# Chapter Six

## RETHINKING MICROFINANCE: THE GRAMEEN II DIARIES

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. Loans were no longer being repaid at the on-time rate of 98 percent that the bank had long advertised: in some areas it had fallen below 75 percent. In 1998 a devastating flood, one of the worst in the country's history, damaged many millions of households and exacerbated Grameen's problems by a further dramatic erosion of loan repayment. The bank had a crisis on its hands.

It responded with a major rethink; old premises were discarded, new approaches—some of them adapted from the work of local competitors, others entirely new—were brought on board. In 2001—just after we completed our original Bangladesh diaries—Grameen's management was ready to roll out a series of new and modified products, which it called "Grameen II." The rollout proved successful, in ways that sometimes surprised even the bank's leadership. The process shows the possibilities for building on the perspectives that we've developed in the previous chapters.

Grameen has since enjoyed a spell of renewed rapid growth in its clients and its portfolio, a growth paralleled in other microfinance





institutions in Bangladesh, including Grameen's two biggest competitors, BRAC (now a name rather than an acronym) and ASA (the Association for Social Advancement). In late 2006 Grameen and its founder, Muhammad Yunus, were awarded the Nobel Peace Prize. A year later *Forbes*, an American business magazine, placed ASA at the top of its first-ever list of the world's 50 best microfinance institutions.[1]

To understand these developments from the point of view of the clients, we ran a special set of financial diaries in Bangladesh in 2002–5.[2] The diaries show that several of the insights generated by the original diaries (and set out in the preceding chapters) are—quite independently—being used to develop workable new products by Bangladeshi institutions as their understanding of the market improves. As there are now approximately 20 million microfinance customers in Bangladesh, this is no trivial development.

### *Organized Finance for the Poor*

There have been many attempts to bring organized financial services to the poor, stretching back at least as far as the rural credit cooperatives of nineteenth-century Europe. But in the 1970s in Asia and the 1980s in Latin America, new pioneers deliberately set out to provide retail financial services *en masse* to poor and very poor populations while charging prices high enough to cover the costs. These advances, it is generally agreed, marked the start of a distinctly new tradition of "modern" financial services for the poor.

Grameen was started, in 1976, not by a banker but by an economics professor, Muhammad Yunus. He was not inspired by the prospect of making profits from banking with poor people, but by the idea of alleviating poverty in his war-torn and desperately poor country. His work was first recognized as important by development aid officers who began to fund it, and by humanitarian nongovernmental organizations (NGOs) that began to imitate it. Indeed, it looked as if he had developed an antipoverty device as much as a new form of banking.

The device was attractively simple. Grameen focused on the poorest rural households—those owning less than half an acre of cultivable land.[3] Representatives from households that met this criterion were invited to form groups of five, each from a different household. The groups were of a single sex, and at first there were as many male as female groups, though by the 1990s nearly all were women. A number of such groups met weekly in their village with a Grameen worker. The main purpose of the meetings, at which members also made a small compulsory savings deposit into a jointly owned fund, was to facilitate the repayment of the loans that each member took from Grameen and which she promised to use in a new or existing small business. As a group, members undertook to monitor each other's loan use and to ensure that all loans were repaid on time. The repayment schedule was a fixed amount each week for a year, covering both principal and interest. Successful on-time repayment guaranteed the rapid release of another, bigger loan. Providing such microenterprise credit was viewed as the most effective way to unleash the productive capacity of villagers trapped by cycles of low incomes and low skills. All of this was achieved while charging customers interest rates on loans of about 20 percent per year, a rate similar to the US bank charges for unsecured loans, such as on credit cards.[4]

When Grameen Bank reached its millionth client in 1991, the community of activists, donors, and policymakers working on international development took special notice. By the time of the first Bangladesh diaries (1999–2000) there were more than two million active Grameen "members," as the clients were called. In the meantime, dozens of NGOs in Bangladesh had set up similar schemes, and BRAC and ASA had grown to be almost as big as Grameen. The first set of Bangladesh diaries showed that no fewer than 30 of the 42 randomly chosen households we studied held accounts with one or more microfinance institutions. On the whole, as we showed in chapter 4, they liked what they got—financial services with relative reliability, conveniently small and frequent repayment installments, and the chance to bank without having to leave the village.

The key messages came to be recognized around the world: success, measured by the economic and social progress of borrowers,





depended on women, on group solidarity, on microenterprises, and on loans. Grameen II, however, would contribute to a different set of messages, based around the provision of broad banking services, including savings, increasingly tailored to individuals and their multiple needs.

### *Grameen II*

Grameen's new "Generalized System," or "Grameen II," came about in response to a decline in the quality of the bank's loan portfolio. The decline was intensified by the 1998 flood, but the bank realized that there were underlying problems that would not go away once the flood had been mopped up. In a frank public discussion of these problems, Muhammad Yunus wrote of "internal weaknesses in the system. The system consisted of a set of well-defined standardized rules. No departure from these rules was allowed. Once a borrower fell off the track, she found it very difficult to move back on."[5] In response, Grameen II made two sets of changes. The first tackled the rigidity and inflexibility in the lending system that Yunus referred to. It recognized that a single loan term (of one year) and a single repayment schedule (of equal invariable weekly installments that cannot be prepaid but have to be paid each and every week for the full year) simply did not match the cash flows of many poor households. Chapter 2, where we study cash flow in detail, confirms that insight. Grameen II accordingly brought in a wide range of loan terms from three months to three years.[6] To help if and when cash flow starts to dry up part way through a loan, or if some new investment opportunity arises, loans could be topped up to their full value before they were fully repaid. In cases of serious repayment difficulties, borrowers could reschedule their loans by extending the term, thus reducing the installment value. This is done within a system that contains incentives to "get back on the track" in the form of a promise of renewed borrowing rights once the problem has mended. Lending became more flexible by removing the requirement to borrow continuously. Grameen II also stepped back from group solidarity, outlawing any

arrangement that makes borrowers responsible for repaying each other's loans.

The second set of changes comprises new or modified products that extend the range of transaction possibilities open to the clients. In so doing, Grameen II no longer assumes that its clients are exclusively interested in borrowing: most of these changes concern saving. Here again our own conclusions, drawn from the financial diaries, support this insight. In the original version of Grameen, copied by all the other Bangladesh microfinance institutions, members were required to save a small amount each week, deposited into a group-owned account. These deposits could not be withdrawn until the members had held their accounts for 10 years, or relinquished their membership of Grameen Bank. Under Grameen II, this compulsory saving was abandoned, and two new savings products were introduced in its place. A personal passbook savings account allowed individuals to deposit and withdraw savings at any time in any value. A commitment (or "contractual") savings plan, known as the Grameen Pension Savings, or GPS, was also introduced that offered a good rate of interest in return for regular monthly deposits over a five- or 10-year term. Here, Grameen was following pioneering work done earlier by ASA, by moving away from compulsory nonwithdrawable savings, and the midsize competitor BURO,[7] by introducing commitment savings.

These changes hold out the promise of making it easier for cash-strapped poor households to manage cash day to day and to accumulate large sums in a secure savings device, two of the core financial service needs we identified in earlier chapters. Note, however, that achieving this outcome was not Grameen's main objective in making these changes. Rather, Grameen wanted to create a source of loan capital by mobilizing more savings. When the flood occurred in the late 1990s Grameen found it harder than it had anticipated to obtain fresh capital. With Grameen II, not only was Grameen able to raise more savings from its poor borrowers, but the bank intensified its mobilization of deposits from the ordinary public. This was dramatically successful: by the end of 2004 the bank's deposit portfolio exceeded its loan portfolio for the first time ever, and savings have continued to grow ever since at a faster rate than the loan portfolio.





By the end of 2007 Grameen clients collectively owned $1.40 of savings in the bank for each $1 they had in loans.

In effect, Grameen turned itself from a microenterprise lender into a true retail bank, but one that continued to focus on poor households.

### *The Grameen II Diaries*

From 2002 to 2005, the NGO MicroSave, who wished to learn more about the Grameen II innovations, supported a fresh set of financial diaries in Bangladesh. These "Grameen II diaries," as we shall call them here to distinguish them from the original Bangladesh diaries, ran for three years rather than 12 months, and diary households were visited once a month (at least) rather than every second week. As a result of these changes we got less detail than in the original, fortnightly, diaries, but we were able to watch changes unroll over a longer time-span.

Our selection procedure for households was also different. Rather than choosing households on the basis of their level of poverty, we did so on the basis of their relationship with microfinance providers. Most held accounts with microfinance institutions (many of them with Grameen, on whom the Grameen II diaries were focused, but several with other providers), but we also chose a few households that had no microfinance member at all, or had former microfinance members. This enabled us to study and compare a broad range of portfolios of households from the same villages but with varying, or no, microfinance partners.

In general terms, the portfolios from the Grameen II diaries are similar to those of the original Bangladesh set, and thus to the portfolios researched in India and South Africa. Once again it was clear that these households, though poor, are active financially. They work with many financial partners, principally but not exclusively in the informal sector. Flows of cash through the instruments they use are large relative to the balances. The mix of instruments—interest-free and private for-interest lending and borrowing, home savings, moneyguards,

savings clubs, and semiformal providers, among others—is similar to the first Bangladesh set. Conversations with the diary householders once again showed that they took their financial life seriously, worried about it, and were on the lookout for ways to extend and improve it.

But there were some striking differences, too. Notably, microfinance providers loomed larger in the later diary set. Comparing households in the original 1999–2000 diary set who had access to microfinance providers, with microfinance-using households in the later Grameen II set, we found that a bigger proportion of the financial transactions of the latter group passed through microfinance providers. In part, this reflects the rapid growth of the microfinance sector in Bangladesh, with the three big players—Grameen, BRAC, and ASA—together adding nine million accounts between 2000 and 2005. As a result, diarists in the Grameen II set were much more likely to have accounts with more than one microfinance provider. They also transacted with their microfinance institutions more often and in larger amounts, taking advantage of the new products.

In the sections that follow we look at the impact of Grameen II's innovations on what we have identified as the key financial needs that millions of poor families find difficulty in meeting: managing cash flow, and building lump sums through long-term saving and through borrowing.

### *Managing Cash Flow with Passbook Savings*

At the time of the original diaries, Grameen Bank customers were required to deposit funds weekly into a saving account, but their access to the funds was severely limited. Grameen II followed a shift in Bangladesh toward open-access, individually owned savings. By the time of the Grameen II diaries (2002–5) most microfinance customers, including those of Grameen, allowed members to save and withdraw as they liked at each weekly meeting (though they generally had to travel to the branch office to pick up the withdrawals). The shift met early resistance from bank workers, who worried that





unlimited withdrawals would push balances too low for comfort, but the customers were pleased. Many used their new savings accounts to help solve the cash-flow management problems that, as we identified in chapter 2, absorbed so much time and gave so much trouble to the original diary households. For most of these users, this was the first time they had had access to a flexible but reliable account of this kind. Typically, they saved a little each week, and withdrew between two and three times a quarter.

Kapila Barua was one of our Grameen II diarists. She did some craftwork at home to supplement her husband's farm-laboring income of about $1.50 a day, earned on those days when he could find work. In our first interview with her she told us how much she liked Grameen's new personal savings, where she had a balance of a little under $18, explaining that withdrawing at will enabled her to manage many small expenses. Her diary shows that she used the weekly meeting to deposit about $4 to $10 each quarter.[8] She made at least one withdrawal each quarter. In the first quarter it was $1 for a food shortfall; in quarter 2 she took out $13 for school costs for her son, and then in the third quarter $4 to help a fellow member make loan repayments, and in the fourth quarter $2 to top up her own loan repayments. In quarter 5 she withdrew $1 to pay her Grameen loan insurance contribution, and in quarter 6 took out $11 and put it toward the purchase of gold earrings. After this she took a breather, making no withdrawals in quarter 7, but in quarter 8 she took out $11 to buy handicraft inputs, and in quarter 9 $4 to buy into Grameen's newly introduced life insurance scheme (insuring her husband's life). Then for six months she made no withdrawals as she saved hard for medical treatment for her son, and in the last quarter that we tracked, she took out $15 to pay doctor's fees and buy drugs for him.

Kapila's final large withdrawal brought her balance down to little more than a dollar. Her modest average balance in her passbook account was typical for the Grameen II diarists, though the combined personal savings of 37 Grameen II diary households with these kinds of accounts did rise somewhat over the three years, by 21 percent from $248 to $299 (about $8 per saver). But aggregate flows were very large relative to opening and closing balances: these 37 households

deposited $4,228 between them in the three years (including interest earned), and withdrew $4,176. Thus, as in chapter 2, we saw large flows and small average balances, but the flows were notably bigger than for the microfinance savings in the original 1999–2000 diary set, when deposits into microfinance savings were standardized at a low rate, and withdrawals much harder to make. What these households were getting was more than simply a chance to withdraw savings: they got a wholly new and valuable money-management device of a sort none of them had experienced before. Because the institutions sent a worker to the village, it was easy to save a little each week into a resource that could be tapped at will for any purpose. This finding reinforces those from chapter 2: that poor households welcome safe, local, convenient open-access savings and use them intensively.

It also shows the perils of inferring that poor households don't *want* to save based only on the fact that they may not *currently* save much. Grameen II demonstrates that introducing better products can dramatically change an equation: with the introduction of the easy-to-use passbook savings account, saving activity rose dramatically.

### *Managing Cash Flow and Forming Large Sums with More Flexible Loans*

Readers will have noticed that among the uses to which Kapila put her Grameen II savings withdrawals was making repayments on her Grameen II loans. This had previously been frowned on by Grameen, but in practice it made loans much easier to manage—when you were short of cash to make a repayment you could fund it in the short-term out of savings. Using savings for this purpose might often be less stressful than relying on help from neighbors, if that's even an option.

A Grameen II novelty that has proved convenient, and was welcomed by many borrowers, is the "loan top-up" facility, under which loans can be refreshed to the amount that had originally been disbursed. This could happen part way through the repayment cycle, so that if you started with a $200 loan and had already paid off $100, you could borrow that $100 again to get back up to $200 and continue





with weekly repayments for an extended term. This works to make loans a better fit with poor-household cash flows.

The "top-ups" were especially appreciated by very poor households like Ramna's, who was another of our Grameen II diarists. She and her husband were completely landless, sheltering on her brother's land and trying to bring up two school-age sons. The husband had few skills and was in poor health, and though he tried day laboring, working in a tea stall, and fishing for crabs, he was never able to maintain steady income during the three years we knew them.

Ramna had joined Grameen II a year before we met her, and had taken a loan of $83 used to buy food stocks in a lean period. She was repaying weekly from a variety of sources including her husband's income, interest-free loans from family and neighbors, and her own Grameen II personal savings. In April 2003 she "topped up" her Grameen loan and used it to buy grain to keep in reserve for the coming monsoon period. This and her subsequent top-ups didn't mean that Ramna was falling into deeper and deeper debt: the top-up merely allowed her to refresh her loan to its original disbursed value, not more. Then in October her father-in-law died and they financed the funeral with another top-up, worth $67. They managed to make repayments during the winter dry season, so that in May 2004, when she was eligible for another top-up, she took it and stored it with a moneyguard, from whom it was later recovered and used to pay down a private loan that had been hanging over them for some time. She topped up with another $75 once more in December, the month of the main rice harvest, and it was spent on stocks of grain and on medical treatment for her husband, with a portion held back to make weekly repayments. They struggled to repay in early 2005 because her own father was ill and they had to find money to pay for his treatment, but in early July she was able to top up again ($65), this time paying school fees as well as restocking with food. When we saw her last at the end of 2005 she had a loan balance of $70 to pay and was looking forward to another top-up.

Her loans cost her 20 percent a year, and were not invested directly to produce income, but Ramna was sure that the facility was helpful. Without it, she asked us, how could she stock up with food, keep the

boys in school, and buy her husband drugs when he needed them? All these maintenance tasks would have been much harder and much more expensive without access to the flow of usefully large lump sums from Grameen loans. Ramna's story highlights two lessons from earlier chapters: that loans can be successfully used both to smooth consumption across seasons and to manage risk, and that reliability matters. Ramna was able to get and use her loans as she wished within a rule-bound reliable framework that she could count on and plan on.

Just as with Kapila's savings account, so with Ramna's loans, we see large flows and small balances. Ramna started with $35 outstanding in her loan account, and ended with $70: in the intervening three years she took loans worth $337, repaid $302, and paid interest of $44.[9] The frequency and reliability of the Grameen loan service makes it both attractive and manageable for households like Ramna's. Indeed, of three households that we selected because we thought they were so poor that no microfinance institution would ever take them, two did in fact open accounts during the three years of the research, drawn in by the observation that the microfinance institutions were now offering a service that suited them, as opposed to being suitable only for "those who can invest."

This echoes another of our themes: the focus on microcredit for microenterprise has contributed enormously to the attraction, success, and spread of microfinance, but has had the unfortunate side effect of diverting attention from a much wider set of households who seek, value, and reliably repay loans for many other purposes. Happily, Ramna was in practice able to use her loans as she wished, notwithstanding Grameen Bank's traditional injunction to spend them only on a "productive investment."

## THE USE OF MICROFINANCE LOANS

Because they dealt with the intimate details of customers' financial transactions over three years, the Grameen II diaries provided one of the best opportunities that researchers have ever enjoyed to understand how microfinance loans are actually used.[10] During the course of the diaries, 43 of the households took at least one microfinance





**Table 6.1** Grameen II Diaries: Total Disbursed Value of Loans, by Source

| | *Value of loan* | *Percentage of total loans taken* |
|---|---|---|
| Interest-free loans from family & neighbors | 15,989 | 23% |
| Credit advanced by shop-keepers | 1,692 | 2% |
| Loans on interest from family, neighbors & moneylenders | 9,033 | 13% |
| Loans from savings-and-loan clubs | 2,468 | 3% |
| Loans from formal banks | 2,167 | 3% |
| Loans from microfinance institutions | 39,668 | 56% |
| Total | $71,017 | 100% |

*Note*: US$ converted from Bangladesh takas at $ = 60 takas, market rate. The table includes all loans, not just microfinance loans, both outstanding at start of period and taken during period for all 43 Grameen II diarists.

loan—from Grameen or from other institutions. Between them they used 239 microfinance loans with a total disbursed value of about $39,000 at the average exchange rate for the period. The average disbursed value of the individual loans was $165 (with a median of $120).

Impressive though these numbers are, they represent only a part of all their borrowing, since households were also borrowing from their families and from savings clubs, neighbors, moneylenders, and even a little from banks. Our diary technique allows us to compare these sources, as shown in table 6.1.

Microfinance institutions, then, supplied comfortably more than half (almost 56 percent) of the disbursed value of all loans taken by these households, though all of them also borrowed from one or more other sources. This is a considerably bigger proportion than the 38 percent in the original 1999–2000 Bangladesh diaries.

What were these loans used for? As shown in table 6.2, we sorted 237 of these loans into six main categories.

We were able to allocate most loans to a single broad category of use, but the 55 in the "mixed" category were split between various

**Table 6.2** Grameen II Diaries: Number and Disbursed Value of Microfinance Loans, by Use Category

| | *Number* | % | *Value (US$)* | % |
|---|---|---|---|---|
| Stock for retail or trading businesses and crafts | 75 | 32% | 15,231 | 39% |
| Asset acquisition and/or maintenance | 37 | 16% | 5,583 | 14% |
| On-lending to others outside the household | 27 | 11% | 5,764 | 14% |
| Paying down other debt | 25 | 11% | 3,413 | 9% |
| Consumption | 18 | 8% | 1,425 | 4% |
| Mixed uses | 55 | 23% | 7,535 | 19% |
| Total | 237 | 100% | 38,951 | 100% |

*Note*: US$ converted from Bangladesh takas at $ = 60 takas, market rate. A total of 239 microfinance loans were used by 43 borrowers. The two loans unaccounted for were placed into savings instruments.

uses. Of these, 35 (almost two-thirds) included a large share for "consumption"; 30 (a little over half) included a large share for paying down other debt; and 26 (just under half) included some kind of investment (in assets or in business stock) as an important use. So a typical "mixed use" loan might be $150, of which $30 used for food, $70 for repairing the house, and $50 for repaying other debt.

Our "asset" category is broad, and includes buying, mortgaging-in or leasing-in of land, house construction and repair, and buying or repairing a wide range of vehicles and boats, farm or business equipment, and tools for trades like carpentry.

If we regard the first two categories—business stocks and all kinds of assets—as "productive" loan uses of the sort that microfinance loan officers prefer, we see that roughly half are used in those ways (a little fewer than half of all loans, and a little more than half of the loan value).

This does not, mean, though, that half of all *users* used their loans for "productive" purposes. This is because productive uses tend





to be strongly associated with particular borrowers. Out of the 43 borrowers in the sample, a handful—just six—were responsible for $11,810—three-quarters—of the value of loans in the biggest category, "business," and between them took two-thirds of all loans issued in that category. So though 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 six households who dominate the business category all have well-established retail or trading businesses and borrow to buy stock as often as they are allowed. Several of them are Grameen members, and for them the introduction of the loan top-up system is a boon. Most take capital from several microfinance institutions. One cattle trader, for example, has a Grameen basic loan that he (or rather his wife) tops up every six months, taking around $100 each time, and has concurrent loans of up to twice that value from two other institutions. The user who has taken more loans, of a higher total value, than anyone else in the sample runs a well-stocked grocery store: during the three years of the research he borrowed $4,580 in 15 loans from three providers (Grameen, ASA, and *Safe*Save), the biggest being a $1,670 "special investment loan" from Grameen. Altogether this one borrower alone took 12 percent of the total value of all loans in the sample.

The most striking finding of this brief review is the diversity of uses on display, set against the concentration of some uses among distinct types of users. On the one hand, it is clear that an early hope of microfinance lending—that virtually every loan would be invested in a microenterprise—has not come about. On the other hand, businesses and asset-investment uses are responsible for more than half the value of loans disbursed, though concentrated among the minority of borrowers well placed to use them in this way.

### *Accumulating Large Sums in Commitment Savings Accounts*

One of the big changes made to poor-owned portfolios by new products at microfinance institutions, then, was to shift some day-to-day

money management into microfinance savings and loan accounts. The other was to open up the scope for building longer-term financial assets that produce usefully large sums. We have just seen how Ramna, who used loan top-ups for her father's funeral, for her son's school fees, and for her husband's medicines, was able to access useful sums quickly through a reliable and flexible loan facility. A slower but ultimately more powerful way to create large sums is to accumulate them in a reliable savings account.

Commercial banks in Bangladesh long offered "Deposit Pension Schemes" to their non-poor clients, and the schemes had proved very popular as ways to commit to saving over the long term. A few microfinance pioneers, notably BURO, had experimented with a pro-poor version in the 1990s, but the idea did not really take off until Grameen II made it available to its several million members.[11] The Grameen version, called Grameen Pension Savings (GPS), offers a good rate of interest to members who agree to save a regular sum of at least one dollar per month for a term of five or 10 years. It is a "pension" in name only. Use is not restricted for retirement needs; indeed, many younger families see the "pensions" as ways to build resources for expenses that loom in the medium term—like the eventual need to pay for children's schooling or weddings.

Like the informal devices such as a RoSCA (see chapter 4 for definitions and descriptions of RoSCAs and other savings clubs), commitment plans like the GPS offer a structure of regular deposit periods. The structure helps its users to discipline themselves to deposit regularly and to maintain the savings for future use.[12] Unlike savings clubs, however, the term does not have to be short enough to eliminate the risks that come from the accumulation of capital owned by multiple people in an informal environment: commitment plans can be long term if the provider is a trustworthy regulated entity such as Grameen. The GPS has a maximum term of 10 years, but on maturity the savings can be transferred into a fixed deposit account and another GPS begun. In future, Grameen could offer a GPS with an even longer term.

When the GPS was first offered to Grameen clients, there were some who were already familiar with the idea of commitment savings—perhaps they knew of people who held one with BURO or with a bank—and others for whom it was new. The first group, often among the less poor, tended to welcome and use it immediately. Jharimon is typical. She and her husband have a well-established home, and, relative to the neighbors, he makes a good income of around $3.50 a day from operating a small laundry in a rented shop. This puts them near the top of the income ladder for microfinance members, and until Grameen II came along the couple hadn't bothered with microfinance membership. But Jharimon was one of several of our diary households who joined Grameen specifically to access the GPS.





The couple assumed at first that they could take advantage of the GPS without joining the bank as a full borrowing member, but the bank did not allow it. So in 2002 Jharimon joined a local Grameen Bank group and immediately opened a GPS worth $3.50 a month with a 10-year term. She wanted to save for the future marriages of her two daughters, one 12 years old and the other still a baby. She also took a small loan "because they offered me one," paid it off quickly, and didn't renew it (despite some gentle pressure from the Grameen worker who preferred to have his members borrowing). In April 2004, satisfied that the GPS was well managed, she opened another 10-year GPS, this time of $2 a month, to fund advanced schooling or a business for her eight-year-old only son when he grows up. Then toward the end of 2004 Grameen, which correctly assessed her as a good client, offered her a big "special investment" loan of $416 to expand the laundry. She took it, and at the same time opened yet another GPS, again of $2 a month. By the end of 2005, Jharimon had saved $262 in her three GPS accounts, net of interest. She had $225 still to pay on her "special" loan. She had become bored with the weekly meetings and now usually just sent her weekly loan repayments and savings through another, poorer member. But she was a satisfied customer.

Jharimon was well-off relative to most diary households, and valued commitment savings before she joined Grameen. But how popular was the GPS with poorer households who had no previous experience of such devices? Answering this question isn't straightforward,

because Grameen II officially requires a GPS of $1 a month as a qualification for borrowing any sum more than $133: so some GPS users hold them only because of this condition. But client Sankar's story helped us understand what was going on in the minds of some of the poorer household heads when faced with this requirement.

Sankar was a landless, illiterate rickshaw driver, whose wife had Grameen membership. They had borrowed from Grameen Bank a few times—in fact one loan had helped him buy his rickshaw. Suddenly his wife told him they would have to open a GPS in order to get the next loan. He was suspicious, he told us. "And now?" we asked. He chuckled. "Now, we try to avoid loans and just use the GPS." Pressed to explain, he said that his income was small but sufficient for their daily needs and they had nothing to invest an expensive loan in. Their priorities now were for their children, and the GPS seemed, compared to borrowing, a cheaper, more relaxed, longer-term way of providing for their future (marriage for the girl, a business for the boy). Like Jharimon, Sankar borrowed sometimes and saved always. "Grameen should have done this years ago," he said, echoing what many others had told us.

Of the millions of GPS holders, we don't know how many appreciate the account in the way that Sankar does, and how many are holding them just because members are required to do so in order to access a loan. But in our diary households we can get some indication. Of the 27 households in our sample who held a GPS, 20 held more than the minimum required to take a loan, and 11 of these held more than one GPS. In most of these cases, presumably, the GPS was held for its own sake, and not just as part of the price of borrowing. Of the remaining seven, some may be like Sankar—that is, savers who began reluctantly but have become enthusiastic as time has gone by. Altogether, it looks as if an understanding of the virtues of "commitment saving" devices is well established and growing.

The 27 Grameen II GPS holders have portfolios that are somewhat different from those of the original 1999–2000 diary set. Not only is the microfinance institutions' share of total savings balances twice as big (31 percent as against 14 percent), but part of that savings is now





held in secure, individually owned and consistently growing long-term instruments.

The GPS helped transform clients' portfolios, but it also helped transform the financial health of Grameen Bank itself. When we started our research late in 2002, the bank's total savings portfolio, at 8,284 million takas (about $142 million at that time), was 68 percent of its loan portfolio of 12,149 million takas. When we finished at the end of 2005, the loans had grown rapidly to 27,970 million takas. But the savings had increased even faster, to 31,659 million takas, 13 percent bigger than the loan portfolio. Looked at from the viewpoint of chapter 4, where we saw the difficulties faced by poor households in accumulating usefully large sums of capital, and at the mechanisms they turned to in order to achieve this end, the evidence suggests that accounts such as the GPS—provided they remain well managed—would represent a major step forward in financial services for the poor if they could be emulated or bettered worldwide.[13]

## *Grameen III?*

Bangladesh's microfinance industry, one of the world's oldest and biggest, continues to develop at a rapid pace. The combination we have described in this chapter—open passbook savings, more flexible ways of lending, and commitment savings accounts—shows how much has been achieved in Bangladesh to improve financial services for the poor. Muhammad Yunus's original vision for Grameen Bank helped the world see the power that access to simple loans can have in helping villagers build small businesses. The innovations brought by Grameen II address a broader set of critical needs that we discovered in the financial diaries: managing cash flows, coping with risk, and accumulating usefully large sums over time.

Still, not every microfinance customer is a Kapila, a Ramna, a Jharimon, or a Sankar. Even those four, like most customers, continue to transact largely in the informal sector, and it is not hard to see why. The interface with the microfinance institutions remains the

weekly village meeting, a breakthrough of the 1970s that is now looking somewhat stale: meetings consume too much precious time, there is no privacy, individual needs go unrecognized, the male workers tend to patronize the women members, and more and more members skip the meeting if they can, preferring just to show up and pay their dues as quickly as possible. Working almost exclusively with women may well have started as a commendable attempt to right a gender imbalance, but, as time goes by, more and more critics point to the failure to find ways to serve men. Many microfinance institutions say that they have abandoned joint liability, but field staff, fearful of loan arrears, continue to impose some forms of it. Similarly, despite attempts to make repayment terms and schedules more flexible, most loans are still for one year with equal invariable weekly payments that cannot be prepaid: the flexibility offered by Grameen's top-up system and competitors' short-term emergency loans remains an exception rather than a rule in the industry. Most clients are still routinely pressured into taking out a fresh loan as soon they have repaid an earlier one.[14] High rates of account closures suggest that many members find these conditions difficult.[15]

Moreover, Bangladesh's regulatory regime is now falling behind that of other countries: unlike other Asian states such as Cambodia or Pakistan, there is no legal identity designed expressly for microfinance providers. Thanks to special legislation, only Grameen Bank is allowed to mobilize savings freely, even though many of its microfinance competitors have shown themselves able to look after deposits safely; and a lack of clarity about what NGOs can and can't do is holding back microfinance NGOs that want to move into leasing, insurance, or small-business lending. Conversely, clients have little recourse in cases of abuse by microfinance institutions, and this is made worse by the failure to provide basic written terms and conditions for microfinance products: ironic at a time when Bangladesh's NGOs are beginning to work in the arena of "rights to information."

Today's shortcomings can be overcome. Given time, legislators will enact an improved microfinance law. Drawing on what we have learned from our diary households, our vision for what microfinance in Bangladesh could then become—perhaps some future





"Grameen III"—is of microfinance institutions positioning themselves as providers of integrated money-management systems for poor households. As such, they would no longer insist that their clients borrow continually, nor borrow exclusively for microenterprise investment. Rather, they would continue to improve the flexibility of the three core products—the passbook savings, the loans, and the commitment savings—to make them less of a "one-size-fits-all" service and more capable of achieving ever closer matches with the expressed demands and actual cash flows of poor households. Once that set of flexible "core services" is in place, improved specialist savings, loan, and insurance services can be developed. They would respond to demands for products for home improvement, medical and educational expenses, and pensions, for example, as well as for microenterprises.

In Bangladesh the purpose of microfinance has always been seen as the eradication of poverty, and its microfinance providers remain focused on the poor. They have shown an astonishing capacity to develop products and take them quickly to scale. That combination—a focus on poverty plus the capacity to scale up quickly—should enable them to exploit new ideas and technologies that can improve quality and build on the foundations laid by Grameen II, again providing a model of financial innovation from which the rest of the world can learn.