary flexibility. This was not the case in our programme, which will be described later.

According to the results of econometric analyses of several large-scale programmes, repayment ratio tends to increase depending on the interest rate at first, and then it tends to decrease when a certain maximum interest rate has been reached (in mathematical terms, it is a concave, or \square shaped curve). The actual optimum interest rate was found to be around 15-20%. This interest rate level is much lower than that of personal or consumer loans and other market-based loans (not to mention loan sharks), however, it often exceeds the interest rates of entrepreneurial loans. Participants are supported not through a lower interest rate level, but additional services.

We decided to go with a 15% APR (annual percentage rate). As a comparison, the interest rates of consumer loans are around 35%; interest rates for so-called personal loans are even higher. The interest rates for mortgage-based loans are between 12 to 20% on the free market, and secured business loans are also offered at 12 to 20%.

To encourage savings, we pay 15% interest for savings accumulated within the frames of the programme.

2. In the formal economic sector, the discrepancy between bureaucratic obligations and the clients' partial or full financial/administrative illiteracy must be resolved. In the following, we list some examples of the tasks a client has to accomplish when starting a business. These are just general requirements, for individual cases there are several additional requirements to meet:
- Check the validity of identity and residential cards and renew them if necessary.
 - Request a so-called “clear bill” from the tax authority certifying that the person has no unpaid tax-related or other public debt. To do this, one has to complete any missed tax returns for the past 5 years, even if the person had no tax-bound income. If there is a debt, a payment agreement has to be signed.
 - Another “clear bill” needs to be obtained from the local government certifying that there is no default payment on rent, dues, or fines. If needed, a payment agreement has to be signed.
 - Apply for support to become an entrepreneur at the local employment centre (more details will follow).
 - Open a business account.
 - Obtain an entrepreneur's license.
 - Pay contributions, submit tax returns, fill out invoices, handle invoices and banking receipts, create financial balance. Find an appropriate bookkeeper for these tasks.

Obviously, our potential clients could not deal with all these tasks on their own even if administrative offices and bank associates provided maximal support. However, this is not the case; what's more, in approximately half of the cases, clients reported that they had to overcome serious institutional resistance based on prejudices.

As a consequence, the job description of field workers is a lot longer and more complex than in developing countries. ***There is no point starting a similar programme without the ongoing, intense presence of field workers.*** The situation is further complicated by the fact that the locations of offices are usually not easily accessible – even if not very far away, they are not easy to access because of transportation difficulties. Getting a certificate often takes a whole day. (It has happened that clients had to return two additional times, which adds up to 3 days – and this is not a rarity.) Field workers can't work without a car and because of the above-mentioned reasons it also helps if the field worker accompanies the client to the given office.

The fact that being tax- and public debt free is a prerequisite of becoming an entrepreneur is a vicious circle, a special “catch 22”. Public utility debts or fines for working in the informal sector qualify as public debt. In our clients’ case, these debts resulted from their status, i.e., not having a legal job. As long as these debts are not paid, however, they can’t make a living, because there are no legal employment opportunities, and they are not allowed to become entrepreneurs – thus they can’t pay their debt. In theory, it is possible to sign an agreement to pay in instalments, but getting through the administrative hurdles exceeds even an average citizen’s capabilities.

We tried to account for these costs when working on the feasibility study. It is important to emphasise that *the field workers’ working hours, transportation and telecommunications costs can’t be redeemed directly*. Practice showed that we underestimated field workers’ costs during planning. The field worker’s biggest workload falls on the period following group formation, in the first couple of months after starting the business. A field worker has the capacity to work with one group in this phase at most.

Another significant modification to the model was that **our programme provides bookkeeping services to new entrepreneurs and primary producers for free. We also consider this as a crucial condition.**

3. Another important consequence of working in the legal sector is that the tax and contribution rates are very high. For new entrepreneurs, the biggest issue is that they have to pay social security contributions starting in the same month when they get their license and if there is an income, personal income tax also must be paid. Contributions applicable to the minimal wage must be paid even if the business had no income at all.

Since the majority of businesses – especially in the agricultural sector – do not generate any income for several months, this is a very heavy burden. To demonstrate the scale of costs, here is a calculation assuming that the entrepreneur is really able to generate a net income equivalent with the minimal wage: at the time of planning and launch of the programme, contributions payable made up 70% of the net minimal wage, and all public charges constituted 105% of the net minimal wage. Obviously, our new businesses are unable to generate such a big amount, thus *due to the scale of public charges, it is necessary to issue bigger loans*.

There was another factor we could not take into account, namely, that the already exceptionally high public charges were raised even higher. This year, contributions already make up 87% of the net minimal wage, and the amount of public charges payable altogether rose to 113%. Business activities that require at least a high school diploma by the law are in an even worse situation: the assumed minimal wage is higher for this

category, still, contributions payable make up 103% of the net income, and public charges altogether amount to 132% (!). Businesses in this category that were launched last year immediately went out of business this year. If we originally assumed this speed of increase in public charges, we might not have launched the programme at all.

In general, we think that a social microlending programme can be launched if the regulatory environment is dependable and the public charges payable by entrepreneurs – or at least new entrepreneurs – are relatively moderate.

There is an active workforce-strengthening tool in Hungary that helps the target group find employment, according to latest evaluations. People over 50 or people with elementary education at most may request the so-called START card. Once they find employment, by submitting the card, the employer will be exempt from paying social contribution for the employee. In certain cumulatively disadvantaged micro-regions, this exemption may last for 3 years. Unfortunately, we were not able to make use of this card because self-employed are ineligible. We realised this issue already at the time of planning of our programme, i.e., that the START card causes competitive disadvantage to the self-employed, and reported this problem to the government. The former administration had no intentions to change the regulation, but ensured the support covering the amount of contributions to our clients for 1 year. The next administration promised to modify the regulation but this never happened and the support for 1 year ran out in the meantime.

We found that similar assistance to new businesses – especially to people with low education in disadvantaged regions – may be beneficial.

4. In relatively developed economies, there are very few businesses that generate profit – or even income – right away. The quickest return time, a couple of months, can be expected for retail activities in our potential clients' case, but in case of agricultural activities, businesses must be kept afloat for several months. To counterbalance this effect and bridge the period without income, there is a state support to become an entrepreneur. In Hungary, this support can be received for 6 months, its maximal monthly amount equals to the minimal wage. This support must be paid back if the business closes within a year. When planning the programme, we relied on this support and it was ***obvious that the majority of new businesses could not be viable without it. In a country where similar support is missing, it is worth setting it up.***

This support does not result in additional expenses if the business really runs for at least 1 year. In Hungary, taxes and contributions paid by the entrepreneur exceed the support by 15 to 30%, depending on the length of time. And it has not been considered that earlier our clients used to receive welfare aid or worked in public work programmes, which have

even higher costs. If *the amount of support is defined at the appropriate level, significant state income can be generated without actual expenses*. Of course, this assumption is valid only if the businesses are viable. A social microlending programme has the potential to act as a significant contributor to the sustainability of the businesses.

This contribution can only be efficient if the rules of support are solid and normative.

This condition was not met in our case. Getting the support depends on not only the quality of the business plans but also other, undeclared and non-normative conditions. The decision lies with the local employment centres and it cannot be appealed against. In some counties, 3 or 4 months support is provided instead of 6 months, and in other counties there is no support for agricultural activities, or it is not provided to the Roma (of course, inexplicitly). At several occasions, the office clerk was not even willing to accept the application if the field worker wasn't present. Unfortunately we didn't expect such issues.

However, we were aware that the support to become an entrepreneur further increases the workload of field workers because it requires a very thorough and detailed business plan. Of course, a business plan had to be completed for our loans, too, but with a lot fewer formal requirements.

In summary, we came to the conclusion during the planning phase that due to local circumstances, we need a different institutional structure than in the Grameen model. In our case, field workers should have a much bigger role, they have more tasks, furthermore, business plans must be completed and a welfare bridge is essential. We also found that Hungarian regulations disfavour individual entrepreneurs when compared with other business formats. This year, this situation further deteriorated due to the modifications of contribution-paying requirements. We are convinced, however, that we need regulations that are friendly to micro businesses in order to decrease unemployment among people with low education, especially the Roma.

From other aspects, our plan followed the original Grameen model: forming groups with 5 members, sequential lending (first 2 members, then second 2 members, and finally the group leader gets the loan), the duration of the loans was 1 year with weakly repayments, and 5% of the loan amount goes to a common group fund. The biggest loan amount was set to 1 million forints (approximately 3,400 euros). Our clients were recruited from a pool where income is less than 60% of the median of household income per consumption unit. We also set success criteria; the most important condition was to recruit 100 new clients in the first year and 300 new clients in the second year.

When the feasibility study was completed, we started a fund-raising activity. In addition to private sponsors, we also managed to sign an agreement securing government support. This is when the European Commission, Directorate General for Regional Policy (DG Regio) announced an invitation to its grant titled "Pan-European Coordination of Roma Integration Methods – Roma Inclusion: Self-employment and microcredit".

The ideas described in the feasibility study almost accurately matched the conditions of the grant invitation. The only real difference was the length of the pilot: we were considering a project period longer than 2 years.

The evaluation of the grant application took rather long. Since we wanted to implement the programme anyway, based on existing private and Hungarian governmental resources, we started to train field workers in February 2010. (The essence of the training is summarised in a separate chapter because it is a crucial component – and it has gone through many improvements always building on earlier experiences.) In March 2010, we were notified that we won the EU grant and finally in June we signed an agreement in the amount of 1.425 million euros – this secured almost 90% of the full budget.⁵ This is when our 2-year pilot was launched that we sum up in this document. In the meantime, we got a favourable decision regarding the extension of our pilot with 3 months, with unmodified grant amount.

An important component of the EU agreement was that the experts of World Bank and UNDP would continuously track the pilot. In cooperation with us, they conduct the impact study and provide assistance with monitoring, too. During the cooperation, we formed a very good partnership with our contacts at World Bank, and we got lots of support from them. We developed a survey that is completed by all serious candidates and is repeated after 1 year has passed. The survey-related work is financed by the WB/UNDP. Monitoring is supported by the online database created by WB where every field worker records his/her activities with the clients.

Thus the implementation structure of the programme was complete, including the organisational structure of the programme (see figure #1).

As the grant agreement was signed, 18 field workers started to work after taking successful exams. For the locations of the pilot, we selected 3 areas with different profiles (later we

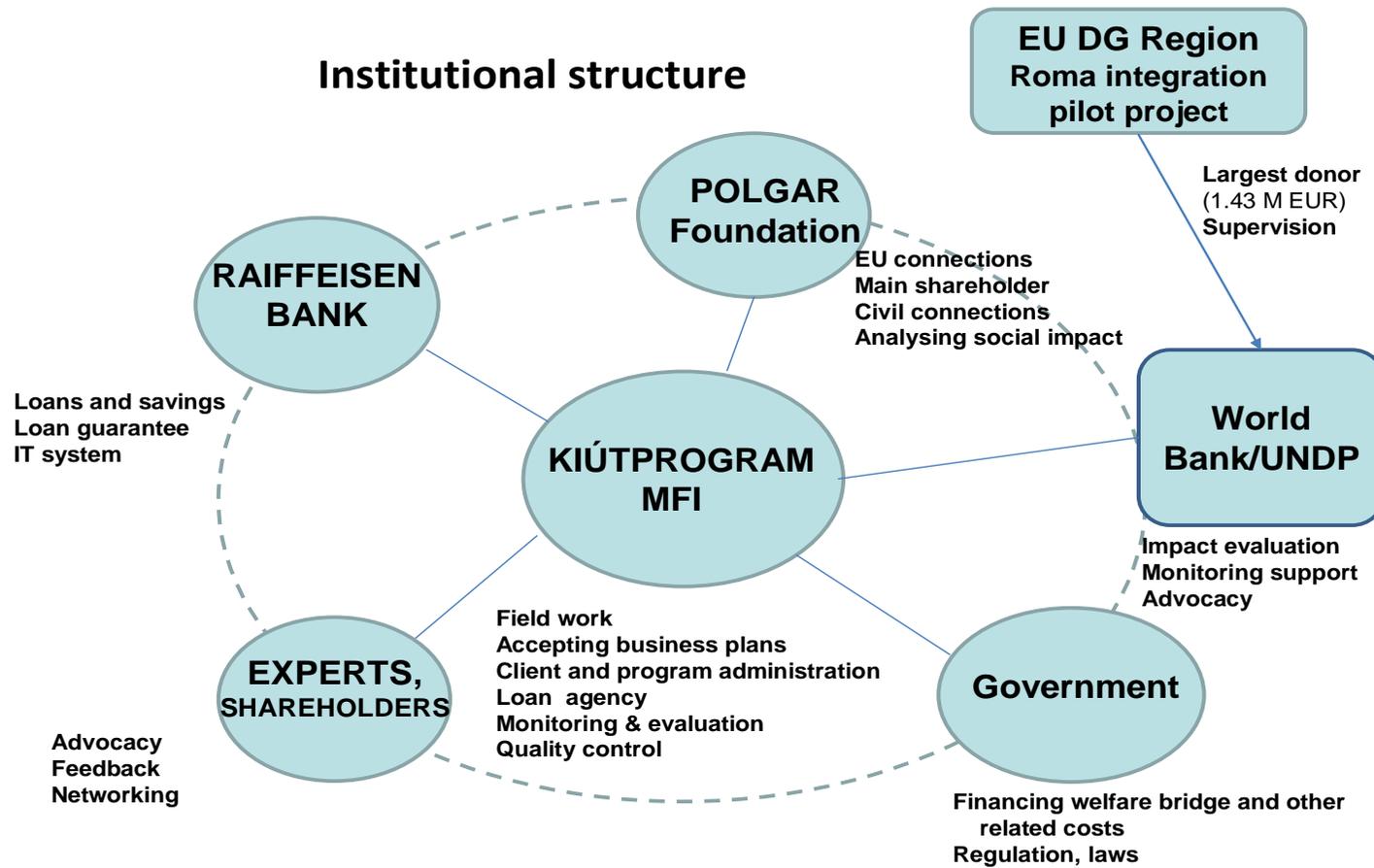
⁵ We must note that not long after the closure of the agreement with the EU, the new Hungarian government decreased the support granted by the former government, and the amount actually received was even less. Currently we aim at getting access to the unused grant amount to be able to continue the pilot. We have not received an answer to our request submitted in December 2011 yet.

expanded these areas). We started fieldwork in some settlements in the counties Borsod-Abaúj-Zemplén and Szabolcs-Szatmár-Bereg, as well as the 8th district of Budapest. The bulk of our work was conducted in the rural areas of Borsod-Abaúj-Zemplén county.

Borsod is the northernmost county of Hungary, with Miskolc as its seat. Before the regime change, it was the centre of the heavy industry in Hungary, and this county lost most jobs after the regime change. The target villages fell in the influence zone of the industrial cities, and a significant portion of the population – including the Roma – worked in the industry earlier. Mass unemployment, however, seriously deteriorated the social structure of the affected villages. In most villages we visited, the Roma lived separately in Roma settlements, or in streets with mostly Roma residents. Almost no one is employed legally.

Szabolcs-Szatmár-Bereg is the northeastern county of Hungary, fundamentally of agricultural background. The proportion of the Roma among the population is the highest in these two counties. The 8th district of Budapest is mostly an ethnically mixed urban crisis area. This district has the highest share of Roma residents in Budapest and this is the most popular destination of Roma who move to the capital in the hope of finding employment.

Figure 1.



6. The Process of Fieldwork

Field workers are crucial to the programme, thus the process is easiest to understand if viewed from their aspect. Through this, we will review the tasks of other staff members, too. From the first “release” of field workers, there is a continuous learning process going on, and their activities also have changed a lot in the meantime. Without too many details, we need to overview the process to understand the incidents of success and failure – unfortunately we had more of these. Fundamentally we describe the series of steps formed by now, also reviewing the modifications that took place since the launch of the project.

1. Exploring the location. Field workers always stay in the vicinity of the target location, but do not work in their place of residence – except for Budapest. (In the first phase, we had exceptions to both rules, but they did not work well.) There is an ideal territorial coverage that enables efficient travel, office routine and group formation. Within this coverage area they select locations in cooperation with the headquarters where groups could be formed. The field worker analyses the location, including its economic, social relations, potential clients, the status of local government, other potential partner organisations such as Roma Minority Self-Government, social services, foundations and other civil organisations. This research involves personal visits, getting familiar with local residents and finding contacts. A “contact” is a local resident who has an extensive web of relationships, can identify with the objective of the programme and is willing to help the field worker connect with interested candidates. The analysis then must be forwarded to the *professional manager* who will decide if the field worker should start the work based on the report. If the decision is negative, the field worker must move on to a new location. The activities of the field workers are coordinated and managed by the professional manager located in Budapest who frequently visits the field.
2. Organising a forum. The field worker organises a forum with the assistance of the contact person. We tried other methods including walking from door to door, but forums proved to be the most efficient ways to inform as many people as possible without applying too much pressure to join. Before the forum, it is a good idea to inform the local government about our presence even if this has only symbolic value. It is the field worker’s job to propagate the forum: distribute fliers, get an article published in the local newspaper, post announcements and secure appropriate location and timing. The field worker often organises this event connecting to another community occasion, thus reaching even more

people. The objective of the forum is to give a general idea about the goals of the programme, clarify that we are not from Provident (a major provider in the market of personal loans), declare the most important rules (e.g. sequential lending to groups, weekly repayments) and have enough interested participants meeting the criteria to start personal interactions.

Field workers conduct recruitment activities and organise forums usually in areas with higher density of Roma population, however, becoming a client is not subject to ethnicity. Only “too high” income causes ineligibility. Nonetheless, the fact that we primarily target Roma clients inhibits the interest of the non-Roma. The proportion of the Roma is 80% among both serious candidates (who complete the questionnaire) and the actual clients.

3. Personal contact. Following the forum, the field worker meets with interested candidates in person. The ideal location for this is the home of the family. The “family visit” is a good occasion to get a real picture of the environment and the financial situation of the candidate. Mutual personal impressions are as important as rational considerations because working together is a long process and mutual trust is a necessity to the last minute. During the visit, the field worker completes the intake questionnaire if the candidate has no objection.

The intake questionnaire clarifies if the candidate meets the income criteria, if the debt of the household is at a manageable level and if there is a willingness to become an entrepreneur. Unpaid taxes and loans should be examined separately, and it must also be clarified if there is unmanageable debt of public utilities or rent – these are reasons for exclusion. We assumed and later verified that huge debts prevent candidates from becoming successful clients.

The goal of the first meeting is to explore personal possibilities. The field worker must find out if the candidate has a business idea, related experience and network. These three conditions are vital for the success of the business. Based on the objective and subjective factors, the field worker must decide if the candidate is suitable for further cooperation. If not, it must be communicated and the field worker must find other potential candidates. Existing candidates can be helpful with finding new candidates. Nevertheless, it is an important rule that close relatives cannot belong to the same group, because it significantly increases the risk of non-payment. At least 8 to 9 suitable candidates must be identified at a location to have a chance for a group, considering dropout rates.

4. Pre-group meetings. After identifying 8 to 9 candidates, group meetings must be organised to find out if they are capable of working as a group and take responsibility for each other. Before receiving the loan, people tend to present their favourable side. After learning about the rules and during the filtering process the group may withdraw trust from someone or a candidate may decide to drop out because of the strict rules. During the pre-group meetings the entrepreneurial questionnaire is filled out that helps explore earlier business experience and material resources. Business experience is meant in a very vague sense, including business-like activities in the informal sector, too. Almost no one ran a formal business among our clients.

It is the field worker's task to prepare and lead the group meetings. The group leader assists the field worker by taking over operative organisational tasks. The group leader is elected by the members of the pre-group because he or she must be someone who is accepted by everyone; nevertheless, the field worker has an important orientating role at this step. The best choice for the group leader's role is the most active, most motivated member. In the pre-group meetings, the field worker describes the details of the programme, talks about business administration and the group discusses each member's business ideas.

5. Filtering. The most important milestone of group preparations is the decision about the potential clients based on the filtering criteria. Those who meet the criteria will officially become group members. At the group and personal meetings the field worker pre-filters candidates by checking these four areas:
 - Are there any unpaid taxes?
 - Are there any unpaid loans to financial institutions?
 - Submit a simple business draft (on a piece of paper; so-called "checked paper");
 - Complete and evaluate the scoring card.

As mentioned above accrued taxes somehow must be handled in order to get the business license. Owing to a financial institution is not a reason for exclusion, but too much debt implies that the person would not take our loan seriously either. During these checks it also becomes obvious if the person was honest with us at the time of the first questionnaire. It is a warning sign if he or she was not. Raiffeisen Bank helps us get the credit reports of the clients.

The field worker helps with the settlement of tax backlog, public utilities debt and unpaid loans by rescheduling them, applying for partial remittal or paying in instalments. The

field workers' knowledge has eased many clients' issues, but this involves tremendous work. If debt is overwhelming and cannot be settled, then the potential client must be excluded.

Owing to a loan shark ("usurer") is the most dangerous type of debt, and we learn about these only informally. Some potential clients talk about smaller debts but do not mention bigger ones. In this regard, the relationships of the group and the field worker in the area are very helpful while the field worker's people skills are also crucial. At the beginning we ran into some issues; the candidates did not want to start a business, but pay back the debt to the loan shark. Selection by field workers and getting more experience prevented this from happening in the second year of the project.

The member of the pre-group prepares a short draft about the planned business (on a piece of "checked paper"). The field worker gives hints about the topics to cover. The draft must contain rough income and cost figures and list potential customers and suppliers. Early in the programme, the field worker recorded these data based on the client's explanations, but we found that this is not a favourable practice because it makes the client dependent. During this process, the field worker shares lots of financial and business information with the clients that they discuss at the pre-group meetings. The field worker also talks about the opportunities. If the client is registered as unemployed then he or she may apply for the support to become an entrepreneur as described above.

The field worker fills out the *scoring card*. It is the evaluation tool of Kiútprogram objectively exploring the suitability of the candidate summarising the information collected from the base questionnaire, the business draft and personal meetings. Subjective factors are also included such as the candidate's motivation, communication skills, existing web of relationships, risk-taking and decision-making skills, family background, business experience, etc.

The field worker sends the business draft and the scoring card with his or her recommendation to the headquarters where the Credit Committee (CC) decides about the feasibility of the idea. The members of the CC include the professional manager, the financial manager at the bank (an employee of the Kiútprogram) and a dedicated expert member of the management board. If there is no agreement, another member of the management board is brought into the committee.

6. Preparing finalised business plans. After filtering, a decision is made about the group and if all goes well, the remaining group members create their finalised business plans. By this time, the ideal number of group members is 6.

The field worker must meet the group at least once a week and work with the clients individually, too. Finalised business plans follow a template; a cash flow plan for 13 months must also be submitted created in Excel. The business plan must contain the reason for taking the loan, present how the loan will be used in detail, a budget of planned investments, market connections of the planned business, potential partners, risk analysis, analysis of future outlook, and finally the assessment by the field worker. The business plan is recorded by the field worker based on the client's input, discussing every detail.

Members of the pre-group discuss each business plan and approve of it before submission. While preparing the business plans, the field worker continuously trains the group members. Lending sequence is determined in this phase and a name is chosen for the group by the pre-group members.

Lending sequence is a crucial issue. Early in the programme it happened that a dominant member persuaded the others to let him or her get the loan first, leading to very harmful consequences. Such an intention surely implies that this person does not intend to repay the loan. Later on, we firmly insisted that the group leader should be the last to get the loan.

Finalised business plans are approved by the CC similarly to the process described above. The procedure of filtering and planning gradually matured during the programme. First we insisted on groups of 5, but the selection process may also result in a different group size.

As mentioned earlier, field workers record their activities with the clients in a database, including the amount of time. The analysis indicated that preparing the business plans took approximately half of the field worker's time dedicated to the groups.

7. Group formation. After the finalised business plans are approved, the group passes an exam where the professional manager and other leaders of Kiútprogram are present. This ceremony is the official formation date of the group. Members are awarded a certificate; they sign the group foundation document (includes lifestyle rules defined by the members), also sign the certification of group membership and a client declaration. The group receives a Group Diary, which is written by the group leader under the field worker's supervision. The most important functions of the Group Diary include the

documentation of the group meetings, recording repayments, taking and returning cash from/to the group fund.

8. Preparing and issuing the loans. Following the set sequence of loans, the first two recipients must start their businesses and every effort must be made to enable clients to get the loan from the bank as registered individual entrepreneurs or primary producers. At this step, business accounts are opened where the cash component of the loan is transferred to; security deposit accounts and group fund accounts are also opened. The security deposit account is a sub-account of the business account where safety repayment instalments are placed. This secures that entrepreneurs can make repayments until the business generates an income. To avoid that entrepreneurs incur a loss due to the interest, the security deposit works as a savings account with a 15% interest at sight. Additionally, we open a personal account for the client that is not connected with the loan. The client and the field worker have joint access to withdraw cash and make transfers.

Parallel to loan preparations, we also prepare the application for the support to become an entrepreneur. The finalised business plan created for Kiútprogram can also be submitted with this application. Accurate timing is very important because applicants must be unemployed, however, they must become entrepreneurs within 30 days after the support is granted.

Clients must also contact the bookkeeper. Kiútprogram located bookkeepers in each region who are willing to work with our clients. Bookkeepers are paid by the programme.

Upon the receipt of the loan amount, the field worker hands over a so-called “loan recipient’s booklet” to the client. We created this booklet so that the client can track repayments, income and expenses on a daily level.

9. Creating and maintaining the business. One-time investment elements and inventory must be bought from the loan. The field worker participates in this activity, accompanies the client and assists if needed. The participation of the field worker has several reasons. Very often, acquisition cannot be completed by public transportation, a vehicle is needed. (Early in the programme, we issued loans to retailers to purchase used cars, but this did not work.) Field worker’s cooperation is necessary because of prejudices against the Roma and the poor; in these cases, field workers act as catalysts. During acquisitions, it is important to provide practical training about budgeting. Clients have rarely seen this much money before, and they might be prone to – for example – purchase higher quality, even

prestigious products. This is perfectly understandable, however, the amount must cover current assets, utility and shipping costs, and so on.

While supporting the clients, we must be very careful so as not to hurt their independence. Too much interference may have a negative effect, the client may try to get things done by the field worker, in case of difficulties may not make real efforts and might blame the field worker for problems. Leaving the client all by himself is the other extreme, which is also not a good solution. The goal is to help clients become gradually independent as soon as possible, which takes several months even in optimal cases and requires high-level emotional intelligence on the field worker's part.

Most businesses can be categorised as either *retail or agricultural* ventures. A small group chose forestry; the others are scattered, unique activities. Depending on the type of activity, some kind of license is almost always required. Just to mention a few, depending on the nature of the business: operating license, license to use public premises, animal health control license, food safety license, fire safety license, legacy protection license, etc. The field worker helps with official procedures. The approach of offices to our clients is very diverse. There are cases when they seem to appreciate the efforts made by our clients to establish a living for their families and are very helpful. In other cases we come across hostility, impeding businesses wherever possible. In some cases, competition is the reason: the office clerk has good relations with the owner of the other shop in the village; in other cases, it's racism. Based on the field workers' subjective estimates, prejudices play a role in about half of the cases when interacting with offices, office clerks, less often business partners. At the same time, the field workers' and the clients' activities are capable of decreasing negative bias.

From this aspect, Roma field workers are in a special situation because during their work they also meet bias personally, although – due to their education and self-assertion – to a lesser extent than their clients. We try to prepare them for these situations during the training; it is the professional manager's important task to help them process such incidents.

10. Tasks connected with the repayment of loans. Field workers must continuously track the repayment of instalments. The group fund can be used if the group decides so; however, management of the fund is the field worker's task. The group fund is only suitable for smaller liquidity problems. If the business is in serious trouble, then a separate procedure is necessary that exceeds the competencies of the group. The lack of income or the

disappearance of the resources for investments or current assets can endanger the existence of the whole business. In such a case, the field worker must indicate that external help is necessary. Kiútprogram sends a specialist in some cases to get information and recommend a solution using the field worker's input. The recommendation contains the material or financial requirements that might help the entrepreneur continue the business. The decision lies with the management board. Once the decision is made, the field worker participates in crisis management and accounting of resources used. The value of goods or financial resources received during the crisis management must be reimbursed by a date defined in the agreement.

There is a critical point in the business cycle approximately half a year after the startup when the client becomes insecure and gets exhausted. This often happens when the support to become an entrepreneur runs out, suddenly raising the sense of insecurity. At this time, the field worker must pay more attention to and reassure the client to help him or her get through this situation, which happens to almost everyone.

We found that if a client starts to skip payments and this adds up to several weeks, the risk of business failure and becoming a defaulter increases significantly. Defaults mean that the group members in the lending sequence get the loan with a delay, or worse, not at all. As expected, this situation leads to serious tension that is sometimes helpful; however, if a business fails, the failing group member simply cannot pay.

The field worker receives late payment reports from the financial manager, and he or she also tracks payment balances. Late payments are categorised according to their seriousness, i.e., after 90 days' non-payment the bank dissolves the contract with the client.

There is a point when the programme and the field worker does everything for the group member and the business because there is still trust that the member acts in good faith despite all the problems. If someone is dishonest regarding the usage of the money or the income, withholds information, or breaks contact with the group and the field worker, then the field worker has no choice but assume ill faith and report the issue. In this case, the group or Kiútprogram may decide to remove the member from the group and the programme. In case of ill faith (maliciousness), the bank puts a halt on lending and initiates collection of debt. Since the loans are unsecured, there is really nothing to collect; this measure has only a psychological effect. The client is automatically added to the banking "black list".

Ideally, at the end of the duration of the loan, the client repays the loan and continues to run the business. Kiútprogram provides bookkeeping for free and pays the entrepreneur's contributions for 1 year. The field worker gradually withdraws from the maintenance of the business in cooperation with the client and helps him or her schedule upcoming tasks, thus making the process foreseeable.

Considering the special importance of field workers' tasks, in the following chapter we describe the training of field workers and then get back to the program.

7. The Syllabus of the Field Workers' Training

Objectives, output requirements

The most important objective of the training programme is to train field workers who can take on a dual role and maintain the sensitive balance of Kiútprogram, namely, candidates who can work both as social workers and business developers. Social work focuses on the selection of clients and individual/group development in order to help clients become entrepreneurs.

Within the framework of these activities, field workers must help participants modify their life styles regarding regularity and planning, and also develop clients' social competencies in areas such as running official errands. Business development activities include business planning, supporting decision making, and lending activities, as well: issuing loans and handling repayments.

Based on the list above, a field worker needs to meet the following requirements to pass the theoretical and practical exams:

- Know the situation of the Roma in Hungary and the difficulties of integration;
- Must be familiar with the model of social group-based microlending, the milestones and documentation needs of the process;
- Know how to start a business and is familiar with the fundamentals of business planning;
- Must be capable to form and lead entrepreneurs' groups.

Two years – five training schedules

We hired field worker candidates five times this far and gave them training sessions integrating the experiences and modifications of the programme. Each time, the number of applicants was

multiple times more than the number of positions, thus careful selection was required in this phase. At selection, we focused on familiarity with the location, attitude, motivation and earlier work experience; altogether 57 people started the training programme, 48 people completed it and 37 passed the exam. The majority of the trainees was very committed, and participated actively in the process. The training was modified based on the feedback and recommendations of the trainees. During the training, students formed a close bond within their groups, and during field practice, the various “generations” of field workers also became connected.

The high number of trainees shows that fluctuation was relatively high among field workers. Burden (primarily psychological) was too heavy for some field workers. There were others we had to let go because their work did not meet the expectations, or they could not perform at the expected level even if giving their best efforts. Currently we have 12 field workers.

Training sessions took 4 to 5 weeks, and all consisted of two components: theoretical background and field practice. The former took about 50 to 60% of time, and the latter was 40 to 50%. The theoretical training was led by the experts of topics such as integration, microlending to groups, business development, banking processes and group management techniques. Training was tailored to the specific content and the size of the groups. Thus besides theoretical presentations and lectures, problem solution in groups was emphasised. Practical training always took place in settlements that are relevant to the programme. These field practices gave opportunity to the candidates to learn about the processes, in an increasingly optimal way because we used earlier experiences. Experienced field workers had a major role in practical training.

The content of the theoretical module can be divided into two phases. The first phase included the first training course in January 2010, and the remaining four training courses starting in December 2010 belong to the second phase. The reason of the difference is that in January 2010 we have not had enough local experience yet; the processes of practical microlending and the methodology of monitoring has not been completed either.

The composition and the content of the training

We consider the fifth (last) training from mid-August to the end of September 2011 as worthy to be presented as “best practice” and used as a model. The most important novelty was that in earlier training courses, theoretical training was followed by fieldwork; here the candidates participated in a short theoretical orientation followed by two weeks’ field practice, and then

they continued with a thorough, detailed theoretical module building on the practical knowledge and experience. This change resulted in the increased share of practical component, but this notion is illusory, since candidates got thorough insight into the theory of group development and microlending while participating in field practice.

Training Schedule (each lesson is 45 minutes long)

- Theoretical orientation (2 days, 20 lessons)
 - Team building activity (2 lessons).
 - The characteristics of Kiútprogram: duality and balance (social and business programme). Group dynamics, entrepreneurial objectives, the lack of collateral (i.e., unsecured loans), the technique of the lending process (3 lessons).
 - The status of the Roma, the difficulties of integration (4 lessons).
 - Organisational structure of the programme, tasks of the staff (4 lessons).
 - Micro financing, lending to groups (4 lessons).
 - The process of fieldwork, the tasks of a field worker (3 lessons).
- Field practice (10 days, 100 lessons)
- Theoretical module (5 days, 50 lessons)
 - Introduction, systematisation of field practice (2 lessons).
 - Overview of the milestones of fieldwork (6 lessons).
 - Introduction to business administration, business planning (4 lessons).
 - Preparation of lending: pre-filtering candidates, the business plan template, the concept of cash flow, typical business formats, and the decision process (6 lessons).
 - Banking background: introduction, product information and the lending process (8 lessons)
 - Database skills: theory and practice (8 lessons)
 - Research, monitoring: theory and practice (6 lessons)
 - Working with the group: principles and techniques (10 lessons)
- Individual learning, working on exam paper (2 days, 20 lessons)
- Verbal and written exam focusing on the complex understanding of practical tasks.

8. The First Crisis and the Correction of the Model

By early 2011, Kiútprogram has presented several signs of crisis, most importantly:

- The increase in the number of late- or non-payment of the loan instalments,
- Slowing down of the pace of new group formation and new lending,
- A deterioration of trust between the management and the field workers.

We were looking for explanations from different angles, gathering information from field workers, managers at various levels and areas, as well as information from our clients. One of the most important conclusions was that *considering potential clients, we need to pay more attention to their potential entrepreneurial capabilities than we did in the past:*

- Is the candidate's personality compatible with becoming an entrepreneur?
- Does the candidate have an “entrepreneurial dream”, something he/she wants to come true?
- Is the candidate capable of running official errands on his/her own?
- Has the candidate ever operated a business or business-like activity, including informal entrepreneurship?
- Can the candidate participate in regular activities, i.e. work regularly, every day? Has he/she done any regular work earlier?
- Does the candidate have a social network that enables him/her to sell products (any products or services)?
- Does the candidate possess the capability to build new relationships?
- Is the candidate able to make plans? We are looking for clients who can plan in advance.
- What does the candidate's credit history look like? How did he/she handle earlier loans?

These realisations are reflected in the activities of the field workers as described in chapter 6. Theoretically we were aware of these aspects, however, we were not consistent enough. For example, we realised that the amount of the loan (or its upper limit) should not be communicated at the first forum, because it attracts people who only go after the money. First we need to learn about business dreams and assure people that we try to support them with a loan.

The field workers work under double pressure. On one hand, we expect them to form groups as soon as possible, on the other hand the groups should operate well, i.e. the members should run viable businesses that enable them to repay the loans. These two objectives are often contradictory. In order to form groups, in some groups not all members are capable to become an entrepreneur.

Therefore, responsibility towards our clients dictates that a group should only be formed if it is very likely that the members will be able to turn their intended businesses successful.

This is the right way of action even if – hoping to get the loan – the biggest pressure to form the group comes from the clients themselves.

If the necessary efforts were made, the lack of group formation should not be considered the failure of the field worker. We generally need more than five sincere candidates to form a group of five, as it was mentioned in the previous section. Places where first efforts to find enough candidates failed should be abandoned even if one or two promising candidates were identified. We must avoid staying at communities too long without forming a group because this will raise hopes in the clients that we feel obliged to meet later on. We need to avoid the feeling that we want to persuade candidates to join the program and that it is important for us that they become our clients.

According to our experiences we modified the group size and started to consistently apply the rule of issuing the loan to the most influent member of the group *last* who should also be the group leader. At the same time, we cut the waiting time between two loan placements from 6 weeks to 4 weeks in sequential lending.

We decreased the amount of the loan and urged clients to start smaller ventures. Before the correction of the model, the average amount of the loans was 2,400 euros, after the correction it changed to 1,900 euros. We aimed at issuing the loans in parts instead of one amount provided that the type of the business made this possible. This solution lessened the risk of loss. During the programme, 89 clients received loans up to April 2012, 8 of them twice, and 3 additional clients three times. All these additional loans were issued after the correction of the model.

We tried to make the duration of the loans more flexible. On one hand, we made durations of less than 1 year possible. Few clients made use of this change, however, the ones who did were successful according experiences so far. On the other hand, in case of many projects it is obvious that the duration of 1 year is too short; no return is possible within that time. Therefore we let regularly paying clients reschedule the instalments of outstanding debt for another 1 year. Generally we found that the end of this support was a serious shock to both the business and the household, this is why we encouraged the accumulation of savings.

In addition to targeting clients with wider net of relationships, we tried to take on *network building activities*. Since we consider this as the most important direction of development, we will describe a case related this issue in detail in chapter 11.

We also modified our internal processes, making steps a lot more deliberate; initially, as with any new projects, our programme had too many incidental components. We expanded our territorial target area, including further counties and looking for places where segregation is not that extreme and the local Roma have external connections. We introduced the function of regional coordinator (mid-level management), however, it did not prove to be a good idea and has been eliminated since.

Following the correction of the model, we commissioned an independent research group of Budapest Institute, a research institute focusing on regulatory policies to conduct an interim assessment of the programme. They summarised their research in a thorough study that will be published separately; we emphasise two of their findings here.

The project set too ambitious goals that we realised too late. Tension between the goals and achieved results affected our work and the internal cohesion negatively. Based on international examples, we underestimated the time and effectiveness needed for recruiting new clients. In the beginning, distrust was high; potential clients did not know us plus they were wary not to be deceived. Most of the serious candidates overestimated the risks. During the first times, it took several months to form a single group for some field workers; without doubt, inexperience also played a role. Nowadays we find that Kiútprogram becomes more familiar among potential clients and there is a growing interest.

The other factor is the role of the bank and related problems. Our compulsory relationship with the bank did not work well. There were some personal issues (change of top management at the bank), and banks were also hit by heavy extra taxes and burdens in the meantime. This changed the CSR willingness of the bank drastically and made operations a lot less flexible. Preparing lending administration took a lot longer than originally agreed by the bank. Because of this, we kept first clients waiting for the loans for many weeks, which caused severe loss of trust. This issue by itself led to cases of defaulting; when skipping payments, clients could bring up that we did not keep our promise either. The bank proved to be very inflexible afterwards, too; modifications took very long to take effect in the banking procedures, and the bank ended up being the barrier of several additional attempts at changes. The bank broke its promise to only act as an automatic administrator in the lending process – despite the fact that we continuously reimbursed the costs of defaulted loans from private

funds. *A fundamental lesson is that a similar project can only be successful if the institution technically administering the loans is fully cooperating.*

It must be mentioned that external circumstances also played a role in the initial difficulties. The incident with the biggest impact was that the government put a hold on public work programmes for the first 3 months of 2011, the most critical season for the subsistence of the poor. As a consequence, demand for the goods sold by our clients suddenly and drastically fell, and all our retailers serving the local market almost immediately went broke. Due to the decreased demand, our group members started to compete with each other instead of cooperation and this further decreased performance.

When modifying the model, we assumed that we started to target people of a somewhat higher status. After evaluating the questionnaires we found that this assumption was false. The correction of the model did not increase the average household income of our clients, did not include more non-Roma and the share of clients living in a mostly Roma environment did not shrink either. What really changed were the clients' subjective capabilities; our new approach attracted serious candidates. Several questions in the questionnaire explored subjective factors, and it is clear that the self-confidence and risk tolerance, as well as optimism are higher among our clients recruited after the correction of the model.

In the questionnaire we also asked candidates how satisfied they were with their lives and financial circumstances – before joining the programme. After the correction of the model, clients tended to be more satisfied with their lives than earlier clients, and the new clients had a bigger difference between their satisfaction levels of life in general and their financial circumstances.

The correction of the model beneficially influenced the repayment of the loans, nonetheless, the repayment rate still does not meet our original expectations, as described in the following chapter.

9. Results and the Costs of Lending

As seen in Table 1, performance significantly improved after the correction of the model. Clients whose group was formed before the correction belong to the 1st batch; this classification is based on the time of selection instead of the time they received the loan.

Table 1: Base data (as of March 31, 2012)

	Persons	Defaulters	Arrears > 90 days (persons)	Amt. borrowed EUR	Average borrowed per person	Arrears per payments due, %
1st batch	41	24	16	97 647	2 382	65
2nd batch	48	3	6	92 866	1 935	23
Total	89	27	22	190 513	2 141	52

4 of the 48 clients in the 2nd batch have fully repaid their loans already and their businesses are active since. Table 1 is somewhat confusing because the majority in the 1st batch (33 of the 41 clients) received their loans earlier than the others. Therefore it is worth comparing the status of repayments on the 90th, 120th and 150th days of the clients' own loan history, as seen in Table 2. Clients who received their loans within 90, 120, or 150 days belong to the 2nd batch, and the figures here are understandably lower.

Table 2: Status at the 90th and 120th day after borrowing

	90th day		120th day		150th day	
	Persons	Arrears per payments due, %	Persons	Arrears per payments due, %	Persons	Arrears per payments due, %
1st batch	41	21	41	28	40	33
2nd batch	39	8	30	9	23	6
Total	80	14	71	19	63	24

Arrears start to accumulate when the support to become an entrepreneur runs out. This support has a dual effect: on one hand, it helps bridge the period when the business does not generate income by replacing the income from welfare aid or public work. On the other hand, it sets some clients at too much ease. They can complement the household budget, which is understandable as they lived in deep poverty, at the same time it only adds to the loss-of-income shock when the support ends. Savings of a part of the support must be encouraged more intensely because half a year is usually not enough to generate the level of income that could counterbalance the loss of the support. In connection with this issue, the process of business planning must also be improved.

This effect is further strengthened by two factors. The first is seasonality; both retail trade and agriculture is strongly seasonal and the situation can deteriorate if a bad season coincides with the ending of the support.

The second factor is external, something we cannot influence. The performance of the Hungarian economy, already problematic, has further declined with the GDP diminishing in the first quarter. Changes in conjuncture have a huge effect. The survival rate of businesses ran by individual entrepreneurs was less than 70% in 2009 and it further worsened during the crisis by all means. Several measures introduced by the government further deteriorated the living conditions of the most disadvantaged. We already mentioned the freeze on public work programmes. Moreover, income from public work decreased by 40% between 2010 and 2011, and this process continues this year. Wages for public work were cut, as was the aid the local government pays if no public work is available. All these factors decreased additional income of our clients and the spending capabilities of their customers, too. From 2012, individual entrepreneurs are hit by further charges, they have competitive disadvantage compared to other business formats.

It is crucial for a social micro credit programme to rely on a coherent governmental policy regarding poverty. Dependable business climate is also a must. We believe that micro entrepreneurs of disadvantaged regions should be granted allowance of contributions.

We also observed that successful clients get into a crisis pretty soon after taking the second loan. One reason is that the instalment increases because of the additional loan; another reason is the inflexibility of the loan product. Retailers would need classic current assets loans following the initial investment. Unfortunately, the deterioration of relationships with the bank prevented this, and lenders in the market do not serve entrepreneurs without a collateral.

A fundamental problem is that many investments need a much longer time than 1 year to produce a return. Because of the duration of the pilot, we could not fix this problem, however, in longer projects longer loans are necessary by all means. This is also necessitated by competition.

Besides the lack of capital, another serious issue is the lack of business and financial knowledge. We try to pass on as much know-how as possible, but continuous training is vital. Many promising businesses require an official certificate and education in addition to existing professional skills. The shortness of the pilot did not allow for this.

There are several ways to improve the efficiency of a social microlending programme if operated regularly. Losses due to defaults are only a smaller proportion of costs. Operating costs are very high in the pilot period, issuing 1,000 euros in loans cost almost 6,000 euros so far. The biggest share of costs is incurred by the field workers' wages and material expenditures. As mentioned earlier, the wages of unsuccessful field workers are not counterbalanced by any issued loans. The learning curve of creating the central organisation also required extra costs at occasions; however, these lessons were valuable as we have an efficient team now.

We calculated the costs if we operated regularly. After a field worker finished business planning and signed contracts, he or she can work with a maximum of 15 clients under our circumstances. For 20 field workers, 5 staff members are needed in the headquarters, including highly qualified lending professionals. Continuous training, legal support, external communications, bookkeeping for the clients require further contractors. Transportation and communication costs are also significant. Altogether, serving 300 clients per month costs a gross amount of 58,000 euros. 21,000 euros of this is paid back to the state budget as taxes and contributions (accumulated by the microlending institution only, not considering the clients). ***In case of continuous operations at full capacity, the cost per client is estimated at approximately 130 euros per month.*** (Considering Hungarian prices.)

If – for simplicity's sake – we calculated with loans of 1-year duration, then issuing loans in the amount of 2,000 euros and the continuous support of the clients cost approximately 1,600 euros (calculating with smaller loans modified after the correction of the model and not considering lending losses). Considering that field workers can support only 5 to 10 clients at the time of business planning and contracting, we estimate that ***the costs of the social microlending organisation is approximately the same as the amount of loans issued, if operating regularly.***

This is significantly more efficient than our cost-efficiency during the pilot, which is also favourable. It is too early to draw far-reaching conclusions, but we estimate that if compared to the costs of public work programmes, our programme is doing well. ***The cost per client per year is basically equal to the cost per person per year in the public work programme.*** A truism of our profession is that public work programmes do not open doors to the labour market; rather, public work decreases the chance of getting employment. If some clients of the microlending programme become tax-paying entrepreneurs in the long run, then the efficiency of our programme is already better than that of a public work programme. A more

accurate estimate can be made when more output data is available about the performance of clients in the 2nd batch.

Based on our experiences so far, we identified 3 factors that positively influence the outlook of becoming an entrepreneur:

- ***Subjective (personal) factors: having a “business dream”, self-confidence and optimism.***
- ***Previous – mostly informal – business experience..***
- ***Connection with some business network.***

Of course, these factors require further analysis.

In the remaining part of the study, we examine two issues: first, how did the group model work; and finally, we present an example of connecting to a business network.

10. The Group Model

In chapter 8 we already described how we loosened the conditions of the group model during the pilot. This also requires further analysis, however, we already have a concept based on our practice so far.

We found that the group model in its original format works only if we find a very strong community by itself – this is very rare. Without this, sequential lending becomes dysfunctional. There are several arguments against it. First, seasonality: delays in time often prevent the last member of the group from launching the business in the given year. Waiting, well-prepared clients often lose their patience, especially if a group member prior in the sequence starts to pay late. If there is no strong local community, then group pressure does not work either. Sequential lending is especially confusing when taking a second loan. The bank did not approve of the second loan until someone still owed money in the group – destroying promising businesses that needed current assets after making the initial investments. (The inflexibility of the bank also played a role here).

This does not mean that groups are unnecessary. Group members influence one another and the field worker’s job is also simpler. It is a lot easier and more effective to inform a group and process knowledge with them, and the field worker also gets much more insight while watching group members interact than talk to them individually.

The group provides security and protection, especially early in the process. It is also useful because an entrepreneur must learn to work with others in order to be successful and the group provides good practice by encouraging the culture of cooperation. To achieve this, at least groups of 3 are necessary.

The argument for sequential lending is to reduce moral hazard. Under our circumstances where almost every business needs some kind of investment, non-eligible use of the money can only happen at the very beginning of the process. It is impossible later when investments are already paid for. (Purchasing a car was an exception; this is why it was excluded after the correction of the model.) If we want a guarantee, sequential lending in 2 phases is satisfactory; in this case, the group leader is the only one getting the loan later, with 4 weeks' delay. The group leader must be selected by the field worker in accordance with the group's opinion, making sure that he or she is really the most influential group member in the hierarchy of the local community.

We came to believe that group lending is beneficial, however, sequential lending can be skipped or applied only minimally.

11. Case study – cucumber growers in the northern part of the Great Plain

This is a real *best practice* story. It is worth taking a closer look because it offers a good illustration for the flexible prospects of social microlending. Hopefully we do not speak too soon as this project is still underway.

“N” is a village with little less than 2,500 inhabitants in one of the poorest, primarily agricultural counties in the northeastern part of Hungary. According to the latest census, 11% of the inhabitants are Roma; this number is in fact most probably higher. In the village, a charismatic church has many followers, especially among the Roma. Our field worker started to work in “N” in early 2011, and a group of 6 Roma women was organised pretty soon – all of them are members of the above-mentioned church.

Three people in the group took the loan for cucumber growing; one person opened a confectionery shop, another one started a small grocery shop, and the group leader (originally) took the loan for poultry husbandry. Due to the sequential nature of the lending, the group leader was the last to receive the loan, which she did this year, because of seasonality reasons. In the meantime, however, she also changed her mind and decided to start cucumber growing instead of poultry husbandry.

What is cucumber growing about? Pickled, 3 to 4 cm long cucumbers can be sold at a good price in Western Europe. If cucumbers grow bigger, the price falls drastically, therefore lots of attention and precise work is needed from April/May to September/October. One person can manage an approximately 250 m long row of cucumbers plants, which can be set up even in the yard around the house.

Based on the above, an economic network was born where the central player is the so-called “integrator” (coordinator). The integrator distributes seeds, nutrients and pesticides, trains participants if necessary and finally ships the cucumbers to the (usually own) processing factory. Prices are agreed upon in advance, and material costs are deducted when the produce is collected. The producer needs to invest in the watering system, posts and drilling a well if there was none on the plot. It is fundamental to have *trust* between the integrator and the producer. The biggest risk for the integrator is that another wholesaler shows up at harvest who gives a higher bid for the product. He/she can easily do this because he/she hasn’t invested in the seeds, materials, and daily work of organising and training. Even in this case, the cost of materials is reimbursed to the integrator; however, there is no profit on the integrator’s invested money and work. A producer who accepts such a deal gets the higher profit only once because the integrator will not contract with him/her again. Taking new producers is another huge risk for the integrator, because it is doubtful if they will follow the rules of growing cucumbers.

However, the producer also takes a risk if the integrator tries to pay less than originally agreed upon or goes bankrupt and cannot buy the product. This latter happened in our case.

What was the role of Kiútprogram in this story? At startup, we issued loans of little over 1000 euros per participant to drill the wells, pay for the watering system and the posts, and pay the social security contributions. At the end, we helped them find another integrator who bought the cucumbers without taking advantage of the growers’ difficult situation.

Because of the contributions and repayment of the loan, producing 250 m of cucumbers does not generate profit by itself in the first year, however, with the help of family members, women cultivated a much bigger area, and thus they ended up with a net income. A real profit can be expected in the following year when no new investments are needed and no contributions must be paid any longer. (See the explanation in the frame above.) The integrator, however, told the growers that due to increased shipping costs she can only afford contracting with them if they recruit additional trustworthy partners in the village.

The initiative was a huge success, our group members, under the group leader's guidance, recruited 25 new growers, mostly Roma women, although there are some who are non-Roma. Trilateral agreements have been created among the growers, the integrator and Kiútprogram. For new participants, we continued to provide loans to cover the cost of investments and contributions, except for the steps of regular group forming and sequential lending. At the same time, forming the group last year has not been useless at all, because without the efforts of the group, the recruitment would not have been successful. The members of our original group will pay the loans back within two months and can continue their business activities without taking any new loans.

The regulation for social security contributions for primary producers is rather peculiar. According to the rules, primary producers must pay contributions in the year when their license is issued, but not from the following year. The amount of the contributions is based upon the assumption that the producer will make at least the minimal wage. This amount must be paid even if no income was generated.

For foreigners, it might be irrelevant how this system came to life due to granting and withdrawing allowances. The point is that the system is rather absurd and dysfunctional since agricultural startups would need allowances the most. Some potential clients (not the cucumber growers) were deterred by the very fact that due to the obligations to pay contributions and repay the loan, they could not make any profit in the first year. Fortunately, our field workers informed them that they should not give up their plans, just put them off a little. If they get their license in December, they are required to pay contributions for only a month, and they will start the actual work – and take the loan – only the following spring.

Even if this regulation is a local peculiarity, probably there is some other type of inconsistency in the employment, taxing or business regulations of any country.

According to the integrator's own account, she had some negative experiences with growers who sold their produce to higher bidders and she hasn't contracted with Roma for several years. Now, however, seeing the achievements of the women and our contribution, she changed her approach and was ready to do additional training if necessary.

Of course, we may face many hurdles before the next harvest. There is no guarantee that everyone will work with the necessary intensity and endurance, and weather is another huge risk factor. Whatever the end result, this case study indicates the right direction if we can continue the programme: help our clients connect with the normal flow of economy by building trust and assist this by providing loans and facilitating networking. Another

important lesson is that we as loan providers need to handle the lending process with maximal flexibility, accommodating to the circumstances.

Briefly we also summarise the story of the confectionery shop. This member received a loan of 2000 euros while the family also had some financial resources on their own, and they invested lots of work into renovating the shop. Within very short time, the shop became a central destination in the village, children – Roma and non-Roma – started to meet there after school instead of hanging out in the streets; actually, this is the only place where people can meet and talk and alcohol is not served. Probably this was the reason why the integrator asked the owner of the confectionery shop to coordinate the collection of cucumbers. Regardless of future events, it is obvious that there has already been a significant advancement in the integration of the Roma in the village.

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