

KIÚTPROGRAM

Executive Summary

1. VISION

The mission of the Kiútprogram MFI (KP) is to help people living in deepest poverty – mainly of Roma origin – to improve their situation with dignity, by providing them with financial services, information and social assistance.

The idea of improvement with dignity covers specific areas, such as to increase the household income resulting from legal work and micro enterprise, allowing improved life styles, mainly improved education for children. This could contribute to breaking the poverty cycle and allow social improvement for the next generation.

The Program intends to share a vision with its future clients that motivate them to participate in local public affairs improving their inclusion and presenting them as examples for their peer group. Another part of the vision is to assist the clients liberating themselves from the debt trap, to achieve social respect by participating in the legal labour market and by becoming contributing members of society.

The planners of Kiútprogram took Professor Muhammad Yunus's Grameen Bank, successfully operating in Bangladesh for decades as the main example. The bank lends tiny amounts of money to the very poorest members of society, mainly to women. The model has been successfully adapted in past years to local conditions in at least 60 countries. Following the Grameen model, one of the main features of our proposal is the organisation of groups of borrowers; where the members support and learn from each other, depend on the success of each other, even make business decisions jointly. Field work therefore always starts with community building facilitating the choice of the best eligible clients and training them to work as a group.

Our most important aim is to introduce clients into legal economy by supporting them to start a legal business. We intend to lend money to start a small business generating enough revenue to service the loan and generate additional income for the family. The clients are entitled to receive continuous administrative, financial and business advice and assistance from Kiútprogram

In the first two years the Program is experimental and intends to reach a relatively small number of participants. The planners of the Program – even if successful - do not claim that it could solve all problems of structural poverty or that it could provide solutions for all poor families. It could however become one of the many necessary tools.

A number of the elements in the Program make delivery difficult or impossible by the Government or Municipal sectors as well as profit oriented enterprise. On the other hand certain other essential elements can only be expected from the State. Such are the (partial) coverage of financial risks of the Program, a “welfare bridge” for families choosing legal work instead of social benefits and certain amendments in prevailing legislation. The promoters of the program intend to contribute themselves through cash and in kind donations, CSR and voluntary work.

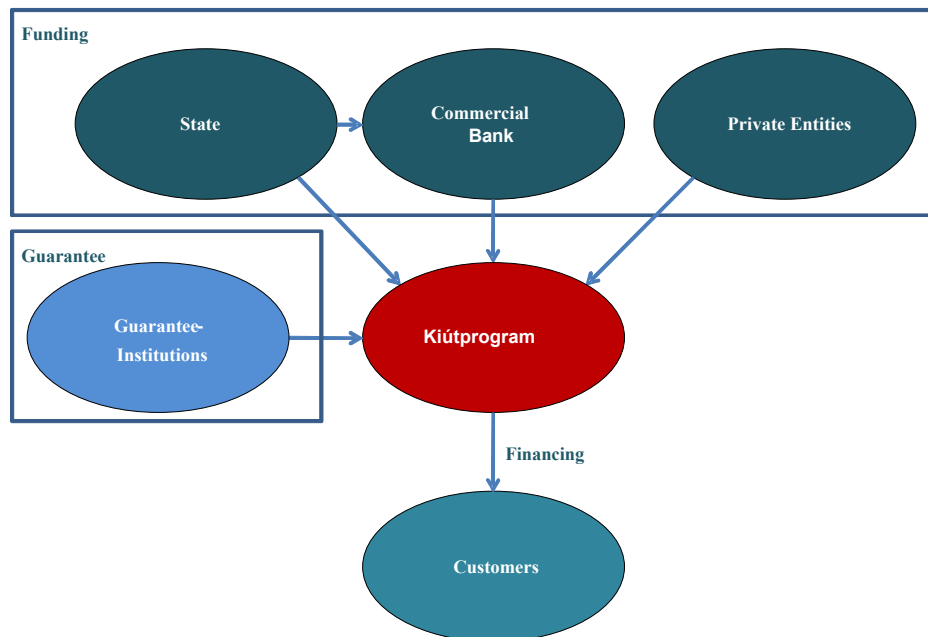
2. Operating the Model

Kiútprogram delivers the micro finance services to its clients through a social enterprise consisting of more corporate entities. The credit and savings products as well as back office services are provided by a commercial bank – in this case Raiffeisen Bank Zrt. The Bank also provides funding with Government refinancing backed by Új Magyarország Mikrohitel Program. “Product marketing”, customer relationship and advisory services are provided by Kiútprogram, as agents of the Bank.

The argument behind this solution is that regulatory conditions do not allow Kiútprogram to act as a financial institution; a regular commercial bank on the other hand is not suitable to service the desperately poor with microfinance.

The commercial bank does not charge commission on its activities; it undertakes banking costs and 20% of loan losses under its CSR program. To cover the remaining 80% of loan losses we are contacting several Government sponsored credit guarantee institutions.

Stakeholders



Funding

State	<ul style="list-style-type: none"> • Indirect support to the Kiútprogram customers through the subsidy of services, amounting to HUF 335.000.000 presumably • Providing guarantee covering 80% of loss loans through a guarantee institution
Raiffeisen Bank	<ul style="list-style-type: none"> • Funding 100 % • Taking over 20% of loss loans in the framework of its social responsibility (CSR) program

	<ul style="list-style-type: none"> • Operating back-office for credit operations • Generating the new credit and saving products in the books • free account management for the clients
<p>Other Private Sponsorship</p>	<ul style="list-style-type: none"> • Cars • Petrol • Computers • Internet connection • Mobile and fixed line phones • Accounting, tax advisory, legal services • Image and web design • Stationery • Social shareholders

The program had already started when we were informed that the EU Commission intended to support Polgar Foundation. The amount of HUF 330.000.000 presumably should be used for the programme between June 2010. - May 2012.

GOVERNMENT ASSISTANCE REQUIRED

Assistance to customer services

The State indirectly assists the clients of Kiútprogram by covering the operational costs of the non-profit organisation. It is suggested that a Government Agency signs an agreement to cover a significant part of the expenditure necessary to provide the services to the clients during the pilot project. According to the financial and operational model the required Government contribution for the two year Pilot period is HUF 300 000 000 Kiútprogram anticipates significant contributions from the private sector as well which are actually subject to current negotiations. It is our intention to return unused Government contributions at the end of the Pilot.

Government refinancing

The loans extended by the Kiútprogram Program will be 75% funded by state sponsored programs designed to assist small enterprise. The balance will be funded by Raiffeisen. As the Program does not exactly comply with prevailing conditions of the State sponsored funding program, certain amendments and simplifications will be required.

Competitive conditions for enterprise

It is essential that Government creates the legal and regulatory background assuring business success for the beneficiaries of this Program, a level playing field.

To find out the necessary Government actions we researched the potential outlays and incomes of individual micro entrepreneurs to establish at what level of income it would be worth their while to come off social benefit and start a business. Our conclusion was that even if our clients were successful to obtain the Governments income support grants to assist

starting an enterprise (six months of minimum salary) the deficit of an enterprise would be HUF 80 000 – 100 000. Our calculations include loan instalments, all taxes and social contributions payable by small entrepreneurs. Very few of the businesses will be able to afford such level of cost.

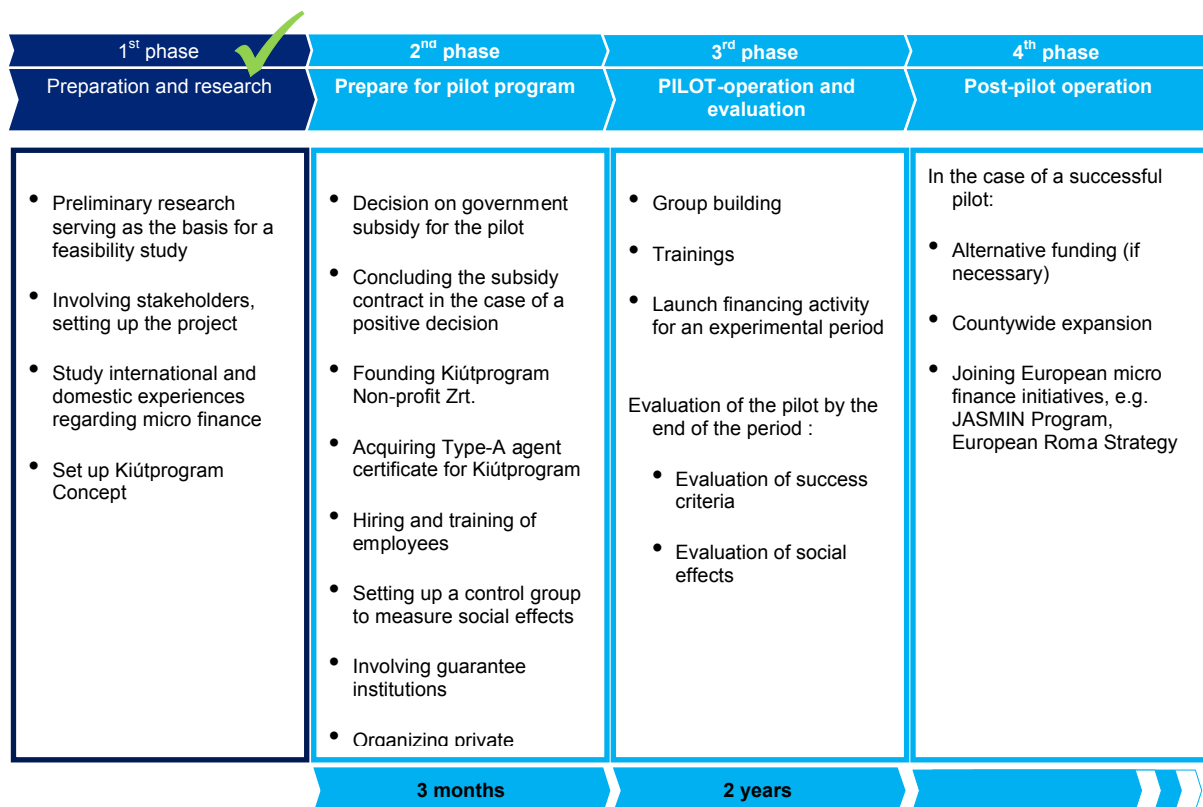
An additional risk of individual tendering by our clients for this assistance is that some of them may fail to succeed. They also may face problems of cash flow if contributions are late to arrive as often happens. We propose that Kiútprogram might apply on their behalf and distribute funds in a timely manner.

As a conclusion we suggest that the Government provide further assistance to the clients of the program to enable their success in the form of small amendments in existing legislation.

The most critical regulatory issue presently is that small companies are entitled to favourable social contribution obligations on their employees qualifying for a START card. These concessions are not available for individual self employed entrepreneurs, our target group, despite the fact that they have similar conditions i.e. they have no qualifications, they are long term job seekers and are entitled to social benefits. This is a serious competitive disadvantage for our potential clients

This discrepancy could easily be eliminated by extending the social contribution concessions to the self-employed as well. It is important in this respect that there are already precedents of support for self employed entrepreneurs in Hungarian legislation since early 2009.

3. Project timing and tasks



EVALUATING SUCCESS

The planners propose the following criteria to establish the success of the program at the end of the pilot period:

1. We plan to have 100 clients in the course of the first and 300 in the course of the second year. Our main task however is to achieve quality as opposed to quantity among our clients, to obtain experience for an eventual roll out. (The planned number of clients means that by the end of the second year 20 field workers should have established and serve 80 groups of borrowers)
2. 75% of borrowers repay the first loans not later than 30 days after the credit period. The repayment ratio for second loans should be 80%.
3. 70% of the good performers come back for a second loan (taking into consideration a 25% default rate this means a 52.5% want to borrow a second time). The returning borrowers do not count towards the target 300 of the second year.
4. The relative equivalent income of households participating in the program increases 10% in the first year and 15% in the second year.
5. The school attendance (kindergarten and other school types) of children of participating households is improving.

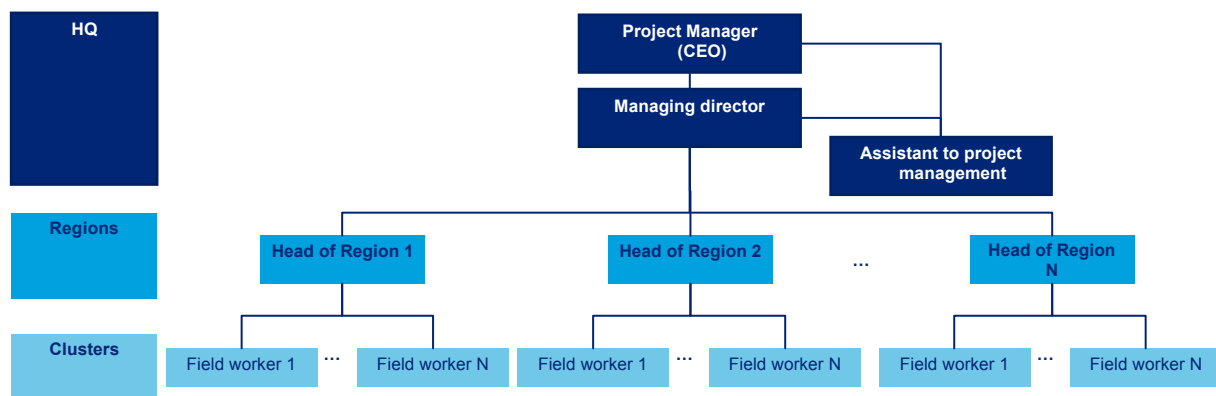
6. Participants of the program increase their participation in local public affairs thereby decreasing their social exclusion.
7. The wellbeing and health of the participants improves.
8. After the expiry of the START concessions successful participants increase their tax and social contribution payments, they join the legal economy
9. The percentage of the victims of usury is decreasing among participating households.

4. Structure of the Program

Target group

The target group of the Program are the desperately poor and socially excluded, mainly but not exclusively Roma. In most cases the field workers should be able to establish who belongs to the group but they have a detailed list of criteria to help their deliberation.

Organisational structure of Kiútprogram



Products

Kiútprogram intend to offer two basic products to clients aiming to assist the business of the new micro enterprise and to simplify the lending procedure. They are a loan product with different conditions (different amounts and maturity) with current account and a savings account.

Loan product

The aims of the loan product are complex. In the first round loans are provided for income generating activities only. In the second round loans for improving quality of life should be considered as well. Loans however can not be used to repay other debt (e.g. to the usurer) or for consumption. Proceeds of the loan funded activity of course can be used for these purposes.

To accommodate different needs of the borrowers we offer HUF 200 000 for six months, HUF 500 000 for twelve months and 1 000 000 for eighteen months.

The committed loan is not necessarily released at once, it may be disbursed as the funded business requires. Repayment is effected in all cases in fixed weekly instalments. Loan disbursement and repayment are fundamentally in cash and personally arranged by the field worker unless the client explicitly wants to use a current account.

There is no grace period, repayment starts with immediate effect. Interest is fixed at 20% pa. Should the planned business not generate immediate cash, repayment may be effected from borrowed and retained funds.

The loan agreement is not enforceable; there is no requirement of formal security or guarantees from borrower.

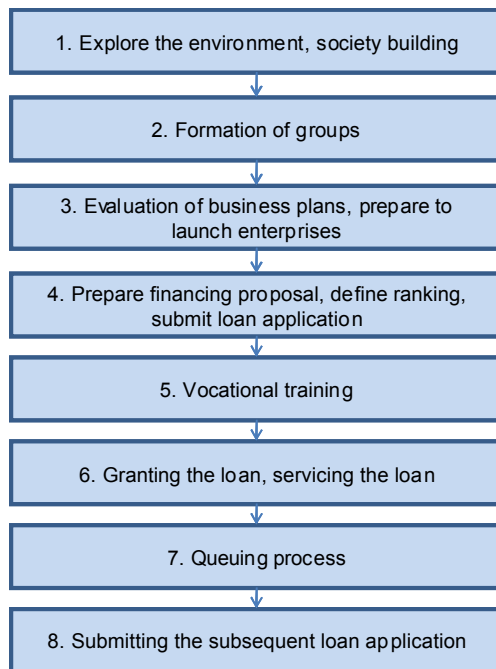
In case of non-payment the field worker has to establish the reason of failure. If he finds that the borrower is acting in good faith and failure is due to unexpected events in his or her business or personal life his duty is to assist the borrower to return to normal repayment. Should he find that the borrower acts in bad faith his duty is to work with the group leader and other group members to resolve the problem, in the worst case to exclude the non-paying member from the group and replace him with another. While one member is in arrears the lending to the group is suspended.

An explicit and important aim of the model is to encourage the participation of women in the program; at least 50% of the groups should have female members. According to international experience group lending schemes are more efficient if participants are women and women use additional household income more efficiently.

Savings product

An important element of the program is that field workers encourage their clients to make however small but regular savings parallel or independently from regular repayments. Kiútprogram therefore automatically opens a savings account for clients as well. The savings account earns interest at 5% under the lending rate (15% in our case) which is accrued on a monthly basis.

Lending procedure



Conditions of possible business propositions

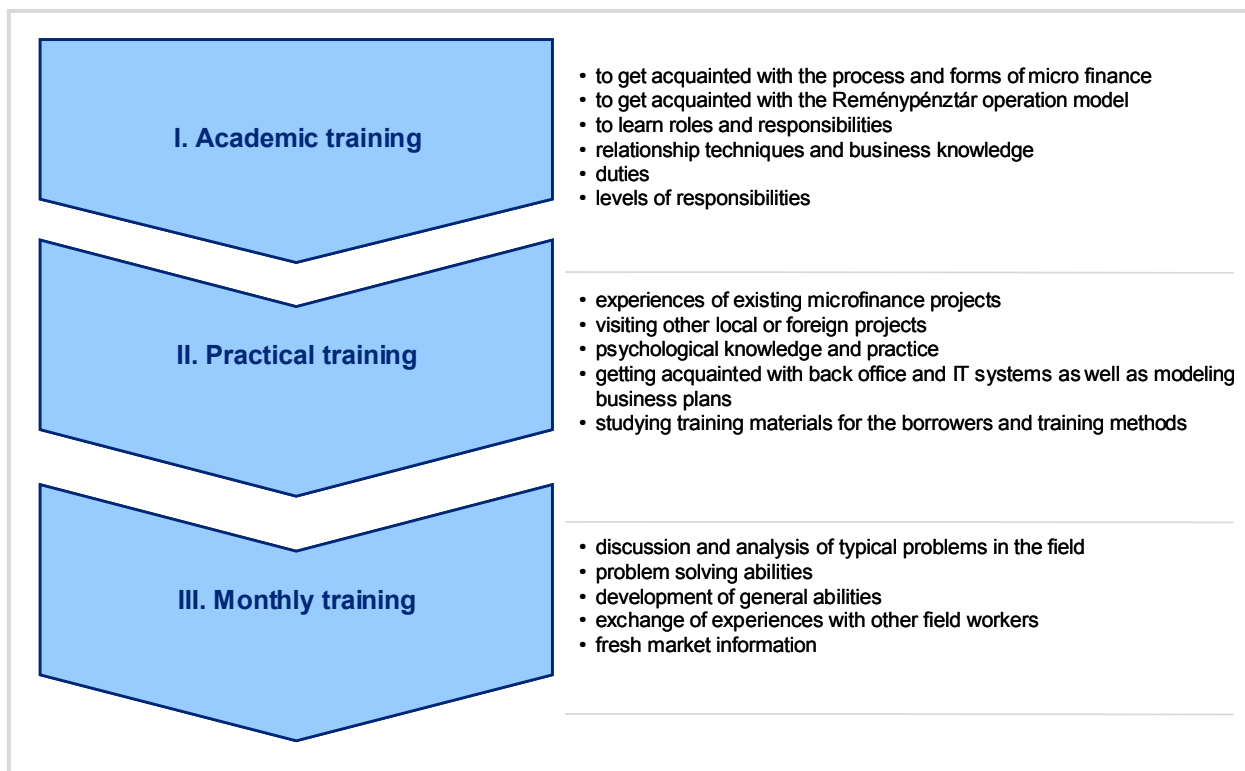
The range of potential business propositions is wide depending on traditions and requirements in the area of the borrowers as well as their ideas and ambition. Field workers should not interfere much in inventing business ideas. To ensure success however it is necessary to define basic conditions all proposals should conform with:

1. relatively short (1 – 1.5 years) cycle
2. not to satisfy immediate requirement but to have some future
3. to be a continuous activity preferably not cyclical
4. to accommodate development and diversification
5. the borrower and her or his helper should have an acceptable minimum of expertise and experience in the activity
6. the borrower should have the necessary network required for the activity
7. the borrower should be aware of the relevant market conditions, where and how to buy and sell, what the competition is doing, how to compete.

Training

Training the field workers

The motivation of the groups of borrowers as well as the success of the newly started businesses depends mainly on the sound judgement, aptitude and efficiency of the field workers. The Program therefore puts great emphasis on choosing, educating and motivating the field workers. They will be extensively trained in the field and exposed early on to direct and regular contacts with the target group through participating in local social work and group events. They shall also participate in a three stage theoretical training as follows:



Training the borrowers

Training starts during the community development phase of selecting the group leaders and establishing the groups. The most important part of this training is assisting the self selection process of creating the groups and jointly developing and accepting the business plans. Formal training of the borrowers commences in the phase after devising and accepting the business propositions to be supported and aims at the expected values and lifestyles of the borrowers. The field worker provides further individual training depending on the characteristics of each individual business.

5. Financial and cost analysis

We totally separate the financial analysis of the loan product and the cost of operations. Thus we can calculate the expenditure required to cover loan losses on the one hand and operations on the other. We do not calculate however future savings on social benefits and additional social contributions and tax income from beneficiaries of the program.

We made following assumptions while planning the model:

- loss of value depends on the amount of outstanding loans
- 25% of new borrowers default
- Successful borrowers ask for a second loan, this is a better quality portfolio, only 14% default
- Interest on loans is 20% funding is 10%

Financial results

Based on the above assumptions the financial results of the program are the following:

	0	1st year	2nd year	3rd year
<i>Average loan portfolio</i>	HUF 0	HUF 52 932 259	HUF 209 186 326	HUF 242 412 791
<i>Impairments and provisions for losses</i>	HUF 0	HUF -12 263 716	HUF -46 191 168	HUF -60 603 198
<i>Interest margin</i>	HUF 0	HUF 5 293 226	HUF 23 371 376	HUF 35 932 256
<i>Interest income</i>	HUF 0	HUF 10 586 452	HUF 44 290 008	HUF 60 173 535
<i>Interest expense</i>	HUF 0	HUF 5 293 226	HUF 20 918 633	HUF 24 241 279
<i>Financial result</i>	HUF 0	HUF -6 970 490	HUF -22 819 792	HUF -24 670 942

Operating costs

The largest part of operating costs – about 50% - is salaries, mainly the field workers' Also significant are transport related expenditure as well as the office costs of Kiútprogram We intend to raise most of non salary costs from private sector sponsorship to minimise State funding requirement

The annual cost of the Program is not much compared to social benefit expected. Should success criteria be achieved, it presents an efficient, long term solution to problems previously handled more expensively and far less satisfactorily A great advantage of the Program is that operating costs and financial losses can largely be covered by the utilisation of already existing State subsidy and credit guarantee systems To achieve this only small amendments are required in the existing structures as well as efficient utilisation of private donations

It is vital to list the benefits our successful plan presents for the State in handling structural social problems:

- the income producing capacity of successful participants improves, their welfare dependency decreases both short and long term
- after the expiry of the contribution concession,(about 3 years from commencement) the stable small businesses produce extra tax and social contribution revenues
- the availability of products and services improves in participating disadvantaged villages
- improvement of school attendance (especially in kindergarten and secondary education) among the children of participating households
- improved health for participants
- lower exposure to usury and other petty crime in communities in the program
- improved self reliance for participants
- increased participation in public affairs resulting in more inclusion
- the success of participants decreases prejudice, proves that mass unemployment is the result of lack of opportunity and not intention Social tension lessens .