

Module 3 /// Innovative Activity Profile 3

Designing Flexible Products from Market Research and Building on the Group Lending Model: Grameen II¹

Organizational Objectives and Description: Classical Grameen

Grameen Bank originated in 1976 when Professor Muhammad Yunus, Head of the Rural Economics Program at the University of Chittagong, Bangladesh, launched research to design a system for delivering credit to the rural poor. Since 1976, the “classical Grameen model” of microfinance has spread to many countries. The elements of the classical model have been variously described; box 1 is based on Grameen’s official description of the elements it has retained in recent years.

What’s innovative? Based on participatory product market research, Grameen Bank developed a new model for its operations, which are now characterized by greater flexibility, more diverse products, and incentives that rely on individuals rather than group mutual liability. Grameen Bank has also innovated in forming social enterprises.

Grameen Bank recently concluded a four-year reassessment and redesign based on extensive client research. This process—referred to as “Grameen II”—was catalyzed by the catastrophic 1998 flood that left half of Bangladesh underwater (water was above the rooftops) for 10 weeks. Grameen borrowers, like many other people, lost most of their possessions, including their houses.

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Grameen Bank, which is owned by the borrowers, launched a huge rehabilitation program by issuing fresh loans to restart income-generating activities and repair or rebuild houses, but borrowers soon felt the burden of their accumulated loans. The new installment sizes exceeded their capacity to repay. Borrowers gradually stopped attending weekly center meetings and loan repayments quickly declined. The repayment crisis compounded problems initiated by an earlier crisis in 1995, when large numbers of borrowers also boycotted center meetings and stopped repaying loans. Husbands of the borrowers, inspired and supported by local politicians, organized this boycott, demanding that Grameen Bank change its rules to allow members to withdraw the group tax component of the group fund when they left the bank. The problem continued for months. Grameen resolved the problem, but the repayment rate had already fallen, and many borrowers still abstained from repaying loans.

These external events revealed and reinforced internal weaknesses. The Grameen system relied on well-defined, standardized rules, and no departure from these rules was allowed. Once a borrower fell off track, she found it very difficult to move back on, because the rules for returning were hard to fulfill. More and more borrowers fell off track. There was a multiplier effect.

Organizational Components and Impacts: Grameen II

The Grameen II process began on April 14, 2000 (the Bengali New Year). By August 2002, the last bank branch had switched to Grameen II. The key features of the new “Grameen Generalized System” (GGS) are summarized here.

All borrowers start with a *basic loan*. Most will continue with this basic loan, cycle after cycle, without difficulty, and meet all of their credit needs very well. For as long as borrowers keep to this schedule, they can upgrade their loans at each cycle. If there is any difficulty, however, the basic loan has an exit strategy: The *flexible loan* is a rescheduled basic loan, with its own set of rules. A big disincentive for a borrower to resort to a flexible loan detour is that her loan ceiling, developed over the years, is wiped out. The flexible loan is not an independent loan; it is only a temporary detour from the basic loan.

Box 1: The classical Grameen model

Goals

The Grameen Bank promotes credit as a human right. Its mission is to help poor families help themselves to overcome poverty. Its efforts are targeted to the poor, particularly poor women. Reaching the poor is the Bank's nonnegotiable mission, whereas reaching sustainability is a directional goal. The Bank must reach sustainability as soon as possible, so that it can expand its outreach without funding constraints.

Management and participation

Generally loans are given through nonprofit organizations or institutions owned primarily by borrowers. Grameen credit gives high priority to building social capital, which is developed by forming groups and centers, developing leadership through annual elections of group and center leaders, and electing board members when the institution is owned by the borrowers. To develop a social agenda owned by the borrowers (similar to the 16 decisions summarized below), the Bank undertakes a process of intensive discussion among the borrowers and encourage them to take their decisions seriously and implement them. Special emphasis is given to forming human capital and fostering concern for the environment. The Bank monitors children's education and provides scholarships and loans for higher education. In developing human capital it encourages the use of technology such as mobile phones and solar power, and it promotes mechanical power to replace manual power. It provides services based on the principle that the people should not go to the bank—the bank should go to the people.

Savings and lending methodology

In fixing the interest rate, the market interest rate is the reference rather than the moneylenders' rate. Grameen seeks to keep the interest rate as close to that of the commercial banking sector as possible, without sacrificing sustainability.

The most distinctive feature of Grameen credit is that it is not based on collateral or legally enforceable contracts but on trust. It is offered to create self-employment that generates income and housing for the poor as opposed to consumption.

To obtain a loan, a borrower must join a group of borrowers. Loans can be received in a continuous sequence. A new loan becomes available to a borrower if her previous loan is repaid. All loans are repaid in weekly or biweekly installments. Credit comes with both obligatory and voluntary savings programs for borrowers.

The 16 decisions of Grameen Bank

1. We shall follow and advance the four principles of Grameen Bank—Discipline, Unity, Courage, and Hard Work—in all walks of our lives.
2. We shall bring prosperity to our families.
3. We shall not live in dilapidated houses. We shall repair our houses and work towards constructing new houses at the earliest.
4. We shall grow vegetables all year round. We shall eat plenty of them and sell the surplus.
5. During the growing seasons, we shall plant as many seedlings as possible.
6. We shall plan to keep our families small. We shall minimize our expenditures. We shall look after our health.
7. We shall educate our children and ensure that they can earn to pay for their education.
8. We shall always keep our children and the environment clean.
9. We shall build and use pit-latrines.
10. We shall drink water from tubewells. If it is not available, we shall boil water or use alum.
11. We shall not take any dowry at our sons' weddings, neither shall we give any dowry at our daughters' weddings. We shall keep our center free from the curse of dowry. We shall not practice child marriage.
12. We shall not inflict any injustice on anyone, neither shall we allow anyone to do so.
13. We shall collectively undertake bigger investments for higher incomes.
14. We shall always be ready to help each other. If anyone is in difficulty, we shall all help him or her.
15. If we come to know of any breach of discipline in any center, we shall all go there and help restore discipline.
16. We shall take part in all social activities collectively.

Source: www.grameen-info.org

In addition, there are two other loan products. To qualify for a *housing loan*, women must register their house sites in their names. The *higher education loan*, which runs parallel to the basic loan, was introduced by Grameen Bank for all students

from Grameen families who qualify to enter institutions of higher education, such as universities, medical schools, engineering schools, and other professional schools. Loans are given directly to students, without going through their parents. Students must repay the loans when they start earning.

As for savings, *individual savings accounts* have replaced the group fund. Each borrower has three obligatory savings accounts: a personal savings account, a special savings account, and a pension deposit account. The pension account is only for borrowers with loans above 8,000 Taka (Tk) (US\$ 138), who must deposit a minimum of Tk 50 (US\$ 0.86) in the account. After 10 years, the borrower will receive a guaranteed amount that is almost double the total amount she has deposited. This feature of GGS has become amazingly attractive to borrowers. Many are saving more than Tk 50 each month (some save Tk 500), and the pension deposit accounts are generating a huge infusion of cash for the bank. Pension savings attract more than Tk 100 million (US\$ 1.75 million) each month.

Once a year, on the last day of the year, a borrower is required to deposit a small amount of money in a *loan insurance savings account*. The size of the deposit is calculated on the basis of the outstanding loan and interest owed by the borrower on that day. She deposits 2.5 percent of the outstanding amount. If a borrower dies during the next year, her entire outstanding loan and interest are paid out of the interest income on the loan insurance savings account. The amount saved into the account is returned to her survivors.

Scholarships are awarded every year on a competitive basis to students from Grameen families. Half of the scholarships are reserved for girls and the other half are open to both boys and girls. Each year Grameen Bank gives out 3,704 scholarships and ensures that each branch can provide at least one. Gradually the number of scholarships will increase as the pool of students who can compete for them grows.

If a borrower maintains a 100 percent repayment record for seven consecutive years, she attains *gold membership*. Aside from receiving special honors and privileges, a gold member can enter a faster track for loans.

To encourage *destitute members* to join Grameen Bank and make them feel comfortable there, GGS relaxes basic bank rules. A destitute person does not have to belong to a group, no saving is necessary, no weekly repayment is necessary, and she decides the terms of her loan, in consultation with her mentor. Centers are encouraged to list destitute families in their respective areas, and groups will be encouraged to take destitute members “under their wings” and mentor them to help them overcome their fears and inhibitions, give them required business skills, and help them take up income-generating activities. Bringing a destitute woman to a level where she can become a regular member of a group is considered a great group achievement. Groups and centers that accomplish this feat receive special awards, privileges, and honors.

The Grameen Accounting and Monitoring System will be *computerized*, along with accounting and management information systems at all branches. All information from the branches will be entered into computers in the area office. Staff will have time to concentrate on improving the quality of borrowers’ lives. Because many branches are connected by mobile phone, Grameen is looking to take the next logical step and integrate the entire information system through an intranet.

The *star system* awards a branch a color-coded star for a given achievement. A 100 percent repayment record earns a branch a green star; a profit earns a blue star. A branch having more in deposits than outstanding loans gets a violet star. If all of the borrowers’ children are in school or have at least completed primary school, a branch gets a brown star. If all borrowers of a branch cross the poverty line, the branch gets a red star. Staff can wear stars on their clothing.

These changes, which are based on ideas and input from Grameen members, have had a very positive impact on outreach and sustainability. In the three years between December 2002 and December 2005, Grameen’s deposit base tripled and its outstanding loans doubled. Profits soared from around Tk 60 million 2001 to Tk 442 million taka (about US\$ 7 million) in 2004. Dropouts are returning, and even some old defaulters are repaying and rejoining. As of December 2006, Grameen had 6.91 million borrowers, 97 percent of whom were women. With 2,319 branches, the

bank served 74,462 villages, more than 89 percent of all villages in Bangladesh.

Lessons Learned, Prospects for the Future, and Issues for Wider Applicability

Lessons learned

Such profound innovation and change in such a well-known and widely replicated model for microfinance is of great importance to microfinance debates. The emphasis on participatory product market research, leading to greater flexibility and product diversification, is especially important. The impressive impacts on outreach and sustainability indicate that the effort is well worth it.

A second important lesson was that the member liability group needed to be replaced with another mechanism. Instead, Grameen built individual incentives into a flexible and workable loan product. Instead of relying on the “stick” of formal group mutual liability, groups now exert more qualitative social pressure and are the basis for (enhanced) social action.

The future

How the system will develop depends on how experience with Grameen II evolves. Updates can be found on the Grameen website. Grameen is considering strategies to increase women’s empowerment, including action research on gender violence. It is also further developing its social enterprises.²

Issues for scaling up

Grameen Bank itself is obviously somewhat unique because of its history, reputation, and scale. It is clear, however, that many of the Grameen II innovations can and probably will be spread to Grameen replications elsewhere. The participatory market research methodologies for product development have been widely disseminated by MicroSave and others, and training is available. In relation to group mutual liability, if Grameen itself has found it to be unworkable in the longer term, at least once credit

discipline has been established, then any replication of this system needs to be treated with considerable caution.

References

Dowla, A., and D. Barua. 2006. *The Poor Always Pay Back: The Grameen II Story*. Bloomfield: Kumarian Press.

Grameen Bank. n.d. www.grameen-info.org.

Grameen Bank. n.d. <http://www.grameen-info.org/gfamily.html>.

² See more details in <http://www.grameen-info.org/gfamily.html>