MicroSave
Market-led solutions for financial services

Offices across Asia, Africa
and Latin America

www.*MicroSave*.net
info@*MicroSave*.net

Drop-outs and Graduates – Lessons from Bangladesh

By

Graham A.N. Wright

June 1997

Drop-outs and Graduates – Lessons from Bangladesh

Graham A.N. Wright

Introduction

The microfinance industry remains a strange, archaic enigma. It is probably the only remaining industry in the world that is typically product- rather than market-driven. Companies in other industries have long since made the transformation and offer their clients the products that they want rather than the products that the company wants to produce. Those companies that have failed to make the transition from being product-driven to being market-driven, (i.e. have failed to respond to the needs/desires of their clients) have almost invariably been driven out of business by more client responsive competitors. There is little or no reason to doubt that the microfinance industry will also follow this trend and that MicroFinance Institutions (MFIs) that do not respond to the needs of their clients will eventually fail. The product-driven approach has long since been superseded by the market-driven approach and the recognition that there is more value in retaining customers than attracting new customers who cost more.

In microfinance, the value of retaining clients is particularly clear. Typically, retained customers are the ones with extensive credit history and who are accessing larger, higher value loans; whereas new customers require induction training and can often weaken the solidarity of groups. MFIs typically break even on a customer only after the fourth or fifth loan (Brand and Gershick, 2000). And yet, many MFIs worldwide suffer chronic problems with clients leaving their programmes.

Careful analysis of the reasons for these "drop outs" almost invariably points to inappropriately designed products that fail to meet the needs of the MFIs' clients (see for example Wright, 2000 and Hulme, 1999). Much of this problem is driven by the attempts to "replicate" models and products from foreign cultures and lands without reference to the economic or socio-cultural environment into which they are being imported. This has been exacerbated by the lack of competition in many of the markets in which MFIs started. This lack of competition and the demand for credit meant that the MFIs could offer almost any product, however client-unfriendly, and there would be demand. Now, with the growth of competition amongst MFIs in many of the markets in which they operate, clients have choice and are voting with their feet. And yet few MFIs have started developing client responsive, market-driven products.

Drop-Outs In East Africa

In East Africa the rate of client drop-out ranges between 25% and 60% per annum. Clearly this represents a substantial barrier to achieving operational sustainability. When an organisation is losing over a quarter of the clients it serves every year, it is "running hard to stand still". In the words of Hulme, "client exit is a significant problem for MFIs. It increases their cost structure, discourages other clients and reduces prospects for sustainability" (Hulme, 1999).

Ironically, many of the clients are driven out not only by the inappropriate design of the MFIs' loan products but also by the unwillingness of MFIs to recognize that (particularly in rural areas) there are seasons when not credit but savings services are required. Thus clients are forced either to take a loan and try (against the odds) to service it despite the low-season, or to leave the MFIs' programme. And all the while, their need for savings services is simply unmet and ignored by the MFIs.

Drop-Outs in Bangladesh

The number of drop-outs an MFI experiences has profound implications for the viability of the institution and reveals a great deal about the quality of the financial services it offers to its clients. High drop-out rates cost the MFI dearly. The groups from which members drop-out are destabilised and must recruit new (less experienced) members, who will qualify for smaller loans thus reducing the overall interest income for the institution. The members who have been with the organisation longer qualify for larger loans, and the newer, replacement members can only get access to smaller ones. Despite this, the newer members have to take a disproportionate risk and guarantee the larger sums taken by their fellow group members, adding further stress to the group guarantee principle. Furthermore, each drop-out is a lost client who has undergone lengthy, expensive training. The new replacement members must either also be given this training on an individual basis, or join the system without the initial training regarded as so important by many MFIs. The former option of *ad hoc* training is extremely cost ineffective, and the latter, if indeed initial training is so important, threatens to undermine the system. In addition, in the face of frequent or multiple drop-outs, some of the groups may disintegrate entirely. Finally, drop-outs often leave because they cannot (or do not want to) manage loan repayments. These drop-outs no longer attend the group's regular meetings, and freed of the group guarantee, and of the incentive of continued access to financial services (be they loan or savings facilities), are more likely to leave behind an outstanding, unpaid loan.

High drop-out rates often indicate dissatisfaction with the financial services being offered by the institution. Members choosing to leave a financial services organisation generally do so either because the organisation is not providing good enough services to warrant the (social and financial) costs involved, and/or because they have identified a better alternative.

Members expelled from a MicroFinance programme (for, of course, not all drop-outs are voluntary) are likely to be indicative of an even more complex bundle of factors. These factors include: client selection (or better said "de-selection") either by fellow members and/or by staff, the clients' ability to pay loans or even savings and clients' motivation to repay loan, which is in part, a proxy indicator of the level of satisfaction with the services.

As can be seen from the above, the reasons for drop-out are, in the words of Mustafa (1996), "multidimensional". Indeed, the unifying theme of the studies on the subject is that the reasons for drop-out are complex. Khan and Chowdhury (1995) also present an interesting table on "Reasons frequently cited for dropout and expulsion by gender" which shows a very high proportion of voluntary drop-outs being driven by the inflexibility of BRAC's system - in particular its savings facilities.

	% of dropped out members mentioned		
Reasons for voluntary dropout	Male	Female	Total
Group fund is not refunded	63.2	70.4	68.0
Savings not withdrawable in emergency	55.3	59.2	57.3
Other NGOs provide better facilities	36.8	52.7	49.8
Family Problem	11.8	45.0	29.3
Failure to repay loan	33.6	38.5	36.6
Reasons for expulsion	Male	Female	Total
Failure to repay loan	44.8	56.1	59.6
Irregular attendance in meeting	17.2	41.5	27.3

Examination of the various studies on drop-outs in Bangladesh (see references below) reveals a common dominant theme among the three quarters of drop-outs who leave voluntarily: dissatisfaction with the financial services being offered, and a belief that other NGOs offer better facilities (including crucially, how the organisation's staff behave with their clients). The majority of voluntary drop-outs are leaving their MicroFinance providers as a result of dissatisfaction with the services and products being offered.

One of the key determinants of drop-out, often lost in the category "failure to repay loan" by these studies, is the insistence by field staff that clients take loans[1]. Irrespective of what official Head Office policy says, there is a clear understanding among most field staff that they should push out loans - often with little care for whether the clients need or can use them. In the words of one BRAC Zone Manager, "If we do not disburse loans how can we cover costs?" (Personal field notes, 1996). Similarly, PromPT's (1996) study of the perceptions of Grameen, BRAC, Proshika, ASA and other MFIs' borrowers, (using participatory rural appraisal and focus group discussions), found that many borrowers felt pressurised or "sweet-talked" into

[1] Although there are suggestions that these practices may now be declining.

taking loans. Matin (1998) also notes, "MFI lending technology is insensitive to variations in household conditions. Most MFIs put all households on a treadmill of continuously increasing loan size and insist on a fixed repayment schedule."

Additional evidence for this can be easily seen in the percentage of clients with outstanding loans at any one time. BURO, Tangail offers credit on an entirely voluntary basis, as and when the client wants it, and (subject to graduated ceilings) however much the client wants. As a result, at any one time only about half of BURO, Tangail's clients have a loan outstanding - although most do choose to take a loan at one stage or other. By contrast, at any one time, almost all Grameen Bank, BRAC and ASA clients have loans outstanding. In the extreme case, ASA's loan policy dictates when the clients must take a loan and how big the loan must be with absolutely no reference to the <u>need</u> of the client for credit at that time. This policy has lead to a remarkable ability of ASA clients to manage their way round the system by on-lending, reciprocal agreements and cumbersome storage arrangements (Rutherford, 1995). But clearly, managing one's way around an inflexible, credit-happy system is not ideal, and so clients will begin to look at the services offered by other MFIs.

It seems clear from the above that clients are "shopping around", "switching bank accounts", in search of flexible, quality financial services. In the words of Khan and Chowdhury (1995), "Other NGOs (Grameen Bank, ASA, Proshika, etc.) working side by side with BRAC in the same areas provided extra facilities to VO members. These included: less deductions from loan, higher loan ceiling, low interest rate, quick disbursement, etc. The study revealed that a good proportion of dropouts had enrolled themselves with other NGOs for better terms and opportunities." The MFI that wants to reduce its level of debilitating drop-out should carefully examine the services and products it is offering its clients and seek to improve them on an on-going basis.

Graduates in Bangladesh

One of the reasons that is notable by its almost complete absence from these listings of grounds for drop-out is "graduation". A few years ago, there was a belief that credit programmes would give such a boost to the income of "beneficiaries" that they would "graduate from poverty". The dynamics of poverty are such that it is clear that the route out of poverty is neither linear nor absolute (Hulme and Mosley, 1997 and Wright 2000).

There were two schools of thought on "graduation". One held that after a limited number of benign (subsidised) loan cycles, the beneficiaries' businesses would no longer need credit. In retrospect, this was supreme naiveté, for there is scarcely a business in the world that does not use overdraft facilities to manage its way through the cyclical nature of the supply of its inputs and demand for its products or services. And vast international financial markets have developed round the need of businesses for capital for expansion. The other school, more plausibly, believed that poor clients could "graduate" with enough wealth and self-confidence to become the clients of formal sector banks. Indeed there are many MicroFinance programmes throughout the world seeking to establish Self Help Groups, Credit Unions or Village Banks and link them to formal sector financial service institutions. This is a more viable and desirable option for those NGOs (for example foreign ones) or Government projects/agencies not intending to stay and establish a permanent banking institution.

But for those NGOs seeking to establish permanent MFIs, these richer, more self-confident, potential "graduates" are the most valuable clients. For it is these clients that will often take the larger loans to expand or maintain the working capital of their business, or to finance asset acquisition. It is these larger loans on which the MFI will make the most profit since the cost of administering the loan is almost exactly the same irrespective of its size. Indeed these longer-term, richer, more self-confident clients should be the better credit risks - although this is subject to debate (as we shall see in "Defaulters" below). And crucially, it is these clients taking larger loans that allow the MFI to finance the provision of smaller loans to poorer clients. The last thing that an MFI with its sights set on financial sustainability wants to see is these precious, higher value clients "graduating". Instead, MFIs should seek to retain them as clients by seeking to meet their needs through a range of client-responsive financial services.

Conclusions for the MicroFinance Industry

There is compelling evidence, not just in Bangladesh but throughout the world, to support the contention that a significant majority of "drop-outs" occurs because MFIs' financial services are inadequate or inappropriate to meet the needs of the very clients they are trying to serve. Drop-outs are expensive for MFIs, both in terms of money already invested that is lost as the member leaves, and in terms of lost potential future business from the member. MFIs seeking to develop permanent sustainable organisations should seek to improve the financial services they are offering in order to reduce client dissatisfaction and thus drop-out. Such a strategy is likely to prove cost-effective.

For those MFIs committed to creating permanent financial service institutions, "graduating" the more experienced and affluent clients into formal sector banking system is not a desirable strategy as it implies the loss of the most valuable and cost effective clients. Indeed, MFIs should be looking to tailor their services to ensure that they retain these high value clients.

For all these reasons, MFIs should pay (and indeed are paying) increasingly close attention to the nature and quality of financial services they offer. The trade-off between the quality of the services and cost of providing the services is a clear one, but getting the balance right is difficult. There is evidence that, to date, MFIs in Bangladesh have put too much emphasis on trying to implement standardised, inflexible low-cost, credit-driven systems when their clients are asking (and willing to pay) for a better quality and broader range of financial services.

The irony of this situation was that the genesis of microfinance in Bangladesh was originally driven by an extensive programme of careful market and operations research designed to understand the needs of the clients and how to best respond to these. Professor Yunus' work with his students at Chittagong University in the village of Jobra in 1976 was quintessential market research. It is to the fundamentals of market research and product development that MFIs must return if they are to retain clients and build sustainable institutions.

References

ASA, "Dropout In Micro-Credit Operation", *ASA*, Dhaka, 1996

Brand, Monic and Julie Gershick, “Maximizing Efficiency in Microfinance: The Path to Enhanced Outreach and Sustainability”, *ACCION International*, Washington, 2000

Hashemi Syed M, “Dropout and Leftouts : The Grameen Targeting of the Hard-core Poor” a paper presented at the Credit Development Forum Workshop On Dropout Features, Extending Outreach And How To Reach The Hard-Core Poor, BIDS, Dhaka, 1997b.

Hulme, D. and P. Mosley, “Finance for the Poor or the Poorest ? Financial Innovation, Poverty and Vulnerability” in “Who Needs Credit ? Poverty and Finance in Bangladesh” (eds.) G.D. Wood and I. Sharif, *University Press Limited*, Dhaka, 1997.

Hulme, David, “Client Exits (Drop outs) From East African Micro-Finance Institutions**”, *MicroSave***, Kampala, 1999.

Matin, I., “Informal Credit Transactions Of Micro-Credit Borrowers In Rural Bangladesh”, *mimeo*, Dhaka, 1998

Mustafa, S, I. Ara, D. Banu, A. Hossain, A. Kabir, M. Moshin, A. Yusuf and S. Jahan, “Beacon of Hope: An Impact Assessment Study of BRAC’s Rural Development Programme”, *RED BRAC*, Dhaka, 1996. and *Zed Books*, UK, 1997.

PromPT, "Financial Services for the Rural Poor - Users' Perspectives", *PromPT*, Dhaka, 1996.

Rutherford, Stuart, “ASA - The Biography of an NGO, Empowerment and Credit in Rural Bangladesh”, *ASA*, Dhaka, 1995.

Wright, Graham A.N., 2000, “Microfinance: The Solution or A Problem ?” in “MicroFinance Systems: Designing Quality Financial Services for the Poor”, Dhaka: University Press Limited and London: Zed Books.