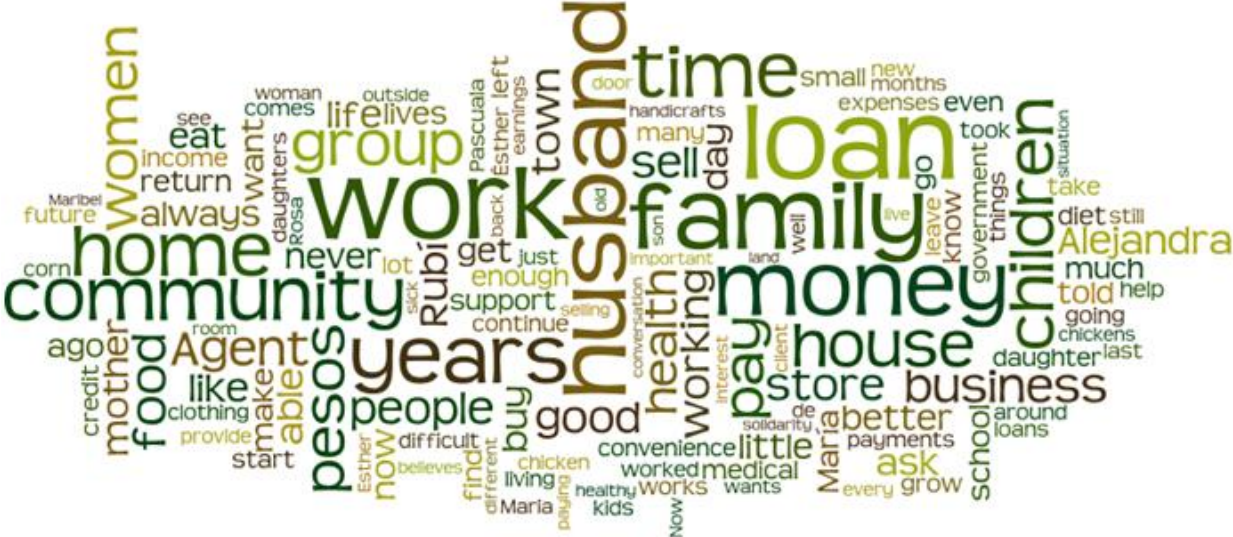


Deconstructing Drop-Out

Uncovering the reasons behind attrition among village-banking microfinance clients



Word cloud created using words from impact story interviews conducted with ex-microfinance clients. Mexico, 2009 and 2012

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Table of Contents

Executive Summary i

Introduction 1

Background..... 2

 A Foundational Understanding of Client Drop-Out..... 2

 Defining and Measuring Client Drop-Out..... 2

 Improving Financial Sustainability through Client Retention 3

 Improving the Social Impact of the Financial Institution through Client Retention 4

Data and Methods 5

Analysis and Results 7

 Analyzing Reasons for Dropping Out: A Complex Chain of Events 7

 Ten Common Contributing Factors to Drop-Out..... 9

 Ten Root Causes of Drop-Out 10

 Correlation Analysis between Contributing Factors to Drop-Out..... 11

 Cluster Analysis with Contributing Factors to Drop-Out..... 13

Discussion..... 15

Conclusion..... 19

Appendix..... 20

Endnotes 22

Executive Summary

Why should microfinance participation drop-out be studied? Clarity on the underlying factors contributing to client drop-out can be a launching point for an expanded discussion on the objectives and measurement methods of client retention. An understanding of these factors can improve the client experience through product innovation and flexible design as well as lead to deeper client loyalty to the organization—ultimately feeding the double bottom line of social impact and financial sustainability.

Yet client-retention data-collection methods vary across the industry and measuring has been inconsistent. Most tools only tell part of the story and do not help uncover the complex and real reasons behind the decision to exit. If the reasons behind clients dropping out were understood in depth, practitioners could offer better options to help the poor manage the underlying causes of failure (and success) that they face participating in microfinance. This paper presents the stories and reasons for dropping out from 59 village-banking microfinance clients across seven countries and microfinance institutions (MFIs) who were interviewed using Freedom from Hunger’s “impact story” methodology.

During open-ended interviews, clients were asked to explain why they had dropped out of a microfinance program. A client who had dropped out was one who was no longer borrowing from the MFI. The results of these qualitative interviews, or impact stories, revealed that it was most often a series of events that led to the decision to leave rather than a single cause for dropping out. Of the reasons for dropping out mentioned, health shocks, business failure and group issues were found to be both the top contributing factors and root causes of client exiting.

The research found combinations of reasons that tended to occur together. For example, when clients experienced a health shock, they were also likely to report their business failed and they defaulted on their loan. If they mentioned having relationship issues, either with other group members or their agent, they also were likely to mention being denied a loan.

An understanding of the most common contributing factors to dropping out, namely health, business failure and group issues, can help institutions anticipate and respond to client needs before drop-out occurs. This could include being more intentional about building the solidarity of the village-banking methodology and the development of products and services that help prevent root causes of drop-out, such as services that help mitigate the effects of health crises, helping prevent business failure through education or mentoring services, or developing flexible policies and procedures to support a client once a shock occurs.

Misdiagnosing reasons for dropping out by focusing on the last link in the chain of events leading to drop-out could result in the wrong interventions being applied. Efforts employed to mitigate business failure alone, when business failure is a consequence of a health crisis, may result in disappointment even when efforts to mitigate business failure is laudable. Consequently, opportunities could be missed for making small efforts early, versus large efforts later, in order to

improve client retention.

In conclusion, Freedom from Hunger’s impact story methodology reveals important findings for understanding the full story behind a client’s departure—stories that influence both the financial sustainability and social impact of a financial institution and it serves as an invitation for further learning about how to most effectively understand drop-out within the microfinance industry.

The stories that ex-clients have to tell are as influential as those of active clients in terms of product development and understanding and meeting client needs in the attempt to improve lives and should not be overlooked, misinterpreted, underestimated or forgotten.

Introduction

Why should microfinance participation drop-out be studied? The experience of active microfinance clients can be monitored by numerous performance indicators and continues to be shaped as industry standards, financial transparency and performance accountability progress. However, what about clients who drop-out? Whether they leave by choice or lack thereof, ex-microfinance clients have an important story to tell that the industry has struggled to fully understand. This story touches the perilous line between financial inclusion and financial marginalization.

The microfinance industry has benefited from an increase of rigorous impact evaluation research in recent years that has shed much needed light on the benefits and limitations of microcredit participation. Current randomized research focuses on active microcredit participants often with varying results.

Most recently, the seven randomized control trial (RCT) evaluations published in the *American Economic Journal: Applied Economics*ⁱ reveal sobering evidence that microcredit works for some people but generally does not transform lives through substantial increases in income. The studies also indicate that microcredit does not have substantial effects on health, women's empowerment or children's education.ⁱⁱ

Conversely, other research suggests that the positive impact found from the seven RCTs may actually be understated.ⁱⁱⁱ In addition, another recent study, published in 2014 by the World Bank,^{iv} tracked microcredit participants over the course of 20 years in Bangladesh. This study showed that microcredit increases personal spending, household assets, the labor supply and children's education.

While the studies mentioned are not considered directly comparable, given differing research methodologies and data-collection periods, they feed the industry debate on the true transformational potential of microcredit participation, specifically, and microfinance participation broadly. Alternatively, what would be revealed if the reasons why people are not successful in the use of microfinance services were to be examined?

Even with the challenges of data collection and the unresolved questions of how to appropriately measure true transformation, the industry continues to make progress in its efforts to better understand the role of credit and expanded financial products for the poor. That being said, significant gaps still exist in understanding why clients drop out.

Clarity on the underlying factors contributing to client drop-out can be a launching point for expanded discussion on the objectives and measurement methods of client retention; how to improve the client experience through product innovation and flexible design; and the improvement of client loyalty to the organization, which ultimately feeds the double bottom line of social impact and financial sustainability.

Painting a complete picture of client drop-out requires looking beyond client retention or drop-out rates and creating ways to uncover the actual causes of client drop-out. Client-retention data-

collection methods vary across the industry and measuring has been inconsistent. Furthermore, quantitative tools only tell part of the story and do not help uncover the real reasons behind the decision to exit. If the reasons behind client drop-out were understood, practitioners could delve deeper into the underlying factors of success and failure that the poor face in microfinance participation.

Background

A Foundational Understanding of Client Drop-Out

There is a lack of consensus in the microfinance industry of how to define and measure client retention or its converse, client drop-out. Comparing retention or drop-out rates across institutions is often extraneous because determining what constitutes a “retained client” versus a client who has exited or dropped out varies by institution (client exit, client drop-out and client desertion are generally used interchangeably), as does the method of computing either the retention rate or drop-out rate. These varying approaches are due primarily to the variety of time periods involved with loan pay-off and renewal and the client’s participation or lack thereof in other products or services offered by the microfinance institution (MFI). Additionally, determining an appropriate formula to compute the drop-out rate depends largely on the depth of the management information system (MIS) established by the MFI.

In order to get at the crux of client drop-out, a foundational understanding of the dimensions of the issue is useful. The following section will discuss the challenges in defining and measuring client drop-out and how it influences the financial sustainability and social impact mission of the MFI.

Defining and Measuring Client Drop-Out

The first step in constructing a meaningful definition of client drop-out is to define what constitutes an active client.^v This involves considering factors such as the amount of time that has elapsed since a loan was taken or transaction completed, whether the client is “resting” (clients who take a break, often referred to as a “resting period,” between loan cycles) and if the client has reached a “decision point^{vi}” of whether to remain active or drop out, among other institution-specific considerations. A list of client drop-out definitions currently used by the industry can be found in the Appendix at the end of this report.

Measuring client retention is represented by a percentage called the client retention rate (or its converse the client drop-out rate). It is one of the 11 social performance indicators reported by MFIs to the MIX Market. Additionally, it is part of the SMART Campaign’s client protection indicators, one of the Social Performance Task Force’s (SPTF) Universal Standard for Social Performance Management and an outcome measurement for Truelift’s pro-poor microfinance organizations.

While recognized as a key performance indicator, due to a lack of industry standards to define,

gather and measure client-exit data, the client-retention rate is not among the standard performance indicators generated and reported consistently by MFIs through the MIX database.^{vii}

There are as many formulas to measure client retention as there are ways to define it. As mentioned earlier, the appropriate formula for an MFI depends heavily on the unique characteristics of the institution and on the strength of its MIS. Detailing the pros and cons of the most common formulas used is beyond the scope of this report; however, current formulas used in the industry are located in the Appendix.

The objective of this report is not to determine whether a client is considered a dropout or to argue the merits of one formula or measure over another, but to uncover reasons for a client leaving the MFI. The clients whose data is presented in this report made a clear break from the MFI by the time Freedom from Hunger had conducted the impact interviews two to three years after an initial interview (see Data and Methods later in this report).

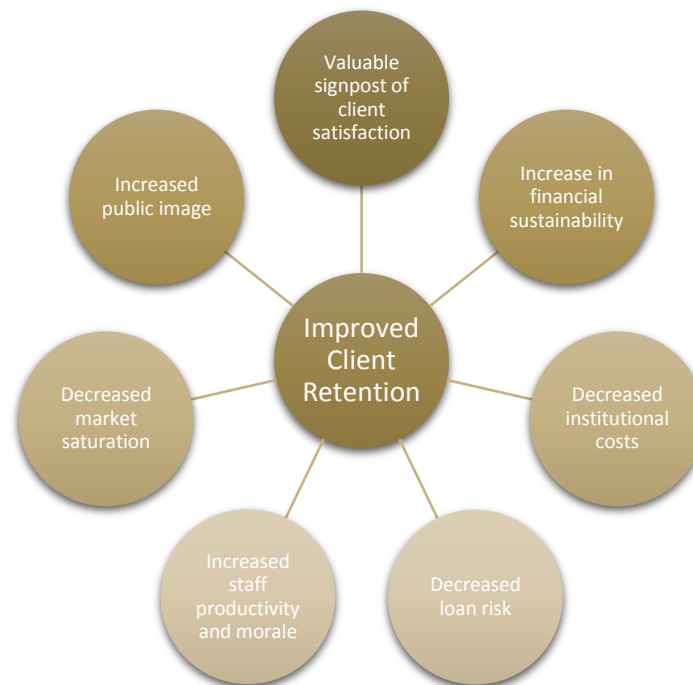
Client drop-out in this report is simply defined as a client who was no longer borrowing or maintaining membership or client status at the time of the follow-up interview. This interview was generally conducted two to three years after the first impact stories were collected for the MFI.

Improving Financial Sustainability through Client Retention

As the industry continues to grow at a robust pace and increased competition is created as a result, greater attention has been paid to industry standards for the protection of clients and social performance. Client retention is vital in the current and increasingly competitive environment for lenders both from a financial sustainability perspective and in terms of carrying out social impact objectives.

Despite a lack of consensus on how to define, gather and measure client retention, there is an industry-wide consensus on the importance of improving it for the sake of the firm's financial stability. Figure 1 summarizes the impacts of improved client retention on the financial stability of the MFI from several different retention studies^{viii} completed over the past decade. As the figure suggests, improved client retention can decrease costs, loan risks and market saturation as well as improve staff morale, MFI public image, serve as evidence of client satisfaction and increase the overall financial sustainability of the MFI.

Figure 1. Impact of improved client retention on the financial stability of the financial institution



Studies cited by Epstein and Yuthas^{ix} and Pawlak and Matul,^x specifically show that

- clients exiting before five years can result in increased costs as it can take up to five loan cycles for an MFI to break even and
- a 5 percent increase in customer retention leads to an increase in profits of between 25 and 80 percent.

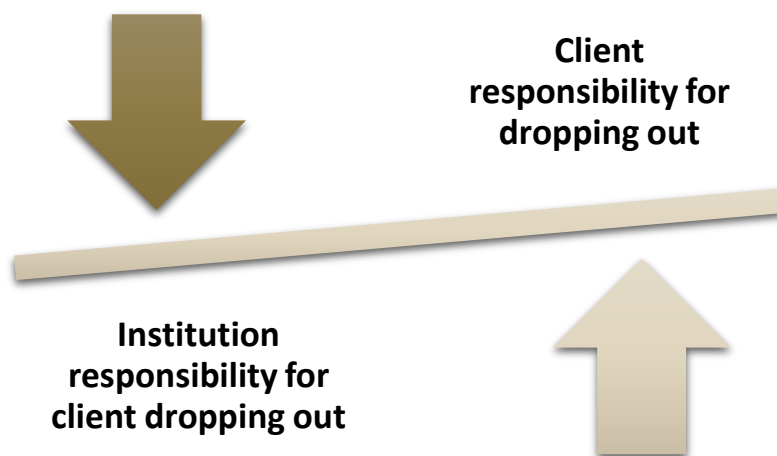
According to a study cited by Hashemi in a 2007 CGAP Focus Note, The Small Enterprise Foundation in South Africa established a client-level monitoring system to better understand the reasons for clients dropping out. After a three-year period during which drop-out rates were reduced, it found that returns on investment increased and losses decreased.^{xi}

Improving the Social Impact of the Financial Institution through Client Retention

Despite growing efforts to measure the impacts of microfinance programs, the industry understands more about the clients who stay than about the clients who drop out. Since it is the clients who drop out who do not receive or maintain value of their participating in microfinance services, an MFI would likely discover more about improving their products and services from them than from those who remained. Often the clients who leave give the most honest feedback, which can uncover gaps in the overall client experience.

The ethical treatment of clients includes understanding why clients leave for negative or positive reasons. Having a deep understanding of these reasons facilitates the MFI's ability to acknowledge how much responsibility rests on the part of the institution or on the part of the client.

Figure 2. Balancing responsibility between the institution and the client



A deliberate understanding of why people drop out paired with efforts to feed this information into product design and policies can improve client retention, loyalty to the organization and ultimately help the MFI carry out its social mission. Recommendations for how to develop and implement a client-exit survey can be found in the recently published paper “Collecting and Using Exit Survey Data” (December 2014)^{xiii} by the Smart Campaign, which includes specific survey examples and how to apply survey data to improve product design and operations.

This paper will show that to fully understand client exit, it is necessary to go beyond quantitative client-retention rates. For example, this can involve a client-level exit-monitoring system in conjunction with in-depth client interviews. Whichever tool is applied, the MFI must ensure that all reasons for clients dropping out are understood and how these reasons are possibly sequenced in order to help institutions better anticipate and respond to client needs. This helps support not only financial sustainability but social impact as well.

Data and Methods

Since 2007, Freedom from Hunger has been developing and testing an impact story methodology to discover client experiences that are representative of the entire clientele of an MFI or even multiple institutions, ranging from success to failure or whatever is happening in between. The key steps are to randomly select clients for story collection and to collect these stories with a systematic, yet open-ended interview process that allows clients to tell as much of the full story as they are willing to share. Drawbacks include relying on clients being forthcoming and truthful (a challenge also shared by more structured interviewing) and the ability to systematically extract useful information from complex stories without bias. In addition, the ability to segment the stories based on differences between rural and urban clients, age, poverty status, length of membership, and other variables that are often found to be useful in understanding client characteristics was not possible across all stories and therefore this analysis was not included here.

The goal of the impact story methodology is to interview people who have just recently joined a

microfinance program (those in their first or second loan cycle) and then interview these same people about three years later (whether or not they are still participating in the program) to learn what happened in their lives during that time period. This method provides a “longitudinal” (before and after) story of impact. This gives a retrospective story of impact and an early opportunity to test the ability to extract useful information from the story to see what can be learned about impact.

More specifically, these impact stories help assess the impact of the *Credit with Education* program in which women from very poor, rural communities come together in groups (often called village banks) to receive from an MFI a combination of loans and savings opportunities, as well as additional value in the form of education for better family health and business. Some *Credit with Education* programs also offer access to health protection services such as linkages to health providers, health products and health-focused financial services.

Thus far, Freedom from Hunger has collected over 700 client impact stories from 25 local partners located in ten countries throughout Latin America, South Asia and sub-Saharan Africa. Six countries were visited a second time after an interval of three or four years to re-interview the impact-story participants. The collection of rich information from these interviews continues to grow as more partners participate in the story-collection process for the first time.

For purposes of this analysis, a subset of the overall collection of impact stories was analyzed to focus on the factors contributing to client dropping out. The clients in this subset shared a common characteristic—they had all become “ex-clients” (dropped out/were no longer taking a loan) of the MFI by the time the second impact interview was conducted. As discussed earlier, this definition does not match the quantitative drop-out levels that institutions use to track retention from one loan cycle to the next or from one six-month or one-year period to the next. The drop-out reflected here is likely a bit more “severe” in that these people have left and would not be counted as “resting between cycles,” even though they could likely rejoin the MFI. The goal of analyzing this subset of impact stories that reflect the ex-client’s experience is to gain an understanding of the underlying reasons for dropping out.

An attempt was made to create a tidy panel of ex-client data that included clients who participated in both an initial impact story interview and a follow-up interview three years later. While these ideal circumstances represent the majority of the data, unexpected events required some adaptation in the data-collection process on the ground. Decisions had to be made in the field when clients were unable to be found for a follow-up interview or, in some cases, refused to be interviewed. In other instances, opportunities presented themselves to interview a new set of ex-clients for the first time impact interview (meaning, there is no interview for them as an active client, only as an ex-client).

Table 1 indicates the impact stories included in this analysis by country and the type of interviews available. In the case of follow-up interviews only, opportunities were taken in the field to interview willing participants who were also ex-clients but for whom a base interview was not collected.

Table 1. Type of impact story interviews used in this analysis

Country	Base and Follow-Up Interviews	Follow-Up Interview Only	Total Drop-Out Stories
Bolivia		1	1
Ecuador	10		10
Peru	12	1	13
Mexico	12	8	20
Philippines		10	10
India	5		5
Total Drop-Out Stories	39	20	59

The time frame for the collection of client interviews varies by partner because over time more partners chose to participate in the impact story-interview process. The table below shows the years that the baseline and follow-up impact stories were collected.

Table 2. Time frame of impact story collection

Country	Base Interviews Collected	Follow-Up Interviews Collected
Bolivia	2009	2012
Ecuador	2010	2013
Peru	2008	2011
Mexico	2009	2012
Philippines	2014	
India	2009	2013

While the samples provided here are not fully representative of the total number of clients who dropped out, given the initial randomly selected cohorts of clients interviewed and tracked and the random selection of dropped-out clients for initial interviews, there is confidence that the data is meaningful and useful to consider reasons for clients dropping out.

Analysis and Results

To generate numerical drop-out data, a general inductive analysis^{xiii} was performed on the 59 impact stories of ex-clients to assess the reasons for dropping out. All reasons contributing to drop-out that the ex-clients shared were logged and tallied to determine whether common themes or patterns would emerge from the group.

Each ex-client's story was also analyzed to determine whether a root cause of the events leading to dropping out could be identified. In some cases this was very clear, in other cases judgment calls had to be made. In some of these situations, the baseline and follow-up interviews were used to better understand the root cause of drop-out. In cases where the root cause for dropping out was not clear, a category of "unclear" was assigned.

Analyzing Reasons for Dropping Out: A Complex Chain of Events

The most common thread found in the collection of ex-client impact stories was that rarely did just one event contribute to drop-out. In most cases, the impact story revealed a complex chain of

events that led to a client dropping out. Meri, a Peruvian ex-client, shares a story about how her income and business were derailed because of an illness.

Meri

Meri's membership with an MFI presented an opportunity to create more profit out of her business. And for 15 years, she did enjoy the fruits of her labor, until an unprecedented health complication changed it all. After having her fifth child, Meri had problems with her uterus. Her precarious health left her in a position where she could no longer work. According to the doctor, an eight-hour bus ride to Lima on extremely rugged terrain would aggravate her weak condition. And so Meri could no longer travel. Prior to her health condition, she used the money from an MFI to invest and to pay for transportation. She spent profits on food and on her children's education and health. However, after her health complications, she became indebted to the hospital and the MFI. Her business and profits were frozen and she did not have another source of income other than the few soles her husband made at the market from polishing people's shoes.

Meri was conscious of what she owed and her debts seemed to accompany every facet of her life. Meanwhile, her health is in jeopardy. "I still have problems. I feel them every day in my core. But there's nothing I can do. A consultation is worth 15 soles and the ultrasound another 30 soles. It seems that my stress deposits in my stomach. And every day I feel the pain, as if anxiety is taking over my potential."

Meri's story, unfortunately a typical one in the collection of ex-client impact stories, uncovers more than just loan default as a cause for dropping out. Understanding the depth of Meri's experience and others' like hers, offers practitioners an opportunity to consider ways to potentially offer support before the chain of events results in drop-out. Figure 3 below depicts the series of events that led to Meri dropping out, which was common for many of the clients interviewed.

Figure 3. An example of the spiral effect of events leading to client drop-out



In Meri's case, if the financial institution only considered loan default as the reason for dropping out, the institution would miss the opportunity to offer support before conditions spiraled downward—or worse, would apply the wrong interventions to the root cause.

Ten Common Contributing Factors to Drop-Out

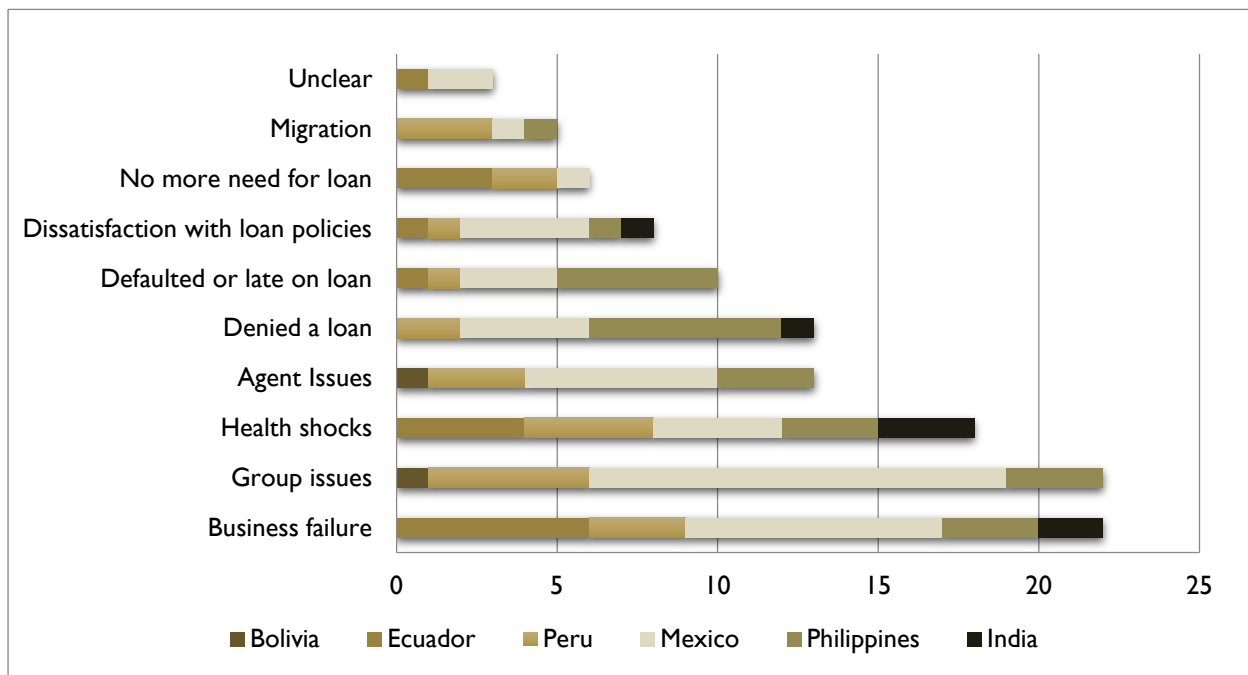
When all factors described by the client as leading to her decision to drop out were taken into account, ten common contributing factors to dropping out emerged from the 59 impact stories. These ten contributing factors to drop-out include: 1. Business Failure; 2. Group Issues; 3. Health Shocks; 4. Agent Issues; 5. Denied a Loan; 6. Defaulted or Late on a Loan, 7. Dissatisfaction with Loan Policies; 8. No More Need for a Loan; 9. Migration; and 10. Unclear. While there were some ex-clients who reported a single cause of drop-out such as “No More Need for a Loan,” most had more than one contributing factor. In still other cases, it was unclear why the client dropped out and so were labeled “Unclear.”

“Group issues” consist of client descriptions of conflicts and disagreements among group members; the results of insolvency of one or more members; and when the group chose to disband. “Agent Issues” include the ways in which clients perceived field agents as having mistreated them; not having met their needs; etc. “Dissatisfaction with Loan Policies” includes dissatisfaction with product design and policies dealing with such issues as meeting times, interest rates, loan sizes, etc.

“No More Need for a Loan” represents only those clients who reached a decision that they no longer needed loans for the success of their business and/or felt that the prior loan investments were sufficient for their needs; this category should not be confused with a decision to leave because they defaulted on a loan, were asked to leave, or were unable to repay their prior loans on time.

The tallied results, in Figure 4, are listed from lowest frequency of contributing factors to highest.

Figure 4. Ten contributing factors to drop-out



The results indicate that business failure and group issues tied as the most frequently mentioned factors that contributed to a client exiting. The second most frequently mentioned factor was health shocks.

A 2005 study prepared by the Civil Society Human and Institutional Development Programme (CHIP) involving client interviews, focus-group discussions and surveys found that 63 percent of borrowers dropped out due to issues with the loan product, organizational staff and group-related factors.^{xiv} Another survey-based study found disparities between reasons for dropping out given by survey respondents and those given by loan officers. The borrowers most often cited conflicts with the trust bank or loan officer as the reason for dropping out (48 percent of cases) while the loan officers most often reported that loan default was the reason for dropping out (90 percent of cases).^{xv}

While drop-out issues can be complex, Esther, a client from Mexico shares that a simple change in how money is collected can lead to client exit and possible financial exclusion.

Esther

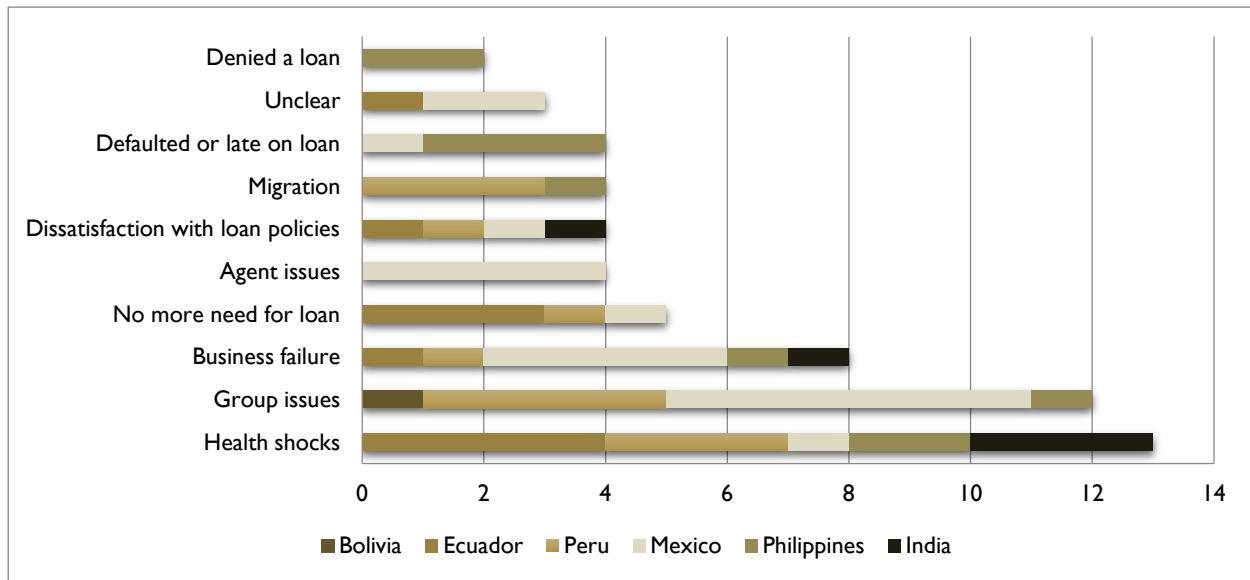
The interest rate climbed from 3.5 to 4.2 percent in a matter of three years. This, combined with the change to depositing in banks rather than during the village-bank meetings, pushed her to stop working with an MFI. “They told me that the interest increased ... and that the cost of the trip is more than the interest!” She says chuckling. “We are in a community, Larrianzar (closest center) is a town and (in Larrianzar) still there is nothing, there is no credit and there are no banks, only stores!”

When the MFI changed its deposit policy, “We had to start traveling to San Cristobal to deposit. I traveled with two or three people. For three, the cost of passage was too expensive. When there are 30 people in the group, I brought 30,000 pesos and this scared me [to travel alone],” explains Esther. “To travel to San Cristobal to deposit is too expensive; Field Agents no longer travel with money. They told us (they changed the policy) because we have assault ... so it goes ... I couldn’t pay the interest let alone the passage.” She pulls out her faded statement to demonstrate her good credit and standing upon deciding not to continue with the MFI. “Some people no longer wanted to continue, so we all had to leave.”

Ten Root Causes of Drop-Out

Understanding the contributing factors to drop-out has more meaning if a single root cause is teased out of each ex-client’s story to identify the most common single cause that sets events in motion leading the client to drop out. An attempt was made to carry out this objective with each of the 59 ex-clients using the ten categories established earlier. In some cases, the root cause was very clear, particularly in cases of migration and where a loan was no longer needed. Three cases were categorized as unclear because a root cause was not able to be identified. In other cases where there were many contributing factors to drop-out, judgment calls were made to determine a single triggering event that eventually led to drop-out. Figure 5 shows that the top three contributing factors of client drop-out remain as the top three root causes of drop-out but differ in frequency and order. Health Shocks now stand out as the top root cause of drop-out followed closely by Group Issues and Business Failure.

Figure 5. Top ten root causes of drop-out



The figure also shows that some of the root causes differ by country; clients in Ecuador most mentioned health as a root cause, but group dynamics appear to be most common for clients in Mexico.

The following excerpt is from Magdalena, a client from Mexico, who shares the details of conflicts within her group, which led to her involuntarily dropping out.

Magdalena

Magdalena tells me of the end of her days as an MFI client. Eight months ago, the woman who deposits their payment in the bank “skipped town” and their money “was lost.” “She was a liar, she robbed us,” says Magdalena. Her group ended involvement with the MFI because “[the group] failed (to make payment) and the MFI did not respond well (to their status as defaulters).” She asked for another loan after this incident, but the loan officer never returned to her group.

Correlation Analysis of Contributing Factors to Drop-Out

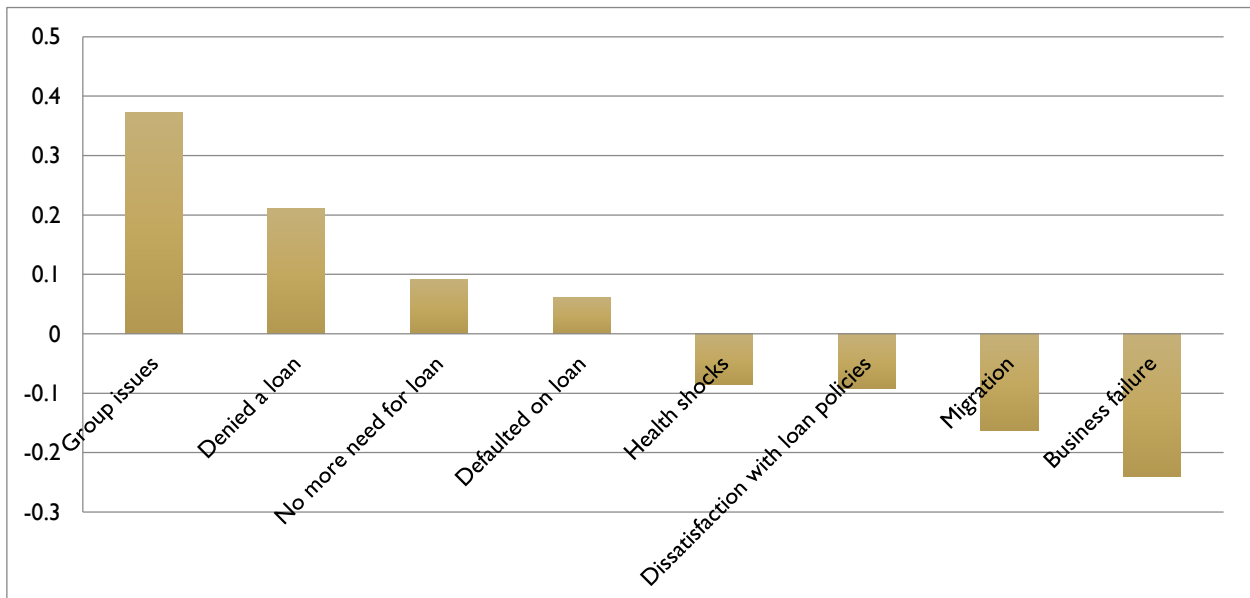
A statistical correlation analysis was performed to determine whether a relationship existed between any two of the contributing factors to drop-out (except for the three cases where reasons for dropping out were unclear). Not to be confused with showing causality, a statistical correlation analysis determines whether a change in one variable is accompanied by a change in another. Positive correlation, a number between 0 (no correlation) and 1 (perfect positive correlation), indicates that the two variables rise or fall together. A negative correlation, a number between 0 (no correlation) and -1 (perfect negative correlation), indicates that the two variables move in opposite directions.

Based on a correlation analysis performed on the contributing factors to drop-out (excluding the

category Unclear),³ two relationships stood out as having the highest positive correlation: 1. Agent Issues and Group Issues and 2. Health Shocks and Defaulted on Loan.

The following graph illustrates correlation between agent issues and other common factors contributing to drop-out. The relationship between Agent Issues and Group Issues was the most highly correlated relationship among all the factors of drop-out.

Figure 6. Reasons for dropping out—Conditional on agent issues



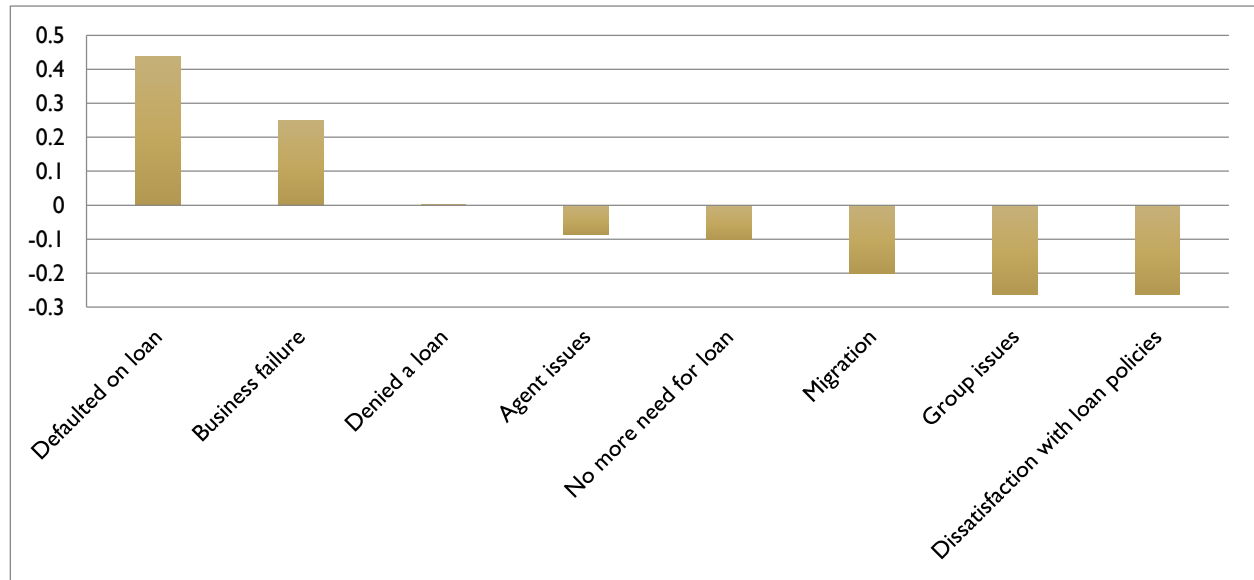
Note that Denied a Loan, No More Need for Loan and Defaulted on Loan are also positively correlated with Agent Issues but don't indicate a strong correlation.

So what does this mean? While this type of analysis does not show causation, it does show that the contributing factors of Agent Issues and Group Issues are positively correlated; that is, when the number of Agent Issues goes up or down, the number of Group Issues tends to move in the same direction and vice versa. This means that when an ex-client mentioned that her group fell apart or that there was group conflict, she also tended to mention that her group had agent issues.

The second most highly correlated relationship among the contributing factors to drop-out was between Health Shocks and Defaulted on Loan.

³ For this analysis and the next analysis on clusters, the three cases for which a single reason for dropping out was assigned "Unclear" were excluded. Since it was unclear why these three clients dropped out, including this category in analyzing relationships among reasons for dropping out would be illogical. Therefore, instead of the ten factors discussed in the prior analysis, only nine are included here.

Figure 7. Reasons for dropping out—Conditional on health shocks



The results show that Health Shocks and Defaulted on Loan are positively correlated; that is, when the number of Health Shocks goes up or down, the number of Defaulted on Loan tends to move in the same direction and vice versa. This means that when a client mentioned experiencing a health shock, she also often mentioned defaulting on her loan.

Note that the Health Shocks category is also positively correlated to Business Failure. Again, this means that as Health Shocks increase or decrease, Business Failure tends to move in the same direction and vice versa. This means that when a client mentioned Health Shocks, she often mentioned Business Failure as well.

Cluster Analysis with Contributing Factors to Drop-Out

A k-means cluster analysis was performed on the 59 ex-client stories and contributing factors to drop-out described above (again, the category of Unclear was excluded from this analysis). This type of organizational analysis offers a way to generate structure within a data set wherein data is sorted into the most statistically optimal clusters with similar characteristics. In the case of this analysis, the k-means cluster analysis offers a way to generate statistically optimal groups or clusters of ex-clients who have the most common contributing factors to drop-out. This type of analysis offers a quantitative view of what could be arrived at intuitively, but is generated using statistical analysis.

Based on the k-means analysis, four clusters were statistically identified. Patterns were inspected within each of these clusters and the results are characterized and compared in Table 3 (from largest cluster to smallest).

Table 3. Cluster analysis results

Description of Patterns in Cluster	Number of Ex-Clients	Average Number of Factors per Ex-Client
1. <u>Single Reason Cluster</u> . This cluster was the largest and reflects clients who generally mentioned one reason for dropping out. The primary reasons, when only one reason was given, for dropping out were Business Failure and Migration.	23	1.13
2. <u>Health Shocks Cluster</u> . All mentioned Health Shocks combined with one or more other reasons—primarily Business Failure, Defaulted on Loan and Denied a Loan. Agent Issues, Group Issues and No More Need for Loan were also mentioned.	18	2.60
3. <u>Relationships and Policies Cluster</u> . Most clients mentioned two or more reasons that were dominated by Group Issues, Agent Issues and Being Denied a Loan. In addition, No More Need for loan, Defaulted on Loan and Business Failure were also mentioned.	13	2.38
4. <u>Group Issues Cluster</u> . All mentioned Group Issues plus one or more reasons that included Dissatisfaction with Loan Policies, Business Failure and Agent Issues.	5	2.60
Total	59	2.08

Figure 8 represents the cluster analysis results graphically to illustrate the characteristics of each group. For example, within the group of 23 clients in Cluster 1, an average of just over one reason was mentioned for dropping out. These generally singular reasons for dropping out included, in order of frequency, Business Failure, Migration, Dissatisfaction with Loan Policies, No More Need for a Loan, Group Issues, Denied a Loan and Agent Issues. This means, the remaining 36 clients (of the 59 evaluated) had stories in which at least two factors determined their reason for dropping out.

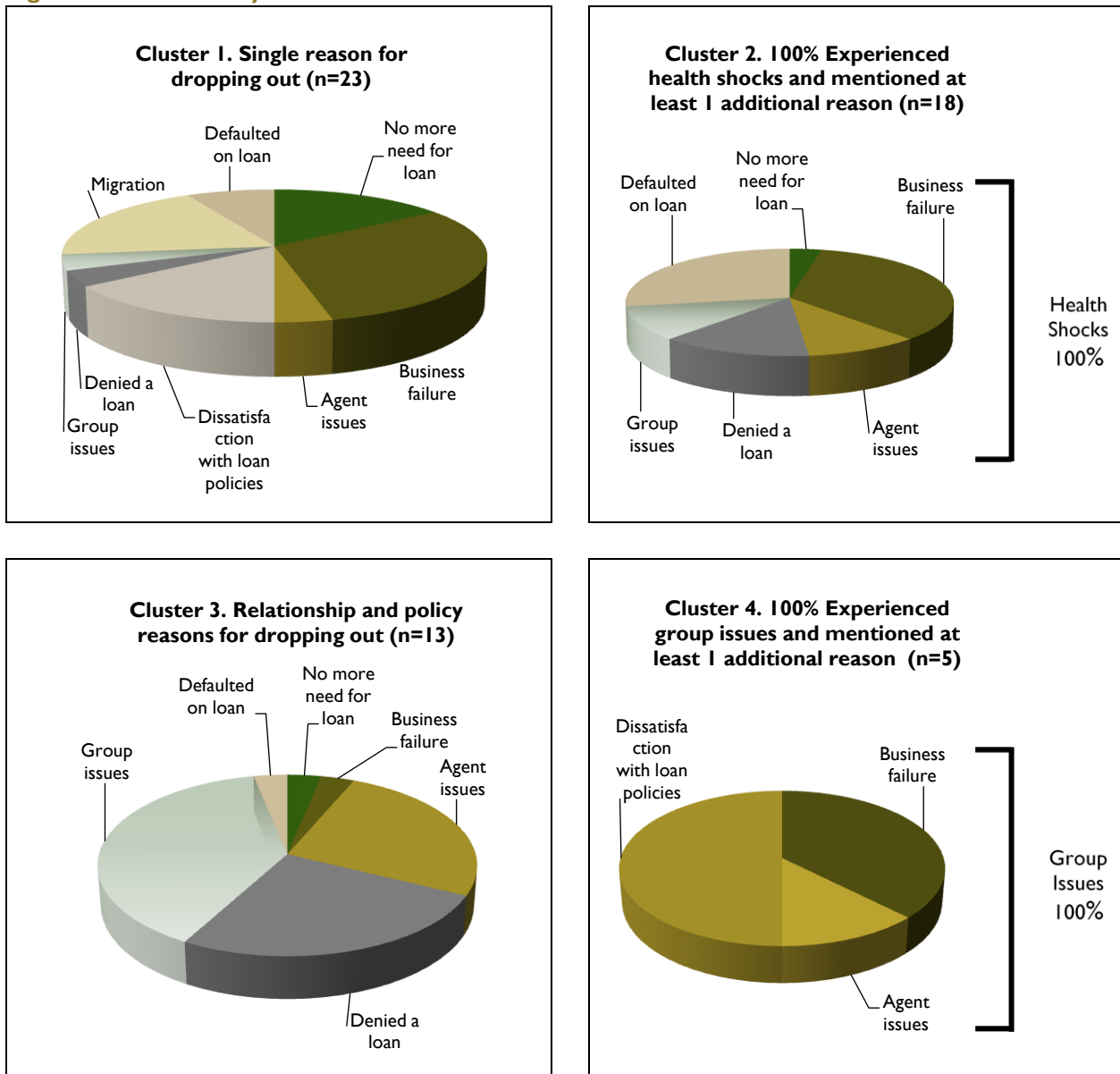
In Cluster 2, all 18 of these clients mentioned health shocks as a reason for dropping out and at least on average one or more other factors: Business Failure, Defaulted on Loan, Denied a Loan, Group Issues, Agent Issues and No More Need for Loan.

In Cluster 3, 13 clients mentioned at least two factors related to either relationships with their groups or agents and being denied a loan. These clients also mentioned No More Need for Loan, Defaulted on Loan and Business Failure.

In Cluster 4, all five clients had Group Issues as a factor for dropping out, plus one or more other factors including Dissatisfaction with Loan Policies, Business Failure and Agent Issues.

These clusters reveal that there are four main experiences shared by clients: one experience is driven by health, one is driven by group issues, one group of clients only had one reason for dropping out and one is driven by relationship issues either with their group or the agent. The clusters also show what is common about those experiences: all clusters involve Business Failure as part of a common experience.

Figure 8. Cluster Analysis Results



Discussion

When ex-clients were asked in open-ended interviews to share reasons why they dropped out of a microfinance program, the resulting impact stories revealed that it was rare there was just one cause for dropping out. It was often a series of events that led to a client leaving. **Of the reasons mentioned, Business Failure, Group Issues and Health Shocks were found to be the top contributing factors and root causes resulting in client exit.**

A correlation analysis found positive relationships between top contributing and root causes of drop-out. This research found that as ex-clients mentioned having issues with their field agent, they also commonly mentioned that their groups had issues and often fell apart. When they mentioned a health shock, loan default and business failure were also likely to be part of their story.

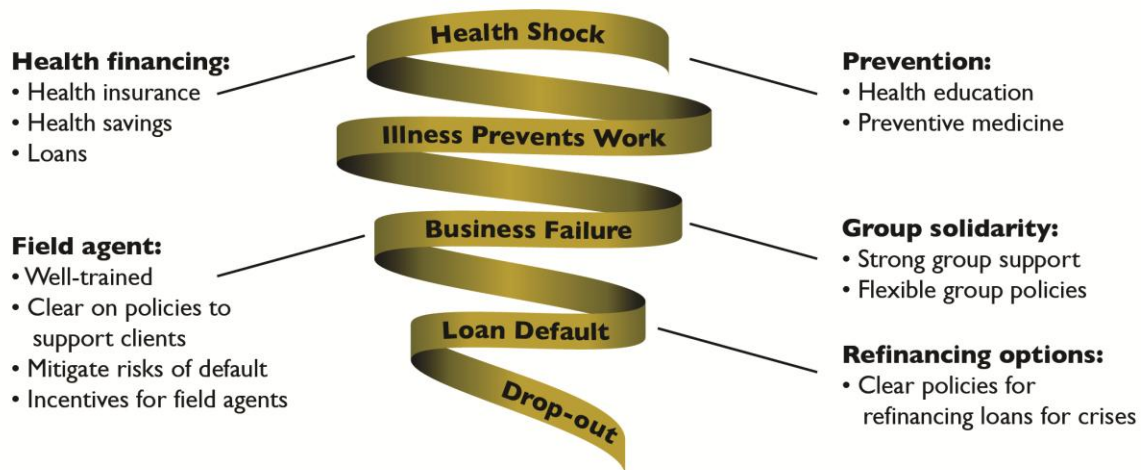
Moreover, the k-means cluster analysis statistically demonstrated additional relationships in the contributing factors for clients dropping out of a microfinance program. Business failure was a significant part of all four clusters of experiences. While the largest cluster was made up of those who mentioned only one reason for dropping out, the remaining clusters represent clients who have at least two or three factors for dropping out, making up over 60 percent of the experiences. The largest cluster of common experiences was of those experiencing a health shock.

Given that in-voluntary or voluntary drop-out is not defined by a stand-alone event, an understanding of the dynamics relating to drop-out, particularly health, business failure, group conflicts—all primary causes of drop-out—can help institutions anticipate and respond to client needs before drop-out occurs. This not only influences how client exit interviews can actively incorporate questions related to these reasons of drop-out, but also how institutions can accept that these are highly common reasons for clients dropping out.

Also, the prevalence of group issues being mentioned for dropping out seems to suggest, for those providing village-banking services, that the group structure is both a reason for success and failure. Village banking relies heavily on the empowerment of group members for decision-making and the growth of social capital among its members; however, this should not be taken for granted to occur naturally. When groups face the insolvency of one member, they could all be forced to leave or individual members could be pushed out. Intentional investments made by MFIs to help build the solidarity of the group would be important for overcoming this drop-out risk.

The development of products and services that help prevent root causes of drop-out, such as services that help mitigate the effects of health crises or prevent business failure, or the design of flexible policies and procedures that support a client once a shock occurs are ways that institutions can intervene before events that lead to drop-out are sent in motion. For example, taking Meri's example from above, an MFI might imagine a series of products, services, policies and procedures with mitigating factors that could have prevented Meri from dropping out.

Figure 9. An example of the spiral effect of events leading to client drop-out with possible interventions



The Smart Campaign published “*What Happens to Microfinance Clients Who Default?*” (January 2015)^{xvi} which examines how practitioners work with clients who have defaulted—which, of course, would likely precede a client dropping out. Several of the study’s findings reinforce the necessity of a deeper understanding of client’s needs and unique vulnerabilities to effectively manage default.

The study found that practitioners do not always distinguish between intentional and unintentional defaulters, which prevents institutions from applying management strategies that might help retain otherwise strong clients who defaulted as a result of a health shock or other unforeseen event. The study also suggests that while most MFI respondents did offer restructuring options to clients who defaulted, questions remain about the timing of when the options were offered.

Finally, the study indicated that only 52 percent of the survey respondents conducted exit surveys with clients who defaulted. This of course is a missed opportunity to gather valuable information to apply to product design and the performance of the organization.

While client retention or drop-out rates as well as the best practice of understanding why clients leave are well-understood benefits for an institution’s financial and social performance, **this report presents a case for being careful about how we seek to understand reasons for dropping out. Misdiagnosing reasons for dropping out by focusing on the last link in the chain of events could result in the wrong interventions or missed opportunities for making small efforts early versus large efforts later to improve client retention.**

For example, in Meri’s case, if business failure was perceived as the root cause of her dropping out, an MFI might mistakenly try to improve her business practices or assume she simply faced too much competition, when her failing business is only a consequence of an earlier problem. In Meri’s case, perhaps having access to a health microinsurance product might have mitigated her early levels of overindebtedness due to increasing medical bills.

In addition, not acknowledging that business failure is a common thread throughout the drop-out stories ignores the importance of making sure microenterprise village-bank loans make use of business education and mentoring if clients are to make the most progress with financial services designed to help grow and sustain businesses.

Quantitative client retention or exit rates are lagging indicators, as is data collected from client exit surveys. Understanding and appreciating the main reasons why clients tend to leave can provide a financial institution with the opportunity to build processes and develop products and services that will mitigate the risks of client exit—prior to client exit becoming a problem.

This analysis suggests that health shocks and business failures were the primary root causes for dropping out across the various contexts. This presents both an opportunity and a challenge because not all MFIs would see themselves in the business of improving health or a client's business. While these are not necessarily “easy” fixes, they apparently are important to the success of clients and the institutions themselves.

As has been shown, there ARE positive reasons for why clients leave, particularly when the only financial service that qualifies a person for membership is microcredit. Some clients find themselves no longer needing microcredit to successfully run their business. While this report will not explore what this means for long-term financial inclusion, it points out an important point about the importance of other financial services. For example, **savings and other noncredit financial products can serve as an anchor for determining financial inclusion since a client leaving a primarily microcredit institution (even for successful reasons) can find themselves without any financial services at all.**

Finally, we have also shown that it is important to understand client exit so that **multiple stakeholders can acknowledge how much responsibility for client exit rests with the financial institution or with the client.** While critics of microcredit often point out the negative consequences of microcredit, this paper presents data that suggests that opportunities exist for institutions to mitigate the consequences of a client crisis through client-centered policies, procedures and practices. However, there are some root causes of client exit that may not be completely avoidable, particularly if a health shock is the root cause.

While MFIs can successfully develop products and services designed to mitigate health risks and Freedom from Hunger has worked with many successful MFI-facilitated health programs, not even fully functioning health systems, insurance systems and social support networks can go ALL the way in preventing the consequences of a significant health crisis. For example, while health insurance may help cover costs of cancer treatment and hospitals can treat it during a period of time, they cannot necessarily fully protect a household financially when a primary income earner, breadwinner, or primary caretaker is no longer able to generate income—either in the short or long term. The burden may not be completely avoidable, as Lilia's story shows:

Lilia

Lilia, from Ecuador, first joined an MFI when she left a salaried position because she was not earning enough money to support her family. She started a cola distributing company with her loan funds. Her mother was living with her at the time and was a financial contributor to the household until she got cancer. The reduction of her mother's little income, with the added costs of the treatment, fractured her family's fragile solvency. When she was interviewed again three years later, she was no longer a client with the MFI. Her family was having difficulty putting enough food on the table, much less keeping a healthy diet. Her mother was still sick and recently had broken her leg. As Lilia shared, "My mom's illness has changed my life." She has been able to cope with her mother's illness with the help of her family, in particular her husband, who helps financially with the expenses for her mother. Lilia has no job and can't work while she is in charge of caring for her mother. "Right now I don't have a job but I really liked my previous job because it was my own business." At that time, the MFI helped her out with loans so she could buy more products to sell. As a member of the MFI, Lilia felt great and happy to be part of the institution, since it helped out only in ways it could. At present, Lilia does not have any loans or savings. "My mom's illness has left us with no money." Lilia would like to return to the foundation, not only for the loans, but also the education from the learning sessions. "I just hope that my family always has good health, and for my mom's illness to go away."

In this case, even MFIs that do provide a range of health services have their limitations in completely protecting households from health shocks and catastrophic health costs, but they can mitigate some risks (such as those articulated in Figure 9 above) and address some issues so that the majority of clients benefit.

Conclusion

Data gathered from 59 ex-clients from seven different countries across Latin America, South Asia, and sub-Saharan Africa reveal important findings for understanding reasons for client exit—both for the influence this has on the financial and social bottom line for a financial institution as well as for understanding the full story leading to a client's departure. Understanding the reasons for clients dropping out can help institutions proactively anticipate these causes of drop-out through the design of their products and services as well as the design of their policies, procedures and how they evaluate reasons for client exit.

This paper also suggests that methodologies used to understand client exit might require modification to accurately capture reasons for dropping out. While the impact story methodology was used to analyze reasons for dropping out, there are many financial institutions that utilize various methods for interviewing clients who have dropped out. This paper does not aim to provide a recommended methodology, but it starts the conversation with this end in mind—finding more effective methodologies not just to understand drop-out, but to also share experiences in the challenges and opportunities for using client exit data.

This paper has shown that ex-clients should be taken into account as much as active clients when it comes to developing products and services, meeting client needs and improving their lives and their stories should not be overlooked, misinterpreted, underestimated, or forgotten.

Appendix

Commonly Used Drop-Out Rate Definitions and Formulas^{xvii}

M-CRIL (Adapted Schreiner Formula)

“A dropout is any client who has had no significant transaction with the MFI for the last six months.”

$$Dr = \frac{X0+NC-X1}{X0+NC}$$

Mix Market (used by True lift, SPTF)^{xviii}

$$Dr = 1 - \frac{X1}{X0+NC}$$

Waterfield Decision Point Formula

“A dropout is a client who had a decision point and decided not to remain.”

$$Dr = 1 - \frac{X1 - Cs}{X0+NC-Cs}$$

CGAP/Waterfield

“A dropout is defined as a client who did not take a follow-on loan within the next “y” number of days.

$$Dr = 1 - \frac{FS}{TS}$$

Adjusted for resters:

$$Dr = 1 - \frac{FS \text{ (within y days)}}{TS}$$

ACCION—“old formula”

$$Dr = \frac{X0+NC-X1}{X0}$$

Adjusted for resters:

$$Dr = \frac{X0+NC+R-X1}{X_0}$$

Legend

Dr	=	Drop-out rate
X0	=	Total number of clients at the beginning of the period
X1	=	Total number of clients at the end of the period
NC	=	New clients - all those who joined during the period
FS	=	Number of repeat loans made during the reference period
TS	=	Number of repaid loans (closed services) in the reference period
FSY	=	Number of repeat loans made within y days since the last repayment during the reference period
Cs	=	Clients with same (continuing loan during the period)

R = $\frac{\text{Number of repeat clients that returned after resting to the program between the beginning and the end of the analyzed period}}{\text{period}}$

Common approaches listed by Givewell:

- 1 “The Small Enterprise Foundation defines its drop-out rate as the number of clients who completed a loan in the six months prior to a given date and did not take out a subsequent loan in that period or within one month following the end of the six-month period divided by the total number of clients who completed a loan in the six months prior to the end of the period.”

 - 2 “Chamroeun defines its drop-out rate in terms of loans, rather than clients, and uses a period of 12 months. It calculates this rate as the ‘number of loans taken out by clients who previously had a loan divided by the number of loans closed in the last 12 months.’ Since this rate is measured in terms of loans (of which a client may have more than one per year), it will result in a lower drop-out rate than if clients were the unit of analysis.” (This formula is the CGAP/Water field formula shown above).

 - 3 “Another formula we’ve seen used is: $1 - \frac{\text{(Clients at the end of the period)}}{\text{(Clients at the start) + (Clients added during the period)}}$. Clients whose loans do not become due during the period and thus do not reach a ‘decision point’ of whether to drop out or not, are included in both the numerator and denominator of the formula, deflating the drop-out rate especially over short periods.” (This formula is the Mix Market formula shown above).
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Endnotes

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- ⁱ The seven studies are published in *American Economic Journal: Applied Economics*, vol 7(1). <<https://www.aeaweb.org/articles.php?doi=10.1257/app.7.1>>
- ⁱⁱ J-PAL and IPA Policy Bulletin. 2015. “Where Credit is Due.” Abdul Latif Jameel Poverty Action Lab and Innovations for Poverty Action.
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- ^{iv} Khandker, Shahidur R. and Samad, Hussain A. March 2014. “Dynamic Effects of Microcredit in Bangladesh.” World Bank Policy Research Working Paper 6821. Development Research Group, Agriculture and Rural Development Team.
- ^v Pawlak, Katarzyna and Matul, Michal. April 2004. “Client Desertion in Microfinance: How to Diagnose it Successfully?” Microfinance Center. Imp-Act and The SEEP Network.
- ^{vi} Waterfield, Chuck. 2006. “The Challenges of Measuring Client Retention.” The Practioner Learning Program, Putting Client Assessment to Work, Technical Note #2. The SEEP Network.
- ^{vii} Epstein, Marc J. and Yuthas, Kristi. March 2013. “Rural Microfinance Retention: Evidence from Malawi,” *Journal of Development Entrepreneurship*. Vol. 18, No. 1. World Scientific Publishing Company.
- ^{viii} Epstein, Marc J. and Yuthas, Kristi. March 2013. “Rural Microfinance Retention: Evidence from Malawi,” *Journal of Development Entrepreneurship*. Vol. 18, No. 1. World Scientific Publishing Company. | Micro-Credit Ratings International Limited, Gurgaon, India (M-CRIL). 2007. “Estimating Client Exit Rate.” Technical Note 1, Rev. | Pakistan Poverty Alleviation Fund, “Client Attrition in Microfinance: Experience and Practice,” Research and Discussion Series. | Waterfield, Chuck. 2006. “The Challenges of Measuring Client Retention.” The Practioner Learning Program, Putting Client Assessment to Work, Technical Note #2. The SEEP Network.
- ^{ix} See note vii.
- ^x See note v.
- ^{xi} Consultative Group to Assist the Poor, CGAP. May 2007. “Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions.” Focus Note no. 41.
- ^{xii} Wardle, Leah. December 2014. “Collecting and Using Exit Survey Data, A Tool for Financial Institutions, Version 1.” The Smart Campaign.
- ^{xiii} Thomas, D. (2006). “A General Inductive Approach for Analyzing Qualitative Evaluation Data.” *American Journal of Evaluation*. 27; 237. <<http://aje.sagepub.com/cgi/content/abstract/27/2/237>>
- ^{xiv} Civil Society Human and Institutional Development Programme (CHIP). (December 2005). Research Brief. “The Causes of the High Rate of Drop-out Amongst Micro-Finance Borrowers.”
- ^{xv} Copestake, James. 2002. “Inequality and the Polarizing Impact of Microcredit: Evidence from Zambia’s Copperbelt.” Department of Economics and International Development, University of Bath, UK.

^{xvi} Solli, Jami. January 2015. “What Happens to Microfinance Clients Who Default? An Exploratory Study of Microfinance Practices.” The Smart Campaign.

^{xvii} Micro-Credit Ratings International Limited, Gurgaon, India (M-CRIL). 2007.” Estimating Client Exit Rate.” Technical Note 1, Rev. | Waterfield, Chuck. 2006. “The Challenges of Measuring Client Retention.” The Practioner Learning Program, Putting Client Assessment to Work, Technical Note #2. The SEEP Network. | Pawlak, Katarzyna and Matul, Michal. April 2004. “Client Desertion in Microfinance: How to Diagnose it Successfully?” Microfinance Center. Imp-Act and The SEEP Network.

^{xviii} The MixMarket retention rate stated as: “Active borrowers at end of period/sum of active borrowers at beginning of period + new borrowers added during period.” Using CRECER as an example (or another MFI) this definition can be found at <http://reports.mixmarket.org/mfi/crecer>>. The “social performance” box must be checked. Under retention rate, an “i” appears and when selected, the retention rate definition appears.