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FAI financial access initiative

PoP Briefing Note # 7

Grameen II and *Portfolios of the Poor*

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The Emergence of Grameen II

The Grameen Bank of Bangladesh is the best-known and most widely imitated microfinance pioneer. But Grameen found itself in trouble in the late 1990s as the quality of its loan portfolio began to decline sharply, and a devastating flood further eroded loan repayments. It responded by adopting a new model in 2001, dubbed Grameen II. Grameen II was designed to be more flexible than the original model: aligning repayment schedules with household income flow, meeting the demand for secure and reliable savings products, and acknowledging the varied needs of clients. These new features were a shift from beliefs underpinning the original Grameen model, which emphasized the need for loans over savings, expectations that loans would be used only for micro-entrepreneurial investment, and the necessity of a strict repayment regiment. The research in *Portfolios of the Poor* includes sets of financial diaries collected from Grameen clients both before and after these changes, from 1999-2005.

The Grameen II Diaries

The first set of Bangladeshi financial diaries was completed in late 2000, but the major changes at Grameen Bank led the researchers to return to Bangladesh for a second set of diaries focused on understanding the new developments at the bank from the point of view of the clients. The results reflected many of the universal themes of the financial diaries: complex and active financial lives, the challenge of the "Triple Whammy" poverty trap (see The Poverty Trap 'Triple Whammy' Briefing Note), and a keen interest in saving. The findings also ultimately demonstrated the ability of Grameen to adjust its products to the diverse needs of Bangladesh's poor.

One marked difference among the later group of diarists is the augmented presence of microfinance institutions in their financial lives. Among those who engaged in microfinance borrowing, microfinance loans were 56% of their total loan portfolios (in contrast with the 38% found in previous year's diaries). This higher proportion enabled us to get a better insight into how microfinance loans are actually used. In addition, a majority of diarists in the second group borrowed from more than one MFI. In part this reflects the rapid growth of the microfinance sector in Bangladesh, with the three big players - Grameen, BRAC and ASA - adding a total of 9 million accounts from 2000-2005. The Grameen II diaries therefore provide unique insight into the impacts of microfinance in a climate of large-scale access, competition, and innovation.

New Products

Withdrawal Enabled Savings Accounts: Managing Cash Flows with Passbook Savings

In the original model, Grameen did not offer a passbook savings mechanism for clients. Instead, it required its clients to make small, fixed deposits during weekly meetings, which they could not access for ten years unless they left the bank. The introduction of the personal passbook savings account under Grameen II allowed clients to deposit and withdraw savings at any time and in any value. This new savings product seemed to satisfy a long-held demand for a secure and reliable money management mechanism that helps its users manage small incomes on a day-to-day basis, ensuring that there is food on the table every day and not just when income is earned, for example. Although diarists went on using the many traditional informal savings mechanisms that are found in Bangladeshi villages, their low reliability meant that they warmly welcomed Grameen's more organized system, particular as it was accessible frequently and near-at-hand: at the weekly meeting in the village every week of the year. The development shows how better product design and delivery can make a meaningful difference.

Top-up Mechanism: Managing Cash Flow and Forming Large Sums with More Flexible Loans

The Grameen diaries found that in many cases, those who were originally left out of microfinance had irregular income flows that made them less able to comply with the year-long sequence of remorseless weekly repayments required by the original Grameen model. Grameen II offers a range of loan terms, including short ones that allow poor borrowers to avoid having to repay during low-income seasons. Its "top-up" mechanism allows clients to re-borrow up to the value of their original loan before that loan is fully repaid: for instance, if a member took out a $200 loan, then after repayment of $100, she would be able to re-borrow another $100. The feature allows borrowers to take fresh capital without creating a spiral of increased indebtedness, since debt loads were no larger than the amount of the original loan. These innovations enabled a greater range of clients, especially poorer ones, to be better served.

Mixed and Varied Uses: Use of Microfinance Loans

Just as the introduction of a top-up mechanism allowed for a greater inclusion of borrowers, the Grameen diaries exposed yet another form of behavior which challenged the original Grameen model. Researchers found that although most microfinance loans were targeted at "productive" or "return creating" purposes, clients also used them for consumption smoothing or for funding life-cycle expenditures. The diaries found that roughly half of loans were used for “productive” purposes, classified as purchasing business stocks and all kind of assets, and half for other uses. This does not mean, however, that half of all *users* borrowed for “productive” purposes. The diaries revealed a strong association of productive investment with a particular type of borrower. Out of the 43 borrowers in the sample, six were responsible for 75% of the value of the loans in the business category, and between them took two-thirds of all loans in that category. So although business was the most common use of loans measured by the number of loans and their value, it was not the most common when measured by the number of borrowers involved. The bottom line is that the diaries showed that the benefits to be had from microfinance borrowing are not just in increasing productive capacity but also in managing consumption and dealing with life-cycle needs. .

Grameen Pension Savings: Accumulating Large Sums in Commitment Savings Accounts

Grameen also introduced a popular commitment savings plan, the Grameen Pension Savings (GPS). GPS offers a good rate of interest in return for regular monthly deposits over a five- or ten-year term. The structure of GPS offers clients the discipline they need to deposit consistently and maintain their savings for future use. GPS is a “pension” in name only and is not restricted to retirement needs: many younger families see the program as a means to save for medium-term expenses, such as school fees or weddings in the future for recently born children. Just as the personal passbook product provided a secure alternative savings mechanism, the GPS product allowed people the ability to plan through long-term savings. Given that informal savings devices are rarely able to take care of savings over the long haul, commitment savings plans like the GPS serve as a major step forward in financial products for the poor.

Grameen III: Policy Implications for the future

The Grameen II diaries revealed that more flexible products tailored specifically to the needs of poor clients can create dramatic positive results. Grameen transitioned from a microenterprise lender into a true retail bank for poor households. However, it should be noted that such systems are, for the most part, the exception and not the rule in the microfinance sector as a whole. Steps need to be taken to increase flexibility both sector-wide as well as in the existing Grameen II model. Given that Grameen has served as a source for financial innovation in the past, it must push the envelope yet further and continue to influence the path of microfinance product design globally.

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