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Country note - Hungary

Kiút ('Way-out') Social Microcredit Program, 2010-2012

Summary

In 2008 the Polgár Foundation for Opportunities (*Polgár Alapítvány az Esélyekért*) launched the preparations of the Kiútprogram, the social microcredit program in Hungary. In June 2010 the program won a community tender and became officially the pilot program of the European Union.

The main goal of the Kiútprogram was to promote social mobility and integration of people in disadvantaged areas by enabling them to become self-employed and to establish small start-ups (or turn their informal activities into registered enterprises). The less explicit mission of the program was to reduce negative stereotypes about poor and vulnerable groups (especially the Roma) by promoting the emergence of local small businesses, thereby demonstrating the willingness and the ability of the participants to act in an autonomous and responsible manner. So, the program's emphasis was as strong in empowerment as in economic and financial inclusion.

The Kiútprogram targeted people in the disadvantaged areas of Hungary, mostly, but not exclusively the Roma population. Apart from deploying financial services (i.e. small business loans based on loan groups), the clients received a wide variety of business development and support services – such as group-level and individual counseling, accounting services, training focusing on financial literacy and business skills, and mentoring. Lack of credit or limited access to financial services, information and motivation problems of the target groups, and ethnic discrimination in general were the main issues the program sought to tackle.

The Kiútprogram Microcredit Initiative Non-profit Ltd. (Kiútprogram Közhasznú Nonprofit Zrt.) was established in 2009 to manage the implementation and the Raiffeisen Bank became the partner institution from the financial sector.

The program was based on the Grameen model but adapted to the Hungarian context. First, field workers played a more important role by providing the clients with assistance, especially in tackling discrimination, in overcoming administrative burden levied on any start up in Hungary (c.f. obtaining official licenses, opening cash and deposit accounts, effectively setting up the business). Second, the program provided an extensive set of business support services (e.g. bookkeeping, business assistance in decision-making, training *after* the disbursement of the loan). This comprehensive approach was justified by the complexity of the challenges the target group faces in the local context.

The program was based on group lending. Group dynamics along with specific operational rules were supposed to enforce repayment. During the pilot phase (2010-2012) the program was revised and modified because of the slow take up of the program and due to the bad performance of the first wave of clients in the first year.

There were three major challenges the program had to face. First, it was hard to find the 'born-to-be-entrepreneurs' – especially in the first set of target settlements (cf. settlements in the most disadvantaged areas of Hungary). Careful assessment of entrepreneurial skills, more rigorous testing of the business ideas, and consistent checking of the individuals' credit history have helped, though did not prove to be still the perfect screening of clients. Second, the "ideal" field worker was supposed to be a personal mentor, a community worker, and a loan agent with relevant financial and business

expertise at the same time. Obviously, this triple set of criteria was not easy to be met by one person. Finally, the lack of welfare-bridge or financial leverage for the first period was clearly a great challenge to many clients of the first year. New businesses need time to turn lucrative (especially in agriculture, the sector preferred by many of the clients of the Kiútprogram). Finally, the management helped the clients of the second program cohort onwards to receive income support, but it was available only for the first six months after loan disbursement and notably not guaranteed for all the clients automatically. The program managers have also started negotiations with the Hungarian government to ensure tax allowances for the participants, but these efforts failed at the end.

The program was successful in reaching out to the target population, but performance indicators were rather mixed. The project continued to a smaller extent (with reduced number of clients) after the official closing date of the pilot phase (June 2012). One of the most important recommendations to program designers in countries with relatively generous social benefit systems (c.f. EU member states) would that the disincentive effects on the labor supply of disadvantaged people should be systematically assessed before the launch of any program. Income support and / or enhanced business support services for the first period are strongly recommended to tilt incentives away from the *status quo*, towards entrepreneurship. In mid-income countries with an over-regulated but still unstable business environment (c.f. transition economies), the program designers have to assess the administrative and compliance costs of market entry and to internalize these costs by increasing the operative costs of the program. Last, but not least, the Kiútprogram provides a good example of how the field workers have to be selected and trained, and why it is necessary to streamline their responsibilities and separate the roles of mentor and social worker from that of the loan agent.

Objectives

The main goal of the Kiútprogram was to promote social mobility and integration of people in disadvantaged areas by enabling them to become self-employed, to establish a registered small business and /or turn the informal activities into a legal enterprise. The implicit mission of the program was to improve majority attitudes and to decrease discrimination against vulnerable groups, such as the Roma people. The program offered microcredit schemes and provided supplementary business support services (e.g. mentoring, training, bookkeeping, marketing) to help clients starting their own business.

The target group was disadvantaged people living in deep poverty in Hungary. The program targeted explicitly, but not exclusively Roma women and men. The founders and sponsors of the program defined the initiative as a '*social microcredit program*', thereby indicating their balanced approach between the social cohesion and financial objectives.

Rationale

National context

In Hungary the share of self-employed among all employed people is significantly smaller among the Roma (5%) than among the general population (15%). Roma self-employment in the overall working age population is also lower in Hungary (2%) than anywhere else in Central Eastern Europe. Interestingly, motivation does not seem to be one of the effective barriers. According to survey results, 24% of the Hungarian Roma population would prefer to start a small business (World Bank – UNDP 2012).

In most countries with considerable Roma minority, people from this group face severe challenges to (re)-enter the job market as self-employed. Research evidence suggests that the main obstacles to start their own business are for example that they have limited access to financial services (including access to bank accounts as well as to credits and loans) and limited experience in running a business. They usually do not have savings, can not provide a collateral and/or are already indebted. In addition, along with generally low level of education, their financial literacy is critically low (Molnár 2012, World Bank-UNDP 2012).

Among the disadvantaged groups, the situation of Roma people in Hungary is further exacerbated by the massive negative stereotypes of the majority, and by the media that tend to present the Roma in conflict situations and do not provide a balanced coverage or the Roma communities' lives (Bernáth-Messing 2013). Prejudices persist, and anti-discrimination legislation and administrative procedures to tackle ethnic discrimination are not effective, presumably to some extent because their enforcement is weak (Majtényi 2009).

Program context

The Kiútprogram aimed to address both market and government failures. First, the program focused on remote, small regions of Hungary, where the level of business activity is low, public infrastructure is underdeveloped and business investments are far below the national average. Normally, in these localities the only employment opportunity is the participation in public work programs, which usually offer seasonal employment and are not effective in helping participants find a permanent job (BI 2011).

Secondly, the program provided assistance to cover the relatively high entry costs (in terms of both financial costs and administrative burden) of starting a business compared to non-Roma reference groups or to people living in less disadvantaged areas of the country (Reszkető-Váradi 2012, Molnár 2012).

Thirdly, the high prevalence of the informal economy in those disadvantaged areas (and mostly in sectors preferred by the target group, esp. agriculture, animal husbandry, and retail) makes it almost impossible to start and operate a lucrative business legally due to the competitive disadvantage caused by paying taxes, social contributions and complying with other relevant regulatory obligations (Reszkető-Váradi 2012, Molnár 2012).

In sum, there were multiple rationales beyond the program: to address the lack of funds necessary for the entrepreneurial activity of the targeted people, to overcome both the information and motivation problems, and to minimize transaction costs and mitigate discrimination.

Activities

Relevant actors

The Polgár Foundation for Opportunities, a Hungarian foundation came up with the idea to adapt the Grameen model to the Hungarian context in 2008. They commissioned a feasibility study to assess needs based on field research. In September 2009 the Foundation submitted a tender to the European Commission for a pilot project in microfinance. This application was based on the results of the preparatory research mapping the potential target regions and the local Roma communities' needs (Molnár 2012, Szuhai 2008). In March 2010, the European Commission decided to support the program as a European pilot project in microfinance for the period starting in October 2010 through June 2012. The Polgár Foundation remained a co-sponsor.

According to Hungarian financial legislation, only firms registered as financial institutions are allowed to disburse loans. Thus Raiffeisen Bank became the financial managing partner of the program. They issued the loans and took expenditures and losses of lending up to HUF 20 million (EUR 67.000) within the framework of their corporate social responsibility program. The bank also offered savings accounts and provided training to bank staff members in the regionally designated local branches.

The Kiútprogram Microcredit Initiative Non-profit Ltd. (the Managing Company) was established in September 2009 to serve as the managing body. The Managing Company was in charge of the smooth operation of the program – that is, of selecting, training and coordinating the field workers, screening and training clients, offering all the supplementary business services (see below), and managing the loan contracts. The World Bank and the UNDP supported the program monitoring (especially the design of the monitoring database, the collection and analysis of monitoring data).

The field workers were the key actors in the actual delivery of the main program services. They were responsible for mapping and screening the potential settlements and participants, providing the training and individual business support at local level, supporting the preparation of individual business plans, and facilitating the operation of loan groups. With the progress of the implementation, they also turned to be the key program agents in charge of monitoring the small business activities, organizing the loan group sessions after loan disbursement, and giving early warning in case of non-repayment or any other emergency. Most of the field workers had education in social work and the selection process was based on screening their relevant experiences. All the selected field workers had to participate in a month-long training module before starting any fieldwork.

Notably, the turnover rate of the field workers was extremely high during the first year of the program (ca. 90% of the field workers hired in the first months of the program implementation period opted out in the next year). The Managing Company advertised to hire new field workers five times during the two-year-long program period, and they have also constantly fine-tuned the training program of the new entrants.

Selection process

The clients were recruited from a pool of population in the target micro regions with less than 60% of Hungary's median household income. The program prioritized women; despite that, only 40% of the applicants and 48% of the clients were female. Interviews with clients (though not based on a representative sample) suggest that even the official numbers might over-represent women, since on several occasions in effect male partners/ husbands ran the business instead of the formal female participant (World Bank-UNDP 2012).

The selection process took place as follows: first, the field workers screened the potential settlements. In 2010-2012 the field workers visited 202 settlements in order to make public announcements on the program, to organize local community meetings. At these meetings they shared information about the microfinance scheme and the supplementary business services. In case of local interest, the field workers visited the families interested to assess the economic and social conditions of the potential participants on site. They also filled the entry questionnaire during these visits to register basic information about the applicants (and their household members). At this stage of the selection process usually 8-9 candidates were chosen to form a loan group (taking future dropout into consideration). The groups were organized based on location, and the candidates also had to go through a number of filtering criteria - for example, having no unpaid taxes or any other debts as the most crucial ones to start a registered business.

In the next stage, group meetings were held, where the field workers tried to explore earlier business experiences of the group members. The group had to select a leader and to approve the group rules. They also had to create a simple but realistic draft business plan. The Credit Committee operated by the

Managing Company evaluated the individual application packages (including the entry questionnaire, the evaluation by the field worker, the draft business plan, and an individual scoring), and made the final decision in consultation with the field worker.

Loan settings

The program designers used the Grameen model as point of reference. So the program was based on group lending, and the loan groups served as substitute to the lack of collateral and as a forum for sharing experiences and mutual learning. Group dynamics and operational rules were supposed to enforce repayment, since the group members received loans sequentially and on the condition of no default - i.e. first, only two members received their first installments, then another two members and the group leader was the last to receive his or her credit share. The loans had originally a one-year tenure and there was a weekly repayment schedule.

According to the original plans, the loans were provided in three setups, each under a weekly repayment schedule (EUR 670 – 6 months tenure, EUR 1,670 – 12 months tenure, EUR 3,330 – 18 month tenure). 49 people received loans under these settings with an average loan of EUR 1,825 per person and an average duration of 52 weeks. (Reszkető and Váradi 2012; World Bank 2013)

Change in program design and management framework

In early 2011, it became clear that adjustments were necessary. There were two main reasons for the adjustments: first, during the fall of 2010, recruitment of clients took off much at a much slower rate than expected. By the end of 2010, the program had 11 loan groups with about 70 participants involved, clearly underperforming the planned target numbers (100 clients by the end of the first year) and jeopardizing the overall outcome indicator of having 400 clients finally. Second, the failure rate was extremely high (80% late- or non-repayment).

During the first half of the second year, the following changes were introduced:

- *Enhanced screening of clients and shift in geographic targeting:* The program managers put greater emphasis on mapping the credit history, the business links and the experience of both the potential clients and their family members. They also moved away from the most disadvantaged small regions. As a result, potential clients who had prior business experience or at least links to existing business networks were more likely chosen. It also resulted in a slightly higher economic stratum as updated target group.
- *Broadening the scope of supported business activities:* Based on field experiences agriculture, hitherto discouraged, was included among the possible sectors to start business in.
- *Enforcing repayment and group dynamics:* The adjustments led also to the formation of loan groups with fewer than five members - a minimum threshold taken very seriously in the first period. They have also focused more on developing business plans along with introduction of stricter evaluation criteria. Reshaping of the loan setting (new average amount and duration: EUR 1,832 and 43 weeks) and the new option to reschedule the loan payments were introduced to assure that clients can pay even after the end of the first six months of business operation. They also maid more effort to support all the clients to get the state support scheme (‘*Vállalkozóvá Válási Támogatás’*, hereafter: *VVT*) available for start-ups for the first six months of operation. It turned out to be crucial primarily to cover tax and social security contributions levied on the self-employed.

  (Notably, according to national regulations, self-employed people have to pay taxes and social contribution based on the minimum wage level fixed for the given financial year – irrespectively of their actual revenues.)

- *Reinforcing management and improving the training of the field workers:* The management of Kiútprogram established a crises committee to assist defaulting clients individually, hired new field workers with better experience in social work and, in response to client feedback, revised the training program of the field workers. They also nominated so-called regional coordinators to improve communication among the field staff and between the program office and the field workers.

Finance

The European Union project 'Pan-European Coordination of Roma Integration Methods – Roma Inclusion: Self-employment and microcredit' was the main financial source for the Kiútprogram, next to the sponsorship of the Polgár Foundation. The overall budget of the program – including operational costs and loan portfolio – was EUR 1.4 million. The EU project provided pre-financing (85%), and the remaining share was transferred after the official closure of the program.

The Hungarian government was co-financing the program management costs to some extent (HUF 200 million, EUR 666,670) and the sum of the start-up state support scheme (*VVT*) given to clients amounted to HUF 135 million (EUR 450,000) during the program period. After the end of the pilot phase, the program follow-up activities and some of the local projects were financed by private charity (mostly by the Polgár Foundation).

Challenges encountered

The program faced several challenges, but, based on the evaluation studies (see the next chapter) we restrict ourselves to pinpointing the top three ones. The first challenge for the program designers was to get targeting right. It was hard to find the 'born-to-be-entrepreneurs' – especially in the first set of target settlements (cf. settlements in the most disadvantaged areas of Hungary). Even a careful assessment of entrepreneurial skills, the rigorous testing of the business ideas, the consistent checking of the individuals' credit history may not guarantee perfect screening of the potential clients. In addition, the sustainability of any business activities in the most disadvantaged areas is made especially hard by the lack of access to regional markets and business networks. Consequently, the Kiútprogram shifted its focus to slightly more "upmarket" clients, to locations with better access to regional markets and existing business networks. They also developed training and information sharing services provided after loan disbursement and offered bookkeeping services to their clients even after the first year of participation. All of these program elements were justified based on feedback both from clients and from field workers, but certainly none of them would guarantee the sustainability of businesses started under the program.

The second challenge was to recruit the "ideal field worker" who was supposed to be a personal mentor, a community worker, and a loan agent with relevant financial and business expertise at the same time. The expectations were high regarding their inclusive attitude, their practical know-how concerning basic financial and business issues, their ability to be an information broker and leveraging group pressure, but also gaining the trust of the group members and representing their interest at the government offices (occasionally negatively discriminating Roma clients otherwise). These expectations added up to a checklist hard to meet by any person. The clear, though more costly solution would have been to assign these tasks to different positions and select staff members with various background and experiences.

Thirdly, new businesses need time to take up, very often even more than one year. Provision of a welfare bridge either in the form of an income support or *via* tax allowances seem to be crucial – especially for the first business year. The Kiútprogram initiated cooperation with the Hungarian public employment offices to ensure access for the clients to the specific state aid scheme available for new entrepreneurs for the first six months of their operation (*VVT*). Unfortunately, they could not sign a partnership agreement at the institutional level, but the field workers were informed about this opportunity and they intensively promoted and supported the individual applications. The lack of financial leverage for the first period was clearly a great challenge to many clients. Alternatively, loan scheme with longer tenure and lower weekly installments are the other options to promote higher repayment figures. It is worth noting though, that even a more relaxed loan setting may not guarantee higher survival rate if business plans do fail in practice.

Impact

There is no *ex post* evaluation study on the project, but a comprehensive monitoring database was set up in partnership with the World Banks and the United Nations Development Program (UNDP). There were 192 participants and 138 clients in total. The program succeeded in reaching out to unemployed people (86% of applicants had been unemployed for more than one year before entry or was registered as inactive), to households with very low monthly income (median monthly household revenue was HUF 68.250, EUR 227) and mostly with a size of 4-5 people. The share of applicants with secondary education or higher was very low (13%), and 87% of them lived in a rural environment.

Regarding the business characteristics, 45% of the businesses to which loans were granted were in agriculture and forestry and 55% in retail. Based on the entry survey, run by the World Bank, 68% of the clients lacked finance in setting up businesses and 95% claimed that the main source of starting capital was the bank loan received. The average level of sales in an ‘average sales’ month was HUF 68,312 (EUR 227, ca. 93% of the minimum wage level in 2010). The repayment and the survival rates were constantly improving. By May 2013 (almost one year after the official program closing date) 45% of the businesses were still in operation and 55% was the payment per credit ratio. The project continued to a smaller extent (with reduced number of clients) after the official closing date of the pilot phase (June 2012). The program management followed old clients and expanded one of the successful business projects (originally a loan group specialized in cucumber-growing, later expanded at the micro-regional level).

Ex post monitoring data suggest that among borrowers repaying on time the share of women and the share of those who were active in community life already before the project (i.e. taking part at least weekly in discussions and decisions of some kind of local community) was significantly higher than in the other groups (World Bank-UNDP 2012). These findings are in line with the international experience, and suggest the importance of gender and local connections / cohesion as selection criteria.

The World Bank-UNDP prepared the final monitoring report (2012), and the program management commissioned a mid-term evaluation study in 2011 (Reszkető-Váradi 2012). Both studies emphasize the importance of a comprehensive approach in the program design, indicated also by labeling the program as a social microcredit program. The program management was consistently initiating changes in the program design, and also kept offering a highly mixed set of services (mentoring, training, financial services). Both papers suggest that longer pilot period (at least, 3-4 years) and less pressure to perform in outcome indicators could have led to the development of business support services and to higher quality services. Costs of the mentoring services had been underestimated, and the shift in geographic targeting was necessary given the contextual challenges and the budget and time-constraints of the project.

External evaluators also agreed that potential participants should be selected and screened very carefully to support only viable business plans for which there is demonstrated demand in the (local/ regional) market, and project design should also think of ‘exit strategies’ that offer help or a clear-cut phasing out support for participants to maintain their business operation even after the program is finished.

Regarding cost-effectiveness, the World Bank-UNDP (2012) and Molnár (2012) compares the Kiútprogam to public work programs. According to their assessment, the costs are about the same (gross EUR 2010 per month per client), but the Kiútprogram might successfully improve clients' chances of becoming employed or self-employed as opposed to public work schemes that do not offer transit options in the long run. Unfortunately, due to lack of *ex post* impact assessment relevant evidence is missing.

For a summary of strengths and weaknesses of the Kiútprogram, based on the monitoring and evaluation reports, see table below.

Strengths	**Weaknesses**
• Comprehensive approach; • Continuing the project on a smaller scale even after the pilot period ended; • Support to business opportunities for which there is demonstrated demand ('cucumber project'); • Changed perception about Roma people being unmotivated and lazy (which is a primary hampering factor for them to be entrepreneurs); • Adjustment of the program based on the on-going experience and clients' feedback.	• Initial difficulty in finding qualified potential clients • Initial failure in the screening of applicants (high rate of non-repayment, clients used loans to pay back informal debts, very few remained operating enterprises after the end of program); • Lack of local markets and the relatively high administrative burden on start-ups was not taken into account enough; • Slow progress in the kick-off phase

Source: Molnár 2012, Reszkető-Váradi 2012, World Bank-UNDP 2012

Conditions for transfer

In the context of welfare states where a public benefit system may provide the potential target group with a safety net (of some sort), the program designers have to be very careful with matching the needs of the clients. The public benefits eligible for long-term unemployed may deter potential program participants and may result in relatively high alternative and highly unforeseeable costs of change. The certainty of public transfers even if low in amount is measured against the risky expected incomes of a start up at the individual level – unless there are additional benefits linked to participation, such as for example opportunities of training, skill and competence-building, and / or building social capital. It is also crucial to provide a welfare bridge for the first period (that means, for the first or even also the second business year) so as to minimize the risk of failure. The relatively generous social benefits provided by the Hungarian government (at least, at the time of the launch of the program) had a strong disincentive effect on the labor supply of disadvantaged people, and this effect shall be better assessed *a priori* in case of similar programs.

In middle-income countries the business environment can be over-regulated compared to developing countries, but still unstable compared to developed ones (see the case of Hungary). *Ex ante* assessment of the administrative burden on start-ups and that of the regulatory environment (especially of the sectoral regulations in case of sector-specific programs) is very important in the design phase. Any similar program should address these contextual challenges by internalizing the related costs emerging on the clients' side (i.e. at least partly re-financing the emerging costs at the clients' side).

The loan scheme, especially the amount of the loans, should also be tailored to the business environment, as well as to the tax regulations in effect. This may mean higher sums as start up capital in the European countries than in the developing context due to stricter regulations and higher tax burden.

Last, but not least, in the Hungarian case the field workers proved to be the key actors in the implementation phase. The Kiútprogram provides good lessons on the selection of the field workers and on the diversification of their tasks. The simultaneous roles of being social worker and loan agent and the complexity of the related services may turn to be critical. It is necessary to streamline the responsibilities and hire staff members specialized in these different roles separately.

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