

VS/2006/0424-HU pilot project Project report

The *Hungarian Microfinance Network* ® as the Hungarian partner of the European Microfinance Network (EMN) launched a 'pilot project' within the international project No. VS/2006/0424 supported by the Committee of the European Union in order to improve the **equal opportunities of women** within the scope of enterprise financing and development.

1. THE PROFESSIONAL, ORGANIZATIONAL AND LEGAL BACKGROUND OF THE ORGANIZATIONS HANDLING THE PROJECT

Professional background

Group 24 of the developed industrial countries made a decision for the first time in 1989 to support the process of economic and political transformation in the former socialist countries of Central and Eastern Europe. The Phare programme was started in 1990 in Poland and Hungary (this is where the PHARE abbreviation comes from: Poland-Hungary Assistance for the Reconstruction of the Economy, in other words Aid-programme for the Economic Transformation of Poland and Hungary) within the scope of this support.

Following the historical changes taking place in the region, the number of the countries receiving the benefits increased gradually. The purpose of the aid-programme was to facilitate the change-over to market economy in the countries of the region, which among others included privatization and the full liberalization of the economy, too. This step provided funds from which the individual governments could finance the transformation managed by themselves.

Recognizing that small and medium-size enterprises play a determinant role in furthering the economy, the government of the Hungarian Republic worked out an entrepreneurship development programme. As an important element of this, the government initiated the establishment of an agency aiming at supporting and motivating the enterprises. Various financial institutions and bodies representing interest joined this initiative, and the 16 founders set up the **Hungarian Foundation for Enterprise Promotion (HFEP)** on 27 March 1990 with a starting capital of HUF 4.24 billion.

Since the objectives of the PHARE programme launched in Hungary and the objectives of HFEP were the same, the HFEP was entrusted with the handling of the aid-programme of 21 million ECU reserved for the development of small and medium-sized enterprises in the 1990 budget of the Phare programme. The Phare required the setting up of Local Enterprise Agencies' (LEA) network, where the previously mentioned target group is supported in the form of professional counselling and business services. Thus, since 1991 the main activity of HFEP has been the creation of the national network of the Local Enterprise Agencies (**enterprise agencies operating in the counties and the capital** ®).

At the outset six pilot LEAs were set up – in the form of a non-profit foundation – then the network was expanded to the whole territory of the country.

The concept of launching the National Microcredit Scheme was outlined at the beginning of 1992. Within the framework of the Phare programme, the Committee of the European Community wanted to lighten the concern also well-known to developed economies, i.e. that most of the micro and small enterprises are not credit-worthy for the profit orientated credit institutions, with this initiative. This is such a market failure where the market mechanism does not operate suitably - (*despite the competition there is no adequate supply created to the demand being present permanently*), the solving of which is in the interest of the national economy, and makes the intervention by the government justified and necessary.

In reply to these demands, the Committee of the European Community separated 1.15 million ECU from the 21-million-ECU subsidy directed to the sector of Small and Medium-sized Enterprises in the 1990-budget of the Phare programme in order to finance the programme to be launched.

After this, the **enterprise agencies operating in the counties and the capital** ® started to operate the first microfinancing construction launched as microfinancing programme in Hungary - *under the name of Microcredit Scheme (today National Microcredit Programme)* – in 1992 under the financial interposition and professional co-ordination of HFEP. At the outset the sources for the programme were provided by Phare (*then the Hungarian government as a co-financer*) in the form of earmarked subsidy subject to conditions. The manual as well as the terms and conditions of the programme were worked out by a British specialist company with the co-operation of Hungarian professionals in view of the domestic characteristics and legal background.

In May 1998, the European Economic Committee of the UN organized the Microcrediting Best Practice Specialists' Meeting together with USAID within the framework of Southeast European Co-operation Initiative (SECI), in which 12 countries - including Greece and Turkey – participated from Central and East Europe. According to the survey conducted by the British Bannock Consulting, the then existing Hungarian practice was the best microcredit programme in the region.

Organizations handling the project

The pilot project was handled by the individual bodies of the **enterprise agencies operating in the counties and the capital** ® forming the *Hungarian Microfinance Network* ® (the most important participants of the Hungarian microfinance sector).

<http://www.hungarian-microfinance.org.hu/>

The members of the Network, the **enterprise agencies operating in the counties and the capital** ® - *the first in Hungary* – began their microfinancing activity as described above in 1992 as a contractual partner to the Hungarian Enterprise Agency. As the entities managing the National Microcredit Programme in practice, only these organizations have microcrediting practice, experience and knowledge of more than a decade in Hungary.

Considering their legal form, these organizations are non-profit foundations (agencies). They are independent organizations having legal personality. The working body of the agencies is run by the managing directors. The managing directors are appointed by the advisory board elected by the founders. The advisory boards are the main supervisory boards of the agencies, which are managed by the president elected by the advisory board from its members.

The majority of the 20 independent enterprise agencies were formed with the comprehensive co-operation of the local communities and with the support of the European Community. When the microfinancing activity began in Hungary at the beginning of the nineties, the

Hungarian Delegates of the European Community as well as the HFEP selected these organizations by means of tenders or in certain cases established these organizations themselves in order to handle the entrepreneurial Phare programmes in Hungary.

Legal background

At the time of conducting the project the legal background to the microcrediting activity of the agencies operating in the counties and the capital was provided for by Section 2 (1) (h) of Act CXII of 1996 on Credit Institutions and Financial Enterprises, pursuant to which only these organizations may perform independently full microcrediting activity falling outside the effect of the act.

The nature of the microcredit projects operated by the organizations handling the project

It is important to note that the microfinancing programmes conducted by the organizations handling the project are only available for the participants considered as entrepreneurs/enterprises from a legal point of view of the sector in accordance with the Hungarian rules of law. The legal notion of 'social enterprise' or 'self-employing enterprise' is unknown in Hungary. That is why with regard to the purpose of the projects here we talk about microcrediting of '*entrepreneurship development purpose*' instead of microcrediting of '*social purpose*'.

2. DESCRIPTION OF THE PROJECT

During the course of the pilot project we started operating a special microcredit construction for female entrepreneurs or women wishing to start their own business under the following conditions:

GENERAL OBJECTIVES:

- to provide financial services in order to handle 'incomplete markets' (capital markets operating insufficiently) that have formed as a result of market failures by taking into consideration and ensuring the equal opportunities of women; in particular:
 - to provide suitable financial support, business advice and guidance for 'microenterprises run by women' by taking into consideration the characteristics and special needs of the sector;
 - the product should complete the services provided by the commercial banks in such a manner that it should provide financial support for 'enterprises run by women' the financing of which is too risky or unremunerative for the commercial banks, or which do not have the legal securities required by the banks;
- to provide help for the target group in order to ensure the own resources necessary for obtaining domestic and European Union subsidies;

SPECIFIC OBJECTIVES:

- to facilitate and motivate the setting up of micro and small enterprises 'run by women';
- to strengthen the small entrepreneurial sector, and to facilitate their improvement and expansion;
- to stimulate the developments and investments of the small entrepreneurial sector by means of the influx of capital tending to the sector;
- to expand the range of financial services provided for the small entrepreneurial sector and to improve the quality of such services;

- to facilitate micro and small enterprises to become the suppliers of big and multinational corporations;
- to facilitate and support the creation of corporate networks,
- to support economic innovation;
- to create new jobs.

THE RELATION OF THE CREDIT PROGRAMME TO OTHER FINANCING CONSTRUCTIONS:

The credit programme realized within the scope of the ‘Microcredit Programme for Women’ operates independently from other constructions, but it can play a complementary role in addition to the credit schemes offered by commercial banks, tenders invited by the European Union and Hungary, or other financing constructions (e.g. National Microcredit Programme and other Local Microcredit Programmes).

CREDIT CONDITIONS

Eligibility criteria

Microenterprises specified in Section 3 of Act XXXIV of 2004, if

- a) the individual entrepreneur or one-person firm, or agricultural producer, or intellectual freelancer is a woman;
- b) in case of an economic organization (or organization or enterprise pursuing other economic activity that has to be registered) the organization is owned by a woman in at least 50%; or
- c) in case of an economic organization (or organization or enterprise pursuing other economic activity that has to be registered) the managing director of the company is a woman.

Other eligibility criteria

- the enterprise must be profit oriented, i.e.
 - individual entrepreneur;
 - economic organization;
 - agricultural producer;
 - intellectual freelancer;
 - organization or enterprise pursuing other economic activity that has to be registered.

Purpose of the credit

The credit may be used:

- freely for investment purposes and for purchasing current assets. (The invoices do not have to be presented for paying out the credit, but the LEA may check if the credit has been used for the required purpose.)

The VAT content of the purchased assets may not be financed from the credit in case of enterprises entitled to reclaim VAT.

Credit amount:

- maximum HUF 5 million

Duration, grace period

- the duration of the credit may be from 6 to 96 month
- the grace period may be maximum 6 months, and may be granted for principal repayment.

Transaction interest

The credit has variable interest and must be paid monthly.

- The annual transaction interest of the credit is the same as the prevailing bank rate minus 1%, but may not be lower than 5%. (If the bank rate falls under 6%, the interest rate of the credit is 5 %.)

Rate of the required collateral

The legal collateral of the credit transaction (and the rate of the coverage) is determined by the Local Enterprise Agency (LEA) operating the programme depending on the specific credit transaction.

3. THEORETICAL BACKGROUND TO THE PROJECT

The theoretical background of the pilot project may be deduced from the theoretical tendency of **market failures**, which starts from the fact that the normal efficient operation of the market has some prerequisites. Since in the given case these conditions can be rather strict and incomplete, they are not satisfied completely in certain market segments. Thus, in those market segments the market will either break down or result in inefficient supply or demand differing from the optimum.

There can be market failures where for some reason the operating functions of the market do not assert themselves satisfactorily or at all.

Accordingly, those places are called market failures in the market processes when central (government) intervention is required in order to maintain undisturbed operation.

'Incomplete markets', including, for example, the certain money markets as well, are considered as one type of the market failures. One of its typical types is microfinancing, where there is no suitable market supply for the continuously existing demand due to the reasons described in the previous chapters. This situation can only be resolved with adequate financing and co-ordination.

At the same time it is important to be aware of the fact that this is not only a financing issue in case of microcrediting and it cannot be narrowed down to the implementation of the profitable operation of certain funds. Those 'benefits' that can be expected from the programmes are much more important, however, it is not easy to transform these benefits into figures.

4. CIRCUMSTANCES REGARDING THE LAUNCH OF THE PILOT PROJECT AND ITS FINANCING

When planning the project, we paid attention to the fact that in case of programmes facilitating unemployed people to become entrepreneurs the yield increasing factor of the funds should not be considered to be a primary and exclusive importance. It appears as a yield for the society if the unemployed people do not queue up for the unemployment benefit (which could as well be provided in figures) for months, if they can keep themselves and

probably their families, and last but not least they have a possibility to avoid the mental and psychic deterioration that is often provable in case of unemployed people, and which makes it more and more difficult for them to return to the labour market. Not to mention its consequence on health.

Accordingly, in the interest of developing and activating enterprises, we **employed positive discrimination** in the course of the realization of the project as an experiment, which manifested in the slight reduction of the interests. During the project the interest of the microcredit products offered by the network was between 7.75 % and 10.75 %. (Pursuant to the decision of the minister for the economics adopted in 2005 the members of the network were allowed to set the interest of the microcredit constructions between 4.75 % and 10.75 %. The transaction interest rate for the credit construction of the pilot project was 6.75 %. We have introduced simplified credit application in case of the created credit construction, and reduced paperwork when accounting for the credit.

Any member of the network agreeing to the objectives of the programme and having enough sources – that could be assigned to the project - could join the programme.

Location of the organizations handling the programme:



A characteristic of the programme is that the participating organizations could create their rules of procedures and system of evaluating aspects by taking into consideration the local characteristics in a decentralized manner.

The funds taken away from our organizations in 2000 and which became decentralized again in 2006 constituted the source of financing. With regard to the fact that the decentralization process has not been completed until now, relatively few of our 20 affiliated organizations have had the financial opportunity to launch the programme independently.

The criteria system of the programme was developed by Fejér Enterprise Agency, and it was finalized by the National Microcredit Professional Committee of the network.

Six regional affiliated organizations joined the programme at different times.

County	Organization	Local Enterprise Agency	Launch date
Bács- Kiskun county	Bács – Kiskun County Foundation for Enterprise Promotion	Bács - Kiskun County Foundation for Enterprise Promotion	1 July 2007
Fejér county	Fejér Enterprise Agency	Fejér Enterprise Agency	1 February 2007
Hajdú- Bihar county	Hajdú – Bihar County Foundation for Enterprise Promotion	Hajdú-Bihar County Foundation for Enterprise Promotion	1 March 2007
Heves county	Heves County Foundation for Regional Development and Enterprise Promotion	Local Enterprise Agency of Heves County	1 April 2007

Szabolcs- Szatmár- Bereg county	„PRIMOM" Foundation for Enterprise Promotion in Szabolcs - Szatmár – Bereg County	PRIMOM Foundation for Enterprise Promotion in Szabolcs-Szatmár-Bereg County	September 2007
Zala county	Zala County Foundation for Enterprise Promotion	Zala County Foundation for Enterprise Promotion	1 February 2007

The unified computerized information system of the programme has been provided by Fejér Enterprise Agency.

4. OBSERVATIONS MADE IN THE REGIONS REGARDING THE PROJECT

BÁCS- KISKUN COUNTY

Project manager: Helén Békefi

The foundation only had enough sources to launch the programme in the summer of 2007.

The source of financing is the decentralized Local Microcredit Fund received back from the HFEP.

The programme was announced and clients began receiving information at the beginning of July in Bács-Kiskun county.

The first applications arrived in August, and two contracts have been concluded in a total value of HUF 6,000,000. The loans were paid out in September.

Method of providing information:

- letter of advice sent to the existing clients,
- oral information provided at events and programmes,
- a letter sent to the mayor's office about the product,
- information on the home page,
- information provided to the rural development managers,
- a video interview was made with a female entrepreneur in order to make the programme popular (the film can be seen on the website of the foundation).

Due to the large interest shown towards the programme, the foundation continued it after September, too.

FEJÉR COUNTY

Project manager: Tibor Szekfü

The project was developed by the Fejér Enterprise Agency.

The programme was launched in Fejér county on 1 February 2007. The source of the credit construction was provided from the own funds of the agency (IBM 2002, HMA 2000 and HMA 2006).

There were some articles published in the local newspaper, but the programme itself was not advertised. The clients mainly found out about the construction from the contracted experts of

the agency and from one another (the information spread very quickly) and they could read about it on the Internet on the website of the agency.

The credit demands significantly increased in August. The agency received credit applications in a total value of HUF 142.7 million. More than HUF 137.7 million have already been approved, and more than HUF 112.1 million have been paid out.

The programme reached the maximum of the liquid assets that could have been assigned to the project in the county. The already approved but yet to be paid credits covered the total amount of the existing liquid assets by the end of August. The credit applications received in September may only be paid out from the repayment of the credits already paid out. There is still great interest shown towards the programme after its closure.

HAJDÚ- BIHAR COUNTY

Project manager: Imre Kiss

The programme was launched in March 2007 in Hajdú- Bihar county. It was advertised by showing its benefits, which proved to be very popular among female entrepreneurs. It was also advertised as a credit that can be used for investment purposes and purchasing current assets.

They are about to start checking that the credit has been used for the required purpose, thus there is no experience in respect of this.

At the outset they intended to assign about HUF 100,000,000 for the programme from the decentralized Local Microcredit Fund, which they increased to about HUF 150,000,000 due to the great demand. (There are still 12 applications in a total value of about HUF 50,000,000 that are yet to be approved.)

The project manager would find it useful if they could offer similar constructions to the entrepreneurs in the future, too, especially if the project owners or other donor organizations also provided enough sources for the constructions. According to them, they could grant about HUF 200 – 300 million annually for this purpose in Hajdú- Bihar county.

The project was closed on 21 August 2007 because they had run out of the available liquid sources. Thus, for the lack of sources they cannot extend the project.

HEVES COUNTY

Project manager: László Juhász

In Heves county the project began on 1 April 2007. In April the programme was advertised in the local radio, the local newspaper and on the Internet (on their home page). The amount of the available sources on 1 April 2007 was HUF 270 million.

The programme was extremely popular. There is demand for its continuation. They plan to relaunch this project next year, too.

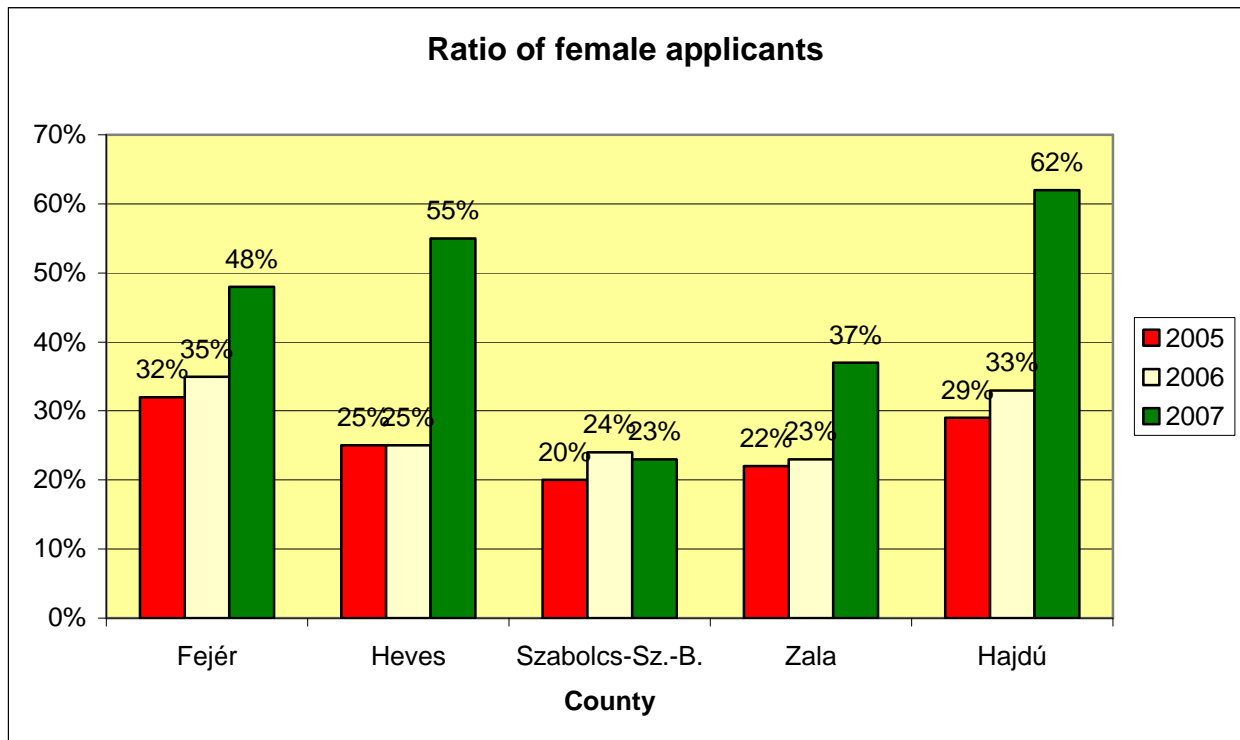
SZABOLCS- SZATMÁR- BEREG COUNTY

Project manager: Menyhért Jászai

For technical reasons the programme was announced in September. They did not have a separate campaign. They offered the construction to the enterprises during the opening hours. There is great interest for it, but due to the short time lapsed the figures of the programme cannot be evaluated.

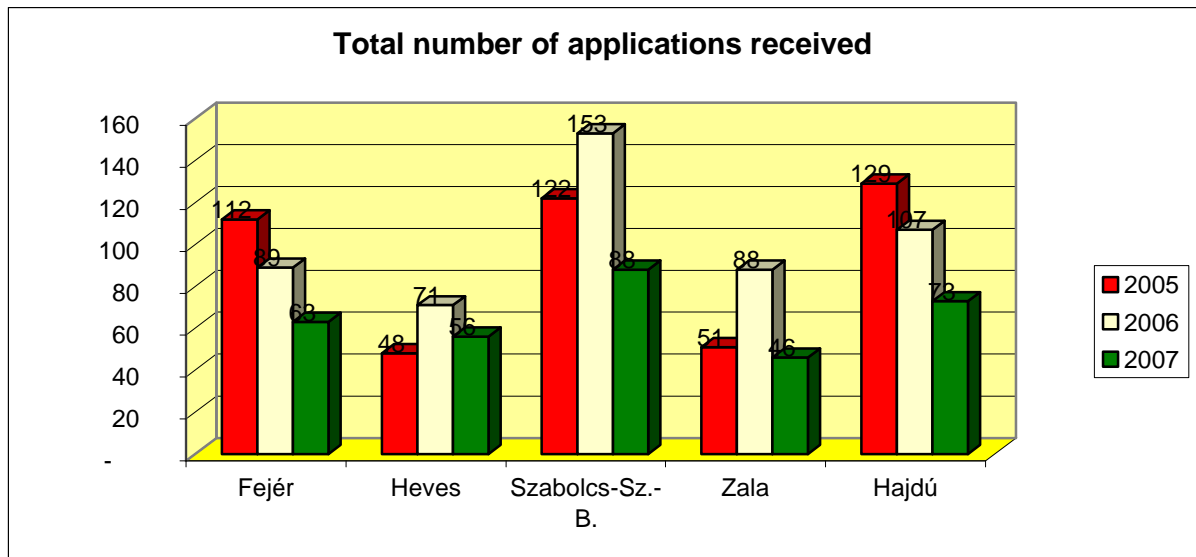
SUMMARY:

On the basis of the experiences it can be said that the programme is extremely successful.



It can be seen that in those counties where there was enough time and sources for the programme, the number of credit applications among the preferred target group increased significantly. With regard to the running up of the programme in a greater scale the amount of sources that could be assigned to the programme meant the bottle-neck in each county.

The client transaction figures broken down to counties and sectors is shown in the below table. When evaluating the figures it must be considered that the domestic situation was very uncertain in Hungary at the time of announcing the programme and the country experienced economic standstill. (Political riots took place in Hungary in the autumn of 2006.) This uncertainty could have been felt both in the profit oriented and non-profit microfinancing sectors resulted in a significant drop in the number of credit applications.



Lessons learnt from the programme in Hungary:

- quite to the contrary of certain public beliefs, the target group is extremely interest sensitive,
- positive discrimination does have a place in economic policy, if we wish to promote enterprises – in the interest of national economy – within a preferred target group,
- the reduced administration demand of the credit application make the application more appealing,
- the simplified financial settlement also makes the credit popular.

14 November 2007

Tibor Szekfü

APPENDIX

Client transaction figures broken down to sectors - VS/2006/0424-HU project - Period: 01 January 2007 – 1 October 2007.

VS/2006/0424-HU

Period: 01/01/2007 - 01/10/2007

Required credit

	Tourism	Industry	Trade	Agriculture	Services	Other	Total	Total in %
Bács-Kiskun County			1 2 000 000		1 4 000 000		2 6 000 000	1.96 %
Fejér County	2 9 000 000	1 5 000 000	14 63 500 000	1 5 000 000	11 47 700 000	3 12 500 000	32 142 700 000	31.37
Hajdú-Bihar County	1 5 000 000	6 22 065 000	12 47 550 000	4 17 000 000	11 49 000 000		34 140 615 000	33.33
Heves County	1 4 000 000	2 10 000 000	10 40 000 000	6 25 700 000	8 33 810 000		27 113 510 000	26.47
Szabolcs-Szatmár-Bereg			1 2 125 000	1 3 500 000	2 8 750 000		4 14 375 000	3.92 %
Zala County	1 2 000 000	1 6 350 000			1 4 000 000		3 12 350 000	2.94 %
Total:	5 2 000 000	10 6 350 000	38 2 125 000	12 3 500 000	34 4 000 000	3 12 500 000	102 429 550 000	2.88%

Submitted credit applications

	Tourism	Industry	Trade	Agriculture	Services	Other	Total	Total in %
Bács-Kiskun County			1 2 000 000		1 4 000 000		2 6 000 000	1.98%
Fejér County	2 9 000 000	1 5 000 000	13 58 500 000	1 5 000 000	11 47 700 000	3 12 500 000	31 137 700 000	30.69
Hajdú-Bihar County	1 5 000 000	6 22 065 000	13 51 550 000	4 17 000 000	10 43 000 000		34 138 615 000	33.66
Heves County	1 4 000 000	2 10 000 000	10 40 000 000	6 25 700 000	8 33 810 000		27 113 510 000	26.94
Szabolcs-Szatmár-Bereg			1 2 125 000	1 3 500 000	2 7 550 000		4 13 175 000	3.96%
Zala County	1 2 000 000	1 6 350 000			1 4 000 000		3 12 350 000	2.97%
Total:	5 2 000 000	10 6 350 000	38 2 125 000	12 3 500 000	33 4 000 000	3 12 500 000	101 421 350 000	2.93%

Approved credits

	Tourism	Industry	Trade	Agriculture	Services	Other	Total	Total in %
Bács-Kiskun County			1 2 000 000		1 4 000 000		2 6 000 000	2.20%
Fejér County	2 9 000 000	1 5 000 000	13 58 500 000	1 5 000 000	11 47 700 000	3 12 500 000	31 137 700 000	34.07
Hajdú-Bihar County	1 5 000 000	3 11 995 000	12 46 950 000	3 15 000 000	9 38 000 000		28 116 945 000	30.77
Heves County	1 4 000 000	2 8 800 000	8 31 000 000	5 20 700 000	7 28 110 000		23 92 610 000	25.27
Szabolcs-Szatmár-Bereg			1 2 125 000	1 3 000 000	2 6 200 000		4 11 325 000	4.40%
Zala County	1 2 000 000	1 6 350 000			1 4 000 000		3 12 350 000	3.30%
Total:	5 2 000 000	7 6 350 000	35 2 125 000	10 3 000 000	31 4 000 000	3 12 500 000	91 376 930 000	3.28%

Paid out credits

	Tourism	Industry	Trade	Agriculture	Services	Other	Total	Total in %
Bács-Kiskun County			1 2 000 000		1 4 000 000		2 6 000 000	2.86%
Fejér County	1 4 000 000	1 5 000 000	11 49 400 000	1 5 000 000	10 43 700 000	1 5 000 000	25 112 100 000	35.71
Hajdú-Bihar County	0	3 12 065 000	9 32 400 000	1 5 000 000	7 28 000 000		20 77 465 000	28.57
Heves County	1 4 000 000	1 4 300 000	5 16 000 000	4 15 700 000	6 26 810 000		17 66 810 000	24.29
Szabolcs-Szatmár-Bereg			1 2 125 000	0	2 6 200 000		3 8 325 000	4.29%
Zala County	1 2 000 000	1 6 350 000			1 4 000 000		3 12 350 000	4.29%
Total:	3 2 000 000	6 6 350 000	27 2 125 000	6 0	27 4 000 000	1 5 000 000	70 283 050 000	4.36%