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Microlending to the Roma in Central and Southeastern Europe: Mixed Results, New Approaches

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The conventional wisdom suggests that vulnerable groups such as the Roma can benefit from microfinance institution (MFI) services, particularly microlending. However, experience from the region is mixed; there are only few examples of successful microlending schemes targeting the Roma. Based on examples from UNDP projects in the region and data from a recent household survey conducted among vulnerable groups in Southeastern Europe by UNDP and GALLUP International, it describes the problems associated with microlending to the Roma and suggests ways to address them.
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INTRODUCTION

The early 1990s in transition economies was a period marked by high unemployment due to downsizing and the closure of loss-making state-owned enterprises. Significant increases in employment came from the bottom-up growth of micro and small companies. Since microbusinesses are mostly dependent on microlending, access to microloans is therefore important in reducing structural unemployment (Forster *et al.*, 2003).

Not all unemployed, however, benefitted from the higher growth that came later. High rates of poverty and insufficient employability left vulnerable

layers of the population including Roma heavily dependent on often-inadequate social welfare programmes and transfer payments. In this situation vulnerable groups often survive by engaging in informal small-scale production, farming, and trade.

These forms of self-employment help to stabilise household consumption and maintain supplies of food in periods of crisis, but the lack of access to affordable financial services – such as microcredits, savings, microinsurance, and financial leasing – hinders the ability of the poor to pursue these endeavours and overcome poverty. Typically, the poor have no access to formal lending institutions due to the high costs in terms of time, money, bureaucratic procedures, and collateral requirements. If the poor want to obtain capital they are forced to rely on informal moneylenders who charge extremely high interest rates and are often linked to organised crime.

Because of the lack of access to credit from formal credit institutions and the prohibitive interest rates of informal moneylenders, the relatively new microlending industry – which is taking root in Bangladesh, Brazil and other countries – would seem to be an appealing option for the Roma.[1] The reality for vulnerable groups, however, has been less promising. Many countries in the region have microfinance programmes but, with few exceptions, they have failed to reach the most vulnerable layers of the population.

Seen from a commercial bank's perspective, microfinance and micro-lending in particular are not appealing for several reasons. First, small loans are more expensive to administer and thus offer lower returns. Administering a loan of a few thousand dollars is not much cheaper than a loan of few millions, but the return is not comparable. Second, vulnerable groups, especially the poor, have difficulties in providing collateral for the loan and thus fall into the 'high-risk' category. Third, small entrepreneurs usually do not follow strict accounting procedures, making it difficult for bankers to assess their creditworthiness. Fourth, most micro and small entrepreneurs and particularly the poor, lack experience and knowledge of business planning, writing business plans etc. As a result both sides, banks and microentrepreneurs, have rational reasons to avoid each other.

These are the reasons why microlending – regardless of the characteristics and the vulnerability criteria of the respective group – remains largely out of the scope of banks, which prefer upstream clients and are sometimes accused of 'skimming' (Christen and Rhyne, 1999). In fact, there is a gap between the needs of microbusinesses (including businesses that are or could

[1] To many people, microfinance means the provision of small amounts of credit to the poor in order to help them engage in small income-generating activities and become self-employed. It has strong potential in this regard and this is why 2005 was declared the 'Year of Microfinance'.

be run by people from vulnerable groups) and those of 'traditional' bank clients. There are numerous banks serving more established entrepreneurs, while there is a sizable microcredit demand (from vulnerable groups) that stays largely unsatisfied (World Bank, 2004). In fact, formal banking and microfinancing are two completely different segments of the banking sector as they do not compete for the same cluster of clients.

Vulnerable groups do use credit, however. To shed light on what opportunities exist for the microfinance industry, and what difficulties the Roma have in obtaining credit, UNDP included a section on access to capital in a major survey of vulnerable groups in Southeastern Europe.

MICROLENDING: THE CURRENT SITUATION OF VULNERABLE GROUPS[2]

The results show that the three major factors limiting access to capital – lack of collateral, lack of credit history, and lack of skills – are more pronounced for the Roma and refugees/internally displaced persons (IDPs) than for the majorities living in close proximity to Roma. The data show that Roma, IDPs and refugees in the countries of Southeastern Europe have less access to credit from commercial banks than do the majority populations living nearby. Among the 3,537 majority-population households surveyed, 910 (26 percent) said they had used some type of credit. By comparison, 15 percent of the 3,534 Roma households and 19 percent of the 1,202 IDP/refugee households said they had taken out loans.

Figure 1 shows the sources of loans for the three groups. The Roma rely more on informal borrowing from friends and family. They are also the least involved in credit cooperatives or credit unions, which further limits their access to microfinance services.

Examples from projects implemented in the region confirm the conclusions based on the sample data. In Bulgaria, UNDP has implemented a Financial Leasing Scheme as part of the JOBS (Job Opportunities through Business Support) programme. Under the scheme (running since 2000) micro and small loans of $3,788,233 have been disbursed to 567 micro and small businesses: food companies, furniture manufacturers, farmers and agri-businesses, apparel and sewing enterprises and various service enterprises. The interest rate charged is the national interest rate (set by the Bulgarian National Bank and is adjusted monthly) plus 10 percentage points. The current rate is 12.36 percent. The unemployed are charged a lower rate

[2] The section is based on research conducted by Khilola Shakurova, intern at UNDP's Bratislava Regional Centre.

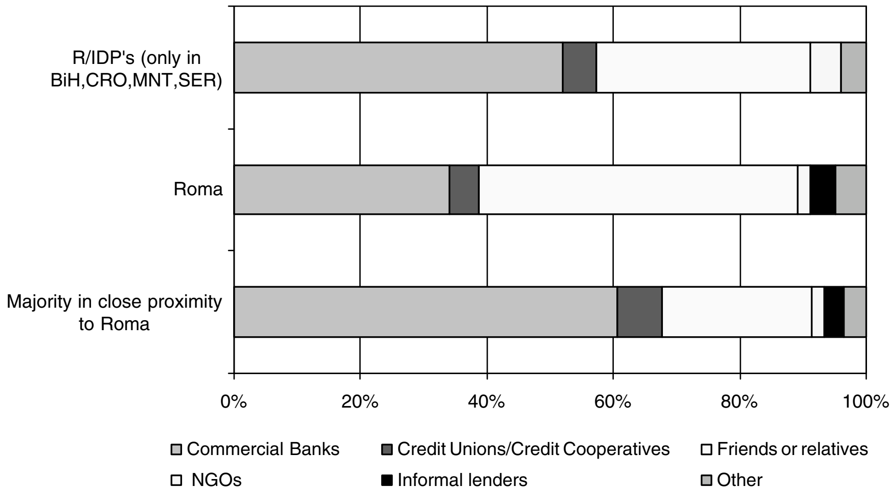

Figure 1: Source of credit (based on the question 'If your household is using any kind of credit, what is its source?'). *Source*: Vulnerable Groups Survey conducted in Southeastern Europe by Gallup and UNDP.

(5 percent above the national interest rate, 7.36 percent). By November 2004, 111 loans have been paid back (total value of $740,636). The portfolio at risk (over 30 days past due) is 2.78 percent and the default rate is 1 percent. Currently, however, only 2.12 percent of borrowers are Roma entrepreneurs (accounting for 2.23 percent of the value of all loans), and 20.28 percent are women (with 16.05 percent of all loans).

These findings show that, although overrepresented among the unemployed, the Roma are usually underrepresented as borrowers, even in projects explicitly designed to provide them access to microcredit. This is also in line with the general trend in Eastern Europe and CIS, where depth of outreach of MFI to the poor is very shallow, compared to other regions (Forster *et al.*, 2003). Thus, the question arises as to what extent small-business-oriented projects can tackle issues such as unemployment among the Roma.

The examples outlined above suggest that 'microfinance' and 'lending to marginalised groups' are different things in an industrialised environment. They may not necessarily coincide. In some cases there is even a 'Catch 22': the less a group needs microfinance services, the better are its chances of qualifying for them; the more it needs such services, the smaller are it chances. And this is especially true for the Roma.

What is special about the Roma? They belong to developed, industrialised ('first-world') societies yet exist in 'third-world' poverty pockets. In a

Table 1: Size of loans (in euros)

	Majority	Roma	R/IDP's
Max	66,260	26,504	19,878
Mean	2,729	706	2,629
Std. dev.	5,289	1,909	3,671

Note: Based on the question 'What is the total amount of the credit(s)/loan(s)?', national currencies have been converted into euros.

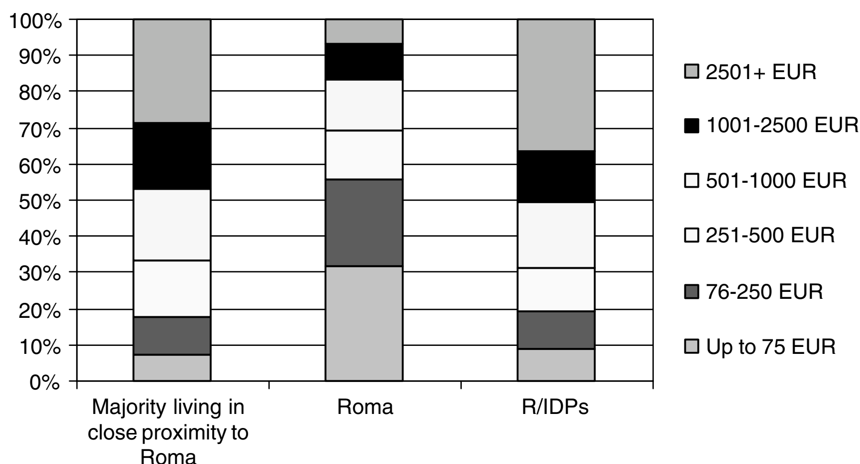

Figure 2: Share of loans (share of loans of different sizes as a share of loans allocated to each group). *Source*: Vulnerable Groups Survey conducted in Southeastern Europe by Gallup and UNDP.

lesser-developed society, a small loan can go much further towards boosting one's economic situation and improving productivity. In a developed economy, by contrast, a loan of a hundred or even few hundred dollars is not more than a consumer loan. The most one can do is small-scale trading with marginal value added. This is perhaps the reason why Roma borrow smaller amounts, approximately one-fourth of the level of those in the majority population, see Table 1 and Figure 2.

LOW COMPETITIVENESS AND WEAK CASH-FLOW

Apart from the smaller loans that the Roma receive, other challenges exist. The marginalised status of the Roma effectively cuts them off from formal lending markets. With various barriers to entry (such as low competitiveness

and discrimination) they face difficulties completing the investment cycle and generating revenues. Roma communities can engage in small-scale crafts, trade or subsistence agriculture, but these activities are rarely marketable or sufficient to generate the necessary cash for repayment.

A Roma-oriented programme in northeastern Slovakia provides a good illustration of these difficulties. An integrated community-mobilisation project called 'Your Spiš' has been under way for 3 years and includes strengthening Roma local community organisations, education activities, training and employment-generation activities. Initially, eight municipalities were involved, by 2004 that number had grown to 13. Project organisers allocated $50,000 for microloans. The average size of a loan is $800 and the annual interest rate is 10 percent, paid in monthly instalments. Despite these favourable conditions, by the end of 2004 only 10 loans had been approved and disbursed due to the lack of sufficient interest among target beneficiaries. Members of the Roma community attributed this to the difficult market environment and the lack of confidence among potential borrowers that their businesses would be successful.

The data support these conclusions. As Figure 3 shows, the Roma borrow primarily for personal reasons, usually for unexpected health-related expenditures, and for family matters, such as weddings. None of this is business-oriented and cannot generate the revenues necessary for repayment.

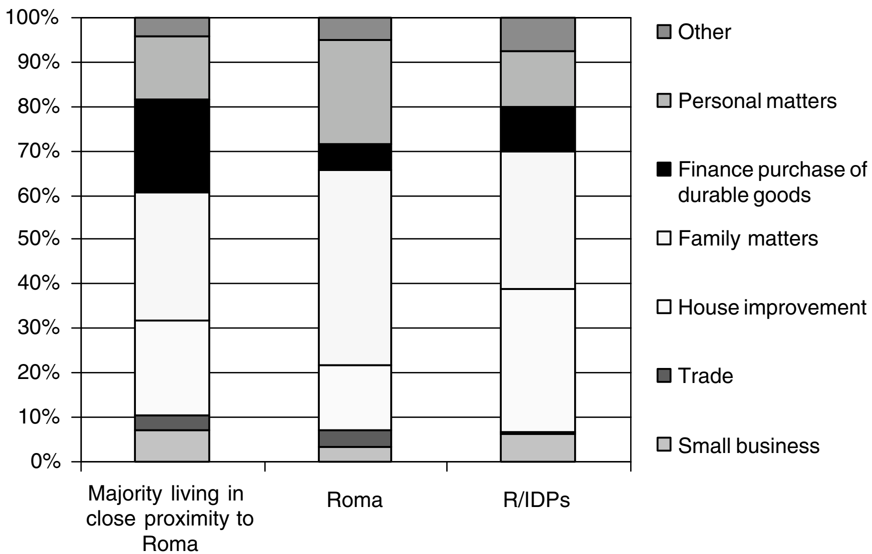

Figure 3: Purpose of loans by groups (share of loans allocated). *Source*: Vulnerable Groups Survey conducted in Southeastern Europe by Gallup and UNDP.

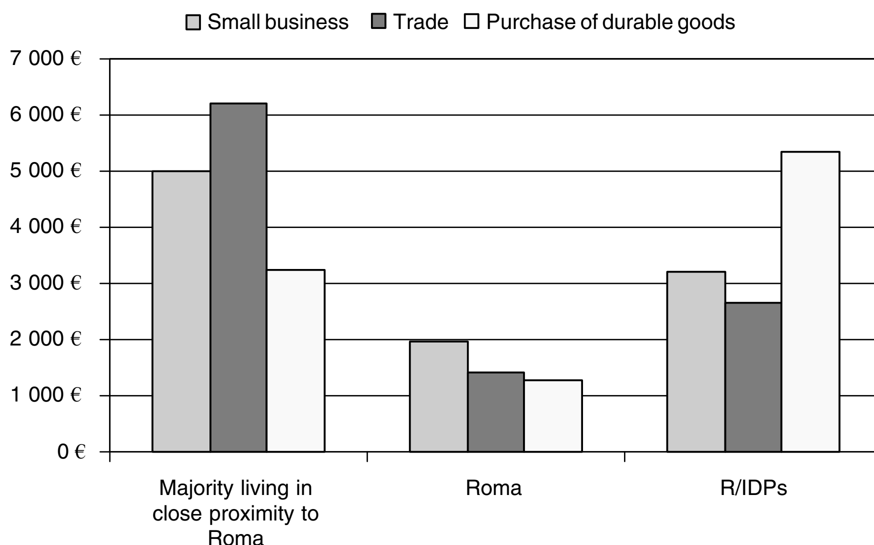

Figure 4: Size of loans by purpose (average loan size by category). *Source*: Vulnerable Groups Survey conducted in Southeastern Europe by Gallup and UNDP.

The data also show that the Roma rarely borrow to finance the purchase of durable goods like small equipments which can help to boost productivity.

The data in Figure 3 suggest that the share of loans for business purposes as a portion of total loans for each surveyed group is more or less equal. This, however, is misleading. Figure 4, which illustrates the distribution of loans by size for three purposes, clearly shows that the Roma are in a disadvantaged position because the small size of the loans they receive is insufficient for anything beyond financing current consumption. Unclear prospects for cash income generation necessary for repaying the loans and dependence on a single economic activity are among the major reasons why microlending is not considered for vulnerable groups (CGAP, 2002b). This is also one of the main reasons preventing the Roma from borrowing more. Another reason is 'peers' insufficient liquidity.' Non-Roma do not trust Roma. Roma have no other choice than borrowing from members of their community, who tend to be similarly poor.

DISTINGUISHING BETWEEN GRANTS AND LOANS AND MEASURING THEIR IMPACT

Another source of problems is related to grant-based assistance. Many Roma communities are receiving social assistance in the form of support and grants

that do not need to be paid back. Often, particularly when community development projects are implemented in parallel with microlending, the distinction between grants and loans is blurred. This creates disincentives to borrow. Why should an individual get involved with risky lending when he or she can obtain an unconditional grant?

Business development services, training and other type of support can either be offered free or for a price. In addition, within the same project, grant-based (subsidised) activities often are offered in parallel with services charging market rates. In order to avoid misguiding the beneficiaries, the 'rules of the game' should be clear, which means clearly distinguishing subsidised from non-subsidised elements (CGAP, 2001). Given the depth of poverty and high level of marginalisation of vulnerable groups such as Roma, it is unrealistic to expect profitability from the total inputs (grants-based components and loans). What is possible, however, is to separate grants-based components, like training and business assistance, from loans. Profitability or at least reaching the break-even point is a must for the loans component. This is not the case for the other components. Clearly distinguishing between subsidised and non-subsidised components would also make it possible to conduct targeted resource mobilisation. Different components should be financed from different sources. Finally, delivering the proper message to the beneficiaries is extremely important – for example, explaining which components are part of the development scheme and which are market-based mechanisms (Fernando, 2004).

This is one of the major preconditions set in the microlending project currently under implementation in Hungary by Autonomia Foundation with the support from the AGFund and UNDP. Launched in December 2004, the project aims to provide funds to Roma entrepreneurs who are willing to start, or expand their businesses, applying both group- and individual-lending techniques to farmers, agricultural producers, and traders. The duration of the loan is expected to be 1 year with an annual interest rate of 19 percent. In addition to the funds, the Roma taking part in the project will receive training in business development.

Currently there are 79 active clients within the project. Of these 18 are experienced microentrepreneurs, 26 local non-governmental organisations that received bridging loans to overcome cash-flow problems, five start-up entrepreneurs and 30 clients that are organised in groups. The number of groups will further increase in the third quarter of the year. Once the loan management system is successfully tested, which is expected to be carried out before the end of first year, project leaders predict that the loan portfolio will grow at a much faster rate.

The project builds on earlier experience with pro-Roma employment projects. One such project was implemented in the Hosszúpalyi settlement, near Debrecen, Hungary, with a population of 5,400, of which approximately 1,200 are Roma. The initial idea was to start basic agricultural production (potatoes, beans, tomatoes, paprika, cucumber and onions) within the community, cultivating the foods for home consumption. During the initial phase, beneficiaries received support in the form of grants, but simultaneously they were being instructed and trained in how to move to the next stage, when production would be expanded so that the surplus could be sold in the market (Csongor *et al.*, 2003). Members of the communities constructed greenhouses for mass production of paprika in order to enhance the quality and quantity, as well as to sell part of the production and hopefully make a profit. The project, starting with 15 families, is still growing. The Roma paprika producers even managed to overcome the suspicions of the majority population regarding their business activities. More importantly, at this stage it was possible to disburse loans with low risk of default.

The gradual maturation from grants to loans is a common element of all successful projects targeting Roma communities. What is even more important, distinguishing between subsidised and non-subsidised components can allow donors and project organisers to better assess the sustainability of their work (Johnson and Rogaly, 1997).

Consistency with the market?

Consistency with market rules and principles is an important element of any sustainable development effort. It means that economic activities should reach the 'break-even' point in a reasonable period of time. The trick, however, lies in the definition of inputs and outputs. What components of a microlending project should be counted as inputs by the beneficiary business? How should profitability be defined?

On the one hand the answer is clear – profit equals revenues in excess of inputs. The problem is that in development projects and projects for marginalised groups in particular not all inputs are counted as elements of the business plan. Some support is provided by other sources and not by the beneficiary. The argument is that the project's outcomes are broader than its outputs and the difference is worth the investment, usually public. This is the logic behind any business incubator – if we count all the 'start-up costs' most businesses would never get off the ground and more people would remain dependent on state welfare. The same logic applies to microfinance for Roma. Just as a third party pays for some of the start-up costs of an incubator, so should a third party cover some of the costs of delivering a microloan to a

beneficiary. In the case of projects targeting marginalised communities, the cost of *not* implementing the project are staggering in terms of failing to stop the emergence of an underclass – definitely a costly phenomenon affecting every member of society, not just those marginalised (Forster *et al.*, 2003).

All these issues are much more relevant for developed economies, where the difference in economic power between marginalised groups and the general population is large. This is why conventional approaches to microlending – developed within and reinforced by the experience from developing countries – should be perhaps revisited so that they reflect the specific situation of the Roma and other marginalised groups. The new approaches should be based on a broader understanding of the benefits of microfinance and should not be limited solely to the financial returns of a loan. In such environments microlending should be treated as one of the many possible options in a continuum between two extremes – fully market-based commercial bank lending and grants-based or other unconditional assistance.

‘Soft loans’ *versus* enforceable guarantees

Perhaps the major problem limiting marginalised groups’ access to micro-loans is the lack of reliable and enforceable mechanisms to secure them. Both Roma communities and borrowers in poor countries do not possess assets that can be used to serve as a bank guarantee and/or rarely borrow in order to buy assets that can be used as collateral. They do not possess credit histories to verify their trustworthiness. These deficiencies can only be partially offset by granting loans to groups of individuals and/or engaging in peer pressure to ensure that the loans are paid back. These methods are not entirely reliable because the ‘peers’ (the local Roma elites) are often part of the organised criminal networks that force borrowers to engage in petty crime to pay back the loans.

While engaging in microfinance and running business incubators have some similarities, the challenges are different. In the case of the latter, the client has a clear ‘exit strategy’ – a date set to leave either the incubator (and continue the business independently) or close the business (and seek income opportunities elsewhere). In the case of lending to the Roma, enforcing strict rules is much more difficult because often the borrower uses the money to finance current consumption to feed his or her family and thus cannot pay the loan back.

Herein lies the major challenge of lending to the Roma: what to do about default? On the one hand, a more permissive attitude sends a powerful message to other members of the community – ‘If X can get away with not

paying back the money, why shouldn't I'? On the other hand, providing tangible and enforceable mechanisms to ensure payment is difficult for various reasons. Often lenders cannot secure collateral. And the cost of enforcement is prohibitively expensive – usually more than the value of the loan itself.

In such cases the winning strategy seems to be leasing schemes. An example from Bulgaria outlines both the opportunities and potential problems of such an approach (Ivanov, 2002). It is a project targeting Roma that is being implemented by an NGO, Creating Effective Grassroots Alternatives (CEGA) foundation. In 1993, with financial support from NOVIB, a Dutch NGO, and the Friedrich Naumann Foundation, and with methodological support from the Institute for Market Economics (IME), it launched a 'Land-based Income Generation for Poor Roma Families in South Bulgaria' programme, similar to the project fostering the sale of paprika in Hungary. Since its inception in 1993, the programme has evolved into a consistent and sustainable mechanism for combining access to land and secured credit with the development of new skills. Participants in the initiative establish limited partnership companies in their communities. The NGO, as the manager of the donor funds, has a representative in the company with veto rights. Each member of the company chooses a plot of land and negotiates the price with the owner. Participants are required to use 20 percent of their own money to purchase the land. The company provides the remaining 80 percent in the form of a 3–5 year loan with a 6 percent annual interest rate. Once a participant in the scheme has purchased land, s/he is eligible to borrow funds in order to purchase farm equipment at 7 percent interest, with an initial downpayment of 30 percent, and a two-year payback period. Over the last 2 years, 21 families from six villages have purchased 14.5 hectares of land. The size of credits varies from $500 to $2,500. All participants are paying back the instalments.

As in the JOBS scheme, the participants become legal owners of the assets (real estate in the case of land lease or equipment in the case of investment loans) only after the loan has been paid back in full. In case of default, within the CEGA-run land-lease scheme, the participants lose their initial 20 percent deposit and any further repayments, which is a persuasive incentive to pay back. Since the programme is not based on grants, participants think twice before investing their savings as initial capital. In the case of the JOBS scheme, leased equipment serves as collateral and the client becomes its legal owner upon repayment of all instalments. The success of both schemes is largely due to the clear and easily enforceable rules providing opportunities for both economic development and socially motivated support.

Be realistic and targeted

As already mentioned, all successful projects build upon an existing business comparative advantage, awareness of a market niche or at least a clear idea what to do. This has profound implications for donors' priorities. It means that probably in a developed economic environment, microfinance cannot be seen as an instrument for helping the most vulnerable, those who are at the bottom. Hence, development assistance should be targeted and flexible depending on the beneficiary and involving various combinations of subsidised and non-subsidised elements. Those on the very bottom (coping with survival) perhaps should be targeted with different instruments than those struggling to take advantage of development opportunities that are already in place (CGAP, 2002a).

The real paradox is that Roma are borrowing. They do so at unaffordable interest rates from informal and potentially abusive moneylenders (CGAP, 2005). However, they are rarely borrowing for productive purposes rather than to meet family emergencies. This is the major reason why existing lending networks are less a part of the economic (and poverty reduction) system and more part of organised crime networks. Moneylenders often act as criminal elements and are a major factor encouraging criminality in Roma communities. Not having access to other financial opportunities, Roma borrow at monthly interest rates of 100 percent or more, and repay these loans under the duress of death threats. In this way, significant shares of Roma communities can become totally dependent on local usurers. Facing death threats against their families, people will do anything possible to pay back the money. The negligible development opportunities facing many Roma mean that criminal activities can be the only feasible way to avoid usurers' revenge. Many cases of murder reported in Roma communities are unofficially explained as resulting from the failure to pay back debts. Local Roma leaders (many are well-off and involved in the exploitation of other Roma) prefer to attribute these crimes to racist groups and assaults against Roma. It is not a coincidence that local moneylenders in many communities are among the most vigorous opponents of microlending schemes (UNDP, 2002).

Providing lending opportunities linked to sustainable, legitimate, income-generating opportunities will reduce the economic underpinning of a significant part of Roma criminality. Hence, the practical challenge is to redefine and refocus microlending practices for Roma communities – taking them out of the 'organised crime – informal lending' nexus into income generation and poverty reduction cycle.

CONCLUSIONS

The experience so far suggests that certain common principles to microfinance for Roma and other marginalised groups should be developed and applied. First of all, microlending should not be seen as a 'stand-alone' tool and a starting point for poverty alleviation among Roma. It can be successful only if applied in a concerted way with other tools like training and traditional business support including assistance in marketing and professional skills development. Some business skills and practices should be in place before turning to microfinance.

This has important implications for donor involvement: microlending should be seen as appropriate for encouraging already existing development potential. This means that the most vulnerable and marginalised are not suitable target groups for such projects and should be aided through different activities with a strong community development focus.

Even for more mature clients, 'pure microlending' is still not a profitable option. Additional 'soft' support measures are necessary, which are inevitably subsidised by the state and/or donors. In this case, a clear distinction between subsidised and non-subsidised components is a must. It is important both for delivering the proper message to the beneficiaries and for donor transparency (different donors usually wish to be involved in different types of activities). In this regard, mixing social aims with more narrow economic considerations can jeopardise the whole scheme because it opens the way to soft loans and ultimately a chain of defaults.

One way of dealing with this issue is distinguishing between different potential clients. Microlending should not be seen as a 'differently worded' tool for social assistance and drastic poverty alleviation. It should be targeting only those whose agenda goes beyond day-to-day survival. All other efforts should focus on providing social assistance (CGAP, 2003).

Finally, while addressing the mature segment of the target group, the problem of loan guarantees can be solved using various leasing schemes that transfer property rights only once the loan is paid back. However, in order to ensure success, there must be a consistent and rigid enforcement of rules and contracts.

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