MicroSave Briefing Notes on Grameen II # 3

The New Loan Arrangements

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Grameen and 'Grameen II'

The first Note in this series, 'What is Grameen II?' introduces the Grameen Bank and the changes it has made recently, known as the 'Grameen Generalised System' or 'Grameen II'.

Changes to **loan arrangements** attracted attention when Grameen II was announced in 2002. The 'flexi' loan – a system for quickly rescheduling loans in repayment arrears – aroused concern: Grameen's loan portfolio was known to have been weakened by floods and other problems in the 1990s, so some worried that wholesale rescheduling of loans would make things worse rather than better. As we shall see, this did not happen. Our analysis of the bank's performance is in another Note in this series: here we describe the new loan arrangements and how staff and borrowers have reacted to them[1].

Classic Grameen's loans

'Classic' Grameen – the products and rules in force up to 2002 – offered at first one type of loan –the 'general loan' – with a fixed term of one year and a repayment schedule of fifty equal weekly instalments each of 2% of the principal. Interest at 10% nominal (roughly 20% annually) was divided into 50 equal payments, which were made along with the principal repayments.

Steadily, other loan products were added. Some, like the 'seasonal' loan, were introduced to ease the rigidity of this one-term one-schedule regime. Others, like the lower-cost longer-term housing loans, and the much smaller loans for drinking water pumps, responded to obvious rural needs. Another, the 'cattle fattening' loan, helped farmers prepare an animal for the Eid festival.

As Muhammad Yunus, the bank's founding Managing Director noted in his introduction to Grameen II, the complex of subsidiary loan types and a rather rigid 'general' loan made the system unstable: the multiple loan types led some members into over-indebtedness, and the single-term single-schedule 'general' loan became hard to manage as loan sizes – and thus weekly instalment sizes – grew. Under 'general' loan rules, instalments could not be pre-paid and the loan could not be paid down ahead of due. This meant that 'once a borrower fell off the track, she found it very difficult to move back on', wrote Yunus. Ahead of Grameen II, loan repayments rates began to fall worryingly.

Grameen II

Grameen II consolidated lessons learned, and to a great extent it focused on solving this 'rigidity' problem. It left the context of loan-taking and repaying unchanged: as before, enrolled 'members' still take and repay loans through 5-person groups meeting in company with other such groups at a weekly venue in the village served by Grameen staff. Grameen II's approach is simple:

The basic loan

The old general loan is replaced by a new '**basic loan**'. The two have much in common: basic loans are still repaid in weekly instalments. But a basic loan may have any term from 3 months to 36 (or even more). It may be scheduled so that the weekly repayments vary in size from season to season. Instalments can be pre-paid and the loan can be paid off prematurely. The loan may also be 'topped up' when half the term is done: the loan outstanding is refreshed up to the original disbursed value. Each borrower has just one basic loan in place of the variety of loan types, and earns a credit limit which rises according to repayment and attendance behaviour[2] and the member's saving balances[3]. With more capital flowing into branches from greater deposit mobilisation, Grameen II also does away with the overall lending limits previously imposed on branches.

Since virtually every one of the 4 million members has a loan or is waiting for one, any change in loan rules is a major matter. What did members make of it? The **transition** went very smoothly: a big job that branch staff did well. We heard very few complaints from members about the process.

But what did the members really **understand** about the changes? They were not given written explanation of the new rules, and learnt about them by word of mouth from workers. The new rules are seen by Grameen much more as *guidance to staff* than as a new compact with clients. As a result, we have found that while most members can name some 'things that have changed'. Almost none see the changes as a systematic reworking of the Grameen approach or are aware of any such thing as 'Grameen II' (in its Bengali language names). Grameen has not tried to present Grameen II as a consolidated 'one-stop' answer to their members' financial needs. We go on to describe reactions in more detail.

[1] All Notes in this series are based on the research project 'Grameen II: A Grounded View' commissioned in 2002 by *MicroSave* from a team lead by Stuart Rutherford. As the title implies, the findings are based on close research in the field, using interviews with staff, clients and the public in the areas served by three sample branches, and a review of the accounts of those branches, and of data from the Grameen HQ. We are grateful to the bank for the support it is lending to the research team.

[2] And, to a limited extent, that of other group and Centre members

[3] See Note 2 in this series, on Savings

Members quickly understood the loan '**top-up**' system. At first there were mixed feelings, some members believing it slowed the growth of credit limits, but by 2004 we found very few who dislike the system, none who didn't know it, and many who value and use it. Staff like it too, since it can be used to help borrowers through sticky patches. With the loan cycle half-finished, but with signs of weakness in the borrower, staff can top up the loan and extend the term, thereby lowering the value of the weekly instalment[4].

But to our surprise we have found that staff rarely use the other new elements of loan flexibility. **Variable loan scheduling** is extremely rare, and **terms** for normal basic loans of other than one year not yet common. Why is this? Why are members not demanding them? Members almost always tell us they have never been told about them. Staff deny this, claiming they explain rules in weekly meetings but members simply forget. But with no written rules and much to explain, what gets through to members is limited to what the staff choose to emphasise and repeat. So why do the staff not use these new features? Many managers are cautious about them, and advise field-staff to go slow. Managers have told me that 'members won't understand variable schedules', and that 'their husbands (who commonly provide the repayment instalments) will think they are being cheated if they have to pay different amounts in different weeks'. Staff also flatly tell me – with little evidence offered – that 'members don't like the idea'. I saw similar attitudes to varying loan terms were on show when I watched a discussion between a worker and member about a new loan. The worker said 'you can have a longer term if you like' (here the member looked up in interest) but went on 'but it will cost you more and will delay your next loan', showing by his[5] body language that he didn't want the member to take anything other than a one-year loan. Why is this? Staff offer various reasons, but, in sum, it is conservativeness: Grameen has run on one-year loans for thirty years, they must be the right thing. Let's not risk too many changes at once.

So it is interesting that with **Special Production** and **Business Expansion** loans, terms other than one year are now becoming common. These bigger loans, for true entrepreneurs, did not feature in the first (2002) public exposure of the Grameen II system. But they have become important and popular. Members qualify for one (which they can hold *in addition to* a basic loan) by having good savings deposits, a good repayment record, and a viable business. Business expansion loans in our three sample branches have average outstanding balances varying from $330 to $900 compared with $65 to $125 for basic loans. These business loans are repaid weekly but usually have longer terms: the average is two years, with many of three. It seems that these new loan types are in the vanguard of methodology. It is in them that we see Yunus's prophecy emerging that staff will 'design his loan product to make it a best fit for his client'. In 2005 we expect to see more experimentation with variable terms and schedules, even in basic loans.

[4] We even found a few 'empty top-ups': the loan term was extended without disbursing fresh capital, so that the weekly instalment fell by half.

[5] Most workers are male: members are overwhelmingly female

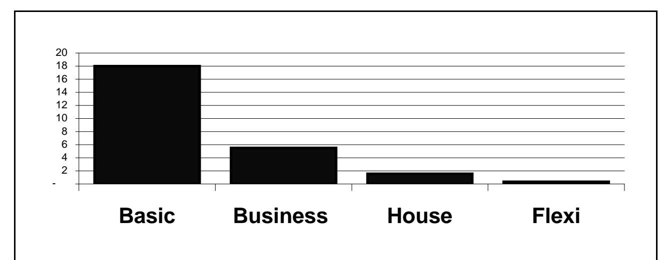
The flexi loan

So what about the controversial **flexi loans**? They were designed to help borrowers in repayment difficulty by offering a quick loan rescheduling with the promise of a return to normal basic loan status if they manage to pay down the loan at the slower rate. Their use has been most prominent in clearing up the backlog of overdue loans inherited from classic Grameen. Now, some of those old loans have been paid off and others written off, and this has helped to strengthen Grameen's portfolio.

But since the transition period staff have been slow to use them for *new* Grameen II basic loans newly overdue. HQ has encouraged the branches to be 'flexi-free', so some staff may feel ashamed to use them. More importantly, we see that staff now have other ways to make loan repayment easier for members. We have shown how the 'top-up' system can be used to this end. Free withdrawals from personal savings (see Note 2) have greatly helped - many members have withdrawn savings during short-term cash-crises. Instalment prepayment and premature pay-offs help match loan repayment to cash flows. Formal financial joint-liability has gone: leaving an understanding between staff and members that if members can manage full repayment at weekly meetings (by taking short-term loans from each other, say) then workers will not try to tap other members when one member's loan really does go bad: this has removed some disincentives to struggle to pay on time. Finally the big influx of new borrowers improves repayment performance, since the smaller first and second loans rarely go bad.

As 2005 opens, Grameen's loan portfolio consists of $284 million in basic and business loans (HQ accounts don't distinguish these two categories), $19m in (mostly old) housing loans, and $27m in the rescheduled flexi loans. For a closer view, the chart shows the loan portfolio in one of our sample branches, branch T:

Branch T: loan portfolio in million taka end Q3 2004 ($1 = 60 taka): there are 3,255 basic, 364 business, 251 housing and 60 flexi loans, in a branch with 3,574 members



This looks healthy. But will the relatively untested big new business loans work well in a group context? Will Grameen II's flexible rules keep basic loans in good shape as loan sizes rise? We will be watching.